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In coming here to speak to you this evening it is perhaps not surprising that I should have in mind my own days at university. How long a time should elapse before one is entitled to reminisce about the past I do not know. But even if seventeen years is sufficient qualification, I will not take advantage of it. I would like to remind you, however, of the extraordinary increase of interest in monetary matters which has developed during this comparatively short time. In 1919, when I graduated, a man who seriously proposed the establishment of a central bank in Canada would have been regarded as a theorist of the first water. Questions of creation of credit or of monetary policy were not then a matter of general public discussion in Canada as they are to-day. Two depressions and one boom, accompanied by wide fluctuations in the purchasing power of money, have stimulated public interest in money and banking. It is not to be wondered at that this new interest has produced some people who cater to the demand for pleasant monetary theories without taking the precaution to study the subject with any great care. I do not believe it is proper to sneer at this movement, or to take a negative attitude and brush aside even the more fanciful suggestions which are made. We must recognize that they are symptoms of a general unrest - that they are based on condemnation of the distress and uncertainty which has been experienced, particularly during the last five years. But what we must try to avoid is the jump from the frying pan into the fire. It seems to me that a grasp of the fundamentals of the subject of money and banking has never been more essential than it is to-day, and those who have had theopportunity of studying at this University, or at other universities, have a definite contribution to make in this respect. I hope that no one of you who graduates from Queen's will be ashamed to be described as a "sound money man". At the moment, that description is applied as a form of reproach. The reason, I believe, can be found in the fact that during the worst years of the deflation, many who should have known better deprecated any attempt to improve the situation by monetary measures. "No tinkering with the currency!" "Sound money!" These were their slogans. And so the very words have come to be associated with the policy of reaction. I hope that in due course a better informed and reasonably prudent but not reactionary attitude in monetary matters will be recognized as the one which is best calculated to serve the interests of the public.

Perhaps I should remind myself - before someone else does - that I did not come here this evening to deal in generalities, but to say something about a specific piece of monetary machinery which was created in this country a year ago - the Bank of Canada.

I think that our picture will be clearer in your minds if I commence by referring to the transactions which took place when we opened our doors for business on March 11th, 1935. You will remember that we immediately assumed responsibility for the redemption of all Dominion notes then outstanding. This liability amounted to about $185 million. Naturally, the Government had to transfer to the Bank sufficient assets to balance the liability. In round amounts, the assets so transferred were:-

(a)	Gold, valued at	$69,000,000
(b)	Silver, valued at about	1,000,000
(c)	Dominion of Canada 3% bonds maturing 1940 of a par value of	115,000,000

The total value of these three items was $185 million, equal to the amount of Dominion notes outstanding.

The day before we commenced business the Dominion note issue had been some $35 million larger than the figures I have just mentioned. It was reduced by repayment of $35 million which the banks had borrowed under the Finance Act. Some of you may remember that in November, 1932, the Government of the day arranged with the chartered banks to borrow this amount and to purchase at the same time $35 million of Dominion Government Treasury Bills. To my knowledge this transaction was the first example in Canada of deliberate action in the field of monetary policy. The Bank of Canada Act provided that Finance Act advances should be repaid on the day on which we commenced business. The repayment was naturally made in Dominion notes, which were cancelled by the Government. The transaction would, therefore, have involved a $35 million reduction in the cash reserves of the chartered banks, if no offsetting action had been taken by us. We considered it wise to offset this reduction and did so by purchasing $35 million of Treasury Bills from the Dominion Government. The Government used the proceeds of this sale of securities to us to redeem Treasury Bills held by the banks, with the result that their cash reserves were unchanged. It should be remembered, of course, that from the time we opened for business the cash reserves of the banks were very largely in the form of deposits with us instead of in the form of Dominion of Canada notes in their vaults. The banks deposited with us a large proportion of the Dominion notes which they held and received credit in their accounts with the Bank of Canada.

I will not attempt to describe the changes which have taken place in our assets and liabilities since the opening date, but having indicated the character of the business to which we fell heir on March 11th, 1935, let me now try to show what the management of that business implies in terms of central banking functions and responsibilities.

The Act to incorporate the Bank of Canada contains a preamble which recites the things which we should do. The list is a formidable one, but for my purposes this evening I think it is sufficient to say that regulation of credit and currency in the best interests of the economic life of the nation is the main duty imposed on us.

I should like to give you an indication of what is meant by control of currency, which is direct, and control of credit, which is indirect. First of all, I should define what I mean when I say "currency". I do not want economists to accuse me of foisting a new definition of currency on the world, but I think I can safely take the liberty of devising a formula for the purpose of my remarks to-day. The definition can usefully be divided into two sections, namely, what was meant before the creation of the Bank of Canada and what is meant now. A little over a year ago Dominion notes were the only legal tender in the country other than gold. Dominion notes were the country's legal tender currency. You will recall that this currency constituted the main cash reserves on which our banking institutions stood. It was, in essence, the financial lifeblood of our whole system. Realizing this, a natural query would be, "Who was responsible for the determination of how much currency there should be to meet the varying requirements of our business life? What machinery existed to enable someone to undertake the task of regulation?" The answer quite simply is that no one admitted any such responsibility, and even if they had done so would have found no suitable regulatory machinery at their disposal. 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, in certain circumstances, if we were on a gold standard, but certainly unsatisfactory when the standard had been abandoned. Elasticity in a currency issue is essential, but our currency laws were such that no elasticity remained after 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 leeway pending the formation of the Bank of Canada, but it did not pretend to effect any fundamental change in our currency arrangements.

So much for the previous regime. To-day, we find notes of the Bank of Canada and deposits with 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. The mistake is sometimes made of regarding the note issue as the most important item. Actually the contrary is true. Deposits with the Bank of Canada are equally important in effect and, at the moment, more than twice as important in amount.

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 $186 million. They also hold about $34 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 $220 million, are their cash reserves against their deposit liabilities in Canada, and they bear a ratio to deposits of about 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. Day by day and month by month we must make up our minds as to whether the cash should be increased or decreased or allowed to remain stationary.

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.

Naturally, these wide swings 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. If a speculative boom appeared to be developing, it would be our duty to try to exercise a restraining influence. In a period of deflation, quite a different policy is required. Let me make it plain that I do not pretend for a moment that central banks are a cure-all for booms and depressions. So far as I am aware, no central bank has ever made such a claim. One must recognize the great importance of influences unconnected with money, and the many ways in which the business of one country is affected by developments in other countries. But these qualifications of the ability of central banks to ensure stability are not an argument against central banks, so long as half a much-needed loaf is better than no bread. Simply because perfection cannot be attained, it does not follow that no effort should be made to achieve an improvement. Any reduction of the extremes of instability would be of great value to us all.

In the time at my disposal, it would be difficult to deal adequately with the possible lending and rediscounting activities of the Bank of Canada. One point might be brought out, namely, that the monetary effect of a loan made by the central bank is quite different from the effect of a loan by a commercial bank. The latter, in making a loan , provides credit. A central bank in making a loan increases the amount of cash in the country. And if we consider 10 per cent as a normal ratio of commercial banks' cash reserves to their liabilities, the increase in cash resulting from a central bank advance of, say, $1,000,000, provides scope for an increase of $10,000,000 in the advances or investments and also in the deposits of the commercial banks. To put it another way, our lending activities may have an effect on credit equal to ten times the amount of our loans. Obviously, in giving consideration to loans, we must think not only of the factors of safety and security, but also the ultimate effect on the credit position of the country. A central bank must be what is known as the lender of last resort, which implies that in times of real need its rediscounting and lending facilities will be freely accorded.

It may not be out of place at this point to say something about certain of our activities which are more easily understandable than those which relate to monetary policy. We act as bankers, fiscal agents and financial advisors of the Dominion Government. That means that we carry the main Government account on our books, that we issue and redeem Dominion Government securities in Ottawa and at our nine Agencies, and that we must advise the Government in regard to the character of its financing. We handle the foreign exchange business of the Government, and also act as agents in shipping abroad the $115 million of gold which is annually purchased from Canadian mines. In connection with all these activities we had to organize properly equipped Securities and Foreign Exchange Departments, functioning in Toronto, Montreal and Ottawa.

You can imagine from my earlier remarks on the necessity of being fully informed that we have set up a Research and Statistical Department. We have tried to make this Department effective without being unduly elaborate, and we bear in mind all the time the futility of accumulating information that is not of real use. If you will allow me one boast in the course of my remarks this evening, I will tell you that the Department is headed by a Queen's graduate.

Up to the present time we have not published any statistical material. A central bank has to use a great deal of discretion in embarking on adventures of this kind. As a matter of fact, the usual and necessary reticence of central banks probably accounts for some of the misconceptions in regard to our activities.

It is easy to expect too little or too much from a central bank. There are those who think that the monetary factor is of such great importance that every other factor will fall into its right place, and the whole economy will work smoothly, if only the central bank provides the right amount of cash, at the right rate, at the right time. Other people go to the opposite extreme and consider that a central bank is merely a fifth wheel to the coach. Neither of these extreme views is, in my opinion, correct. It should also be remembered that some of the most useful actions of a central bank may pass unnoticed or cannot be known; indeed the extent to which beneficial actions are beneficial must necessarily escape the knowledge of a central bank itself. One can imagine - especially if the monetary theorists are right - a boom and the following depression being entirely prevented from happening by sufficiently drastic action of a central bank prior to the boom. Neither the bank nor anyone else would ever know what the country had been saved from. Central banks might claim many such services in the past; but it is their failure to act in time which attracts attention, and rightly so.

In the final analysis, a central bank must attend to its own business, say little, and expect that over a period of years the results will speak for themselves. In that, it does not or should not differ greatly from a sensible individual. But there is at least one point of difference, inasmuch as any central bank worthy of the name can state with perfect sincerity that its actions are never dictated by self-interest. Its interest is the public interest, and its only problem is to understand how the public interest can best be served.