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Radio Address

Subject - "Bank of Canada"

By

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November 17th, 1938

I was glad to receive an invitation from the Canadian Broadcasting Corporation to give two fifteen minute talks on the subject of the Bank of Canada. There is every reason why the public should know something about the organization and functions of the country's central Bank. For one thing, they are affected by its activities; for another, the Bank is a public institution, owned by the Canadian people through their Government.

Some of those who recall the great public interest which was aroused when the Bank was created in 1934, and when it commenced operations early in 1935, have urged us from time to time to do more to maintain that interest, because it was a good interest - an unselfish interest in a national institution. We in the Bank share these views, but I must confess that it is by no means easy to attain the desired results, for the subject of central banking is somewhat technical, and therefore difficult to discuss in terms which make for general interest and understanding. In my remarks to-night, and on December 1st, I cannot avoid technicalities entirely, but I shall do my best to give what I hope will be clear answers to the questions: What is the job of a central bank, and how does it do it?

A key to the job which a central bank is supposed to perform is found in the preamble to the Bank of Canada Act, which says, amongst other things, that the

Bank should endeavour 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. I would like to underline those words, "so far as may be possible within the scope of monetary action".

Let me point out first of all - and with special emphasis - that a central bank cannot succeed in the task which is assigned to it unless it is absolutely impartial. It must not take a special interest in one section of the country, or in one of the country's industries, to the prejudice of other sections or other industries. And in matters of policy it must not give weight to considerations of popularity. You will agree that the standards I am setting are almost inhumanly high. They should be so in the case of a central bank, because a weak central bank is a very poor creature indeed; and you may be sure that there is something wrong with a central bank whose actions meet with everyone's approval.

Let me come now to a more definite consideration of the functions of such a bank. Its primary duty is to see that at any given moment in the development of its country's economy there is the right amount of money in existence, neither too much, nor too little. By money, I mean not only notes and coin, but deposits in the banks. Am I already upon controversial ground? Will you say that you well understand the possibility of there being too little money, but that it is difficult to see why there should be too much. This is so important a point that I must permit myself a short digression before we go any further. Money is not wealth. If it were, we could not have too much of it. As it is, if there is too much money, you may suffer from some degree of inflation, that is, an artificial rise in prices through an excess of money. When there is an excessive quantity of money, the efforts of those who own it to exchange the money for goods or property lead to this rise in prices. Now the main trouble about inflation is that it is certain, in practice, to alter the shares in the national income which different sections of the people obtain, some receiving increased incomes which they have done nothing to earn, while others lose through no fault of their own. This state of affairs arises because the price of <u>everything</u> does not change uniformly immediately and in exact proportion to the change in the amount of money. If every price <u>did</u> change exactly in proportion and at once, so that we had, say, twice as much money and had to pay twice as much for everything, and all debts were doubled, then nothing would really be changed - we should be neither better nor worse off. But, in practice, when there is a general rise in prices, some will rise faster than others; salaries and wages, for example, may not rise as quickly as the cost of living. Existing contracts cannot be altered at once, so that all creditors tend to lose, and all debtors to gain. One can, of course, conceive a state of affairs where the Government may wish to benefit certain classes of the community at the expense of other sections, but inflation will never redistribute the national income in the way a good Government would wish, for inflation tends to favour speculators, and to destroy the savings of the men and women of small means who have not the knowledge or facilities to protect themselves against developments of this kind.

Let us return now to the proposition that a certain amount of money - no more and no less - is appropriate at a certain time. Again, before proceeding, I must introduce one very necessary qualification. We cannot judge what amount of money is desirable by thinking of its amount only. We have also to think of the rate at which money turns over, what is sometimes called the "velocity of circulation". If conditions are such that people can sell their goods or services at a profit, their incomes will rise. The total of these incomes, known as the national income, must therefore rise, and it may, in fact often will, rise without any corresponding addition to the total amount of money. The increased volume of business transactions will be financed merely by a quicker turnover of the existing volume of money. It might even be the case that people's incomes will go up while the total amount of money is going down. Income is what matters. Conversely, if people cannot sell goods and services profitably, the turnover of money will decline, incomes will drop, but the total amount of money may be increasing all the time.

Now when there is a state of stagnation, a depression, it is usually a good thing that the amount of money should be increased, perhaps very considerably, with a view to creating the conditions under which profitable spending may be resumed. There will have been a rapid decline in turnover, so this should be met by an increase in the volume of money which is, in such circumstances, not inflationary, and may be a longish time in having its effect. It will, however, create conditions under which the cost of borrowing becomes relatively cheap, so that old debts at higher rates can be replaced by new ones at lower rates, and fresh enterprises can be launched. When good times return, a part of this additional supply of money can perhaps be drawn in again, because what remains will be circulating more quickly. This matter of velocity is a very important consideration which, though it seems so obvious, is frequently overlooked.

I should point out, of course, that an increase in the supply of money will not necessarily work a miracle in connection with debts which are of a bad or doubtful character. The solution of the problems which these debts occasion may have to be sought along other lines.

It is the business of the central bank to decide how much money there should be, allowing for changes in the rate of turnover, after considering all the factors in the economic life of the country, such as the volume of production, the level of prices at home and abroad, the state of trade, internal and external, the borrowing needs of the community, capital movements, seasonal requirements, and so on. Naturally, it is not an easy matter to decide. Besides which, as you will at once guess, while the central bank may be able to determine the right amount of money assuming a given rate of turnover, it cannot determine the way in which, or the rate at which, that money will be spent. Its power, therefore, is limited.

Nevertheless, it is well that there should be some central body in existence to decide the problem of the requisite volume. The central bank may decide wrongly. If alert, it may be able to correct its error before it is too late. If, however, there is no central control at all, the volume of money is practically certain at times to become too great or too small.

I would not have you think I am expressing the belief that central bank action, or indeed any action of the financial system as a whole, can either ensure prosperity or avoid depression. Monetary action will not enlarge the markets for Canada's great export industries, nor will monetary action enable us to consume these products at home, instead of sending them abroad. These are limitations of great importance in a country such as Canada which - whether we like it or not - is vitally dependent on foreign trade and, therefore, on the actions of other nations. You may ask then what monetary action can accomplish if it cannot do the things I have just mentioned. My answer is that a good monetary policy and a good financial organization will help to remove obstacles to the production of goods for which there is a demand: it will help to curb the speculative and productive excesses of a boom; and it will render unnecessary that type of liquidation which is caused by a shortage of monetary resources during a depression. You will realize that if these things can be accomplished, a service of the greatest importance will have been rendered.

In my next talk on the subject of the Bank of Canada, at 11.15 p. m. on December 1st next, I expect to deal with methods of control, and say something more in regard to the objectives of a central bank.