Speech made by the Governor of the Bank of Canada before the Canadian Club, Toronto, Jan.6/1936.

During the last twelve months I have had the question put to me on many occasions: "What is the Bank of Canada? What does it do?" Those are not easy questions to answer in a few minutes, and sometimes the answers seem to have a paralysing effect on the questioners. They tend to change the subject rapidly, or to say at the finish, "Yes, I daresay that is the theory of central banking - most interesting - but what do you actually do?"

Before embarking on that subject, I think that it would not be out of place if I indicated very briefly why central banking is so much more prominent nowadays than it was before the war. In those happy days the gold standard functioned, if not to perfection, at least very satisfactorily. If the business situation of a country was such that there was a legitimate need for more currency, gold reserves could be increased for this purpose. The action took place in the ordinary course of business and was practically automatic. To the extent that guidance and adjustments were required, London was the centre which exercised the main influence, and on London the main responsibility therefore rested.

After the war, and again since 1931, the story is quite a different one. Of the 48 central banks in existence to-day, no less than twenty-two have been organized since the war. One can be sure that a widespread movement of this kind is not accidental; it is based on a real need. Countries which did not possess a central bank in gold standard days might very well have found one most useful, but there is always a certain inertia to be overcome before a step of this kind is taken. The fact that the inertia has been overcome may be ascribed in part to the unsettled conditions of post-war years. It came to be recognized that central banks were essential. Take the case of Canada. Our currency laws provided for certain free issues of Dominion notes and for another limited issue against which 25 per cent gold reserve had to be maintained. Additional issues could not be made without 100 per cent gold backing. Not a bad arrangement if we were on a gold standard, but certainly unsatisfactory when the standard had been abandoned. As anyone can understand, changes in the volume of business may mean that larger or smaller amounts of currency are required. I do not suggest for one moment that the amount of currency required varies exactly with changes in the volume of business. Changes in the velocity of turnover are even more important. Nevertheless, elasticity in the currency issue is essential. Our currency laws were such that no elasticity remained if the gold standard ceased to operate. Under such conditions, if we had reached the limit provided by the law, there we stayed, no matter what was transpiring in the business world. It is true that borrowing by the chartered banks under the Finance Act had the effect of increasing the currency outstanding, and repayment of the loans decreased it. This Act provided facilities to cover seasonal fluctuations, but, except for this purpose, could not be regarded as the solution, since no bank would want to, or should want to, borrow except for temporary periods. It is hardly necessary to deal here with the amendment to the Dominion Notes Act which was put into effect about the middle of 1934, though I would not minimize the importance of this change. It provided much needed elasticity pending the formation of the Bank of Canada, but it did not pretend to effect any fundamental change in our currency arrangements.

When I speak of currency, you will realize that I mean the only legal tender in the country other than gold, and you will recall that this currency constituted the main cash reserves on which our banking institutions stood. It was, in essence, the financial life blood of our whole system. To-day, we find deposits with the Bank of Canada and notes of the Bank of Canada in the category which was formerly occupied by Dominion notes alone. These notes and deposits combined can be described as the country's cash. Prior to the creation of the Bank of Canada, no one was willing to admit responsibility for the determination of how much cash there should be to meet the varying requirements of our business life. That responsibility was firmly placed on us when the Bank of Canada Act was passed. The preamble of the Act reads as follows:-

> "Whereas it is desirable to establish a central bank in Canada to regulate credit and currency in the best interests of the economic life of the nation, to control and protect the external value of the national monetary unit and to mitigate by its influence fluctuations in the general level of production, trade, prices and employment, so far as may be possible within the scope of monetary action and generally to promote the economic and financial welfare of the Dominion".

Preambles such as the one I have just read are dangerous things. This one says, in effect - "We want prosperity and stability and peace of mind; see that you provide them!" It is true that it contains the sensible qualification, "so far as may be possible within the scope of monetary action". And we know that monetary action will not permanently enable us to gain new foreign markets for our goods or do many other things on which employment and prosperity depend. But, qualify it as we may, a very serious responsibility remains, and that responsibility we must endeavour to discharge to the best of our ability.

From time to time you may examine the weekly statement which we publish. A recent one shows that the banks keep on deposit with us some $180 million. They also hold about $35 million of our notes. The notes are legal tender, but deposits with us are in effect the same thing as they can be converted into notes at any time. These two assets of the chartered banks, totalling some $215 million, are their cash reserves against their deposit liabilities in Canada, and they bear a ratio to deposits of a little more than 10 per cent. Banks have certain views in regard to the amount of cash they should hold in relation to deposits. If the ratio goes too low, they must pull in their horns - collect loans or sell securities. If the ratio seems high, they may expand by buying securities or making new loans if good borrowers are available. By doing so in both cases they restore their cash proportion to normal. Subject to changes in the amount of Bank of Canada notes in general circulation in the hands of the public, the only way in which the total amount of bank reserves can be changed - increased or decreased - is through action on the part of the Bank of Canada. If we increase our assets by buying gold or securities or making advances - up go chartered bank reserves. If our advances are repaid, or we sell gold or securities - down go the chartered bank reserves.

There, as briefly as I can describe them, are the mechanical features of the control of currency. Not a complicated operation physically. But let me assure you it can carry momentous consequences. If I may illustrate by an exaggerated example, let us suppose that, while we were still off the gold standard, bank cash was reduced 50 per cent and banks forced to reduce their assets and liabilities by approximately the same percentage, which means ten times the amount of the cash reduction. You can imagine that the repercussions from such a development would be very serious indeed. Or suppose that with inflationary motives we doubled the cash. In such a case the effect is not necessarily immediate. The banks, I assume, would have the good sense not to expand their assets in proportion to the new cash. But I recall no case in history where an unnecessary and large expansion of cash was not followed by some inflation if the cash is left lying around long enough. I can imagine the process taking years: I cannot imagine it failing to materialize eventually.

At this point I can almost hear someone say: "All very well as theory, but what do you really do?" To that I have no answer, because in fact the processes which I have described represent to us not theory but the daily grind. Naturally, the wide swings to which I referred a moment ago are examples so exaggerated that we must not think of them as practical possibilities. Even the minor movements, however, are of real importance in view of the delicacy of the machinery of credit. In charting our course of action the fullest possible information on business and financial conditions in Canada and other countries is essential. It might also be said that common sense and, if possible, a sixth sense, are even more desirable.

There is a school of thought, with which I need hardly say I disagree, which regards a central bank as an institution which is unlikely to do much good. But all schools will unite in agreeing that a central bank which did very foolish things would be dynamite indeed - that it could affect the real wages and savings of the Canadian people in ways which would constitute a grievous injustice. I should be glad to see a greater general understanding of these facts. It is desirable that there should be a sounder knowledge of central bank operations - not of the details necessarily, but of the main factors. Enlightened public opinion is the greatest safeguard that a central bank can have.

Perhaps you will notice that in discussing the Bank of Canada I make no comment on the question of ownership. This is a matter of high policy, the determination of which lies with the Government.

I am not going to inflict on you an extensive catalogue of our activities, but, in view of the fact that our institution is a new thing in this country, I would like to say something about its physical characteristics. A little over a year ago, we had no staff, no premises, no equipment. We had the advantage that we were destined to take over the Currency Division of the Department of Finance and the various offices of the Assistant Receivers General across Canada. We had to organize a head office in Ottawa and an office in Montreal, and we had to adapt the governmental offices to fit into the new system. The most important routine work which we have to perform is in connection with the supply of Bank of Canada notes. The $93 million of notes now outstanding have a life which varies from nine months to a year, depending on the denomination. The smaller denominations need to be renewed more frequently than the larger, but the entire circulation is redeemed and reissued in the course of a year. It may convey more if I say that since we opened for business some nine months ago we have issued over 49 million separate notes and redeemed some 38 million notes. In dealing with note issues the volume of work naturally depends on the number of pieces handled rather than on the total dollar amount. A large reserve stock has to be carried, not only to meet all possible requirements but also for the reason that notes should be matured before issue. Fortunately they do not take as long as wine to reach maturity, but six months is a desirable time.

We are the Financial Advisors of the Dominion Government, and as such must supply them with the best and most impartial advice which we are capable of giving in financial matters. We act as Issuing Agents when Dominion loans are floated or Treasury Bills sold. In connection with these activities, and also for the purpose of dealing with our own large portfolio of securities, it was necessary to organize a Securities Department, with representatives in Toronto and Montreal as well as in Ottawa. Obviously we must maintain close touch with the securities markets in Canada and abroad.

The Dominion Government, as you can understand, has very large dealings in foreign exchange. Shipment abroad of the gold bought from Canadian mines - over $115 million a year - provides a supply of foreign exchange. We act as Agents in shipping the gold. The Government's need for exchange arises from interest payments on or redemption of foreign debt, and various other remittances which it must make. As bankers for the Dominion Government it was our duty to set up a Department to handle this foreign exchange business. The Department operates in Toronto and Montreal, and maintains close connection with the principal exchange centres outside of Canada.

Last, but by no means least, we have initiated a Research and Statistical Department. We carefully abstained from setting up an over-elaborate organization. We determined to do our utmost to avoid duplication of material available elsewhere, and to avoid also the compilation of statistics which did not serve a definite and useful purpose to the Bank. These principles might seem to lead us along an extremely straight and narrow path, but in fact we have found there is a broad field for accumulation of financial and public debt statistics not presently available elsewhere.

That ends the abridged catalogue of our activities. I have described them so that you may have some idea of our organization. I have said something about control of currency to indicate the most important function and most serious responsibility of the Bank of Canada. You can understand that a central bank should never claim that it has power to work miracles. It should not point with pride to anything it has done; still less talk about what it hopes to do. By the same token, a central bank's Governor is so limited by these considerations that unless he can talk about subjects other than central banking he is liable to be dull company.

While I have deprecated any claims to perfection on the part of central banks, I think that it is permissible to say that in any central bank worthy of the name you have an organization which has no axe to grind, no personal or selfish motives for its actions. Its interest is the public interest, and that is the interest which we shall try to serve to the maximum of our capacity.