# THE ROYAL BANK OF CANADA

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AS Canada settles down to peace, there are many encouraging features about its economic life, but some need to be considered with discretion because unwise decisions would carry with them the danger of upsetting reconstruction plans. In this class falls the amount of money available for spending. What once appeared a normal total now seems ridiculously small; at the end of the war there was in existence a much larger amount of liquid assets than ever was dreamed of, amounting in bank deposits and currency alone to $458 per capita, compared with $224 in 1939 and $184 in 1926.

One mistaken thought should be banished before judgment is passed on any matter relating to money. Some people say "Money is the root of all evil," but they are wrong in their quotation: it is not money, but "love of money" which is referred to in the Bible. Money is merely a useful measure, necessitated by the fact that few people work for wages in kind, and very few, in these days, make things for their own use. Most are engaged in producing goods which exchange for money, or in performing services for which money is given. This money is evidence of work done, and in trade for it the owner receives the product of other work. Money is a measure of value given, to be exchanged for value to be received. One might as well designate a twelve-inch ruler, or a set of scales, as "the root of evil."

Confusion over money had several starting places. Philosophers raised questions, looking askance at anyone who showed more than a subsistence interest in it. Reformers have hatched unorthodox, and often selfish, monetary plans which they thought would place their party, or country, ahead of all the world in power or prestige. Few generations have been free of the difficulties raised by such people, and few errors have been more mischievous than those associated with money; yet the subject raises no very formidable difficulties if it is properly approached.

Money originated in barter, or, at least, grew out of the inconvenience of barter. Not until it came into use could men specialize in their work, and devote themselves to the tasks which gave them the greatest satisfaction, or in which they were most proficient. Money became the third "commodity," making a link between what the artisan contributed through his skill and what he desired. Exchange became an important aspect of economic life, but the fact remains that it is the flow of goods and resources from one country to another, and from one person to another, that is the important thing. In industry, money is a productive instrument. No factory can produce goods without the money necessary to exchange for plant and raw materials; with money, the machinery and goods are fused into a going concern. It follows that if money is hoarded it is not fulfilling its function, since by its nature it is expected to circulate and keep up the interchange of goods.

In the broad sense commonly used today, money is any medium of exchange which is generally acceptable in business transactions. It is, incidentally, one of the advantages of banking that men need to have less currency in their pockets, or hidden under the hearthstone. By using the banks for their saving and paying, they relegate currency to its place as a handy medium for small payments. Actual currency is being replaced more and more by money of account. While keeping records of income and payments in terms of money, people can earn thousands of dollars, pay out thousands, own thousands in real estate, furniture, factories and other things, and yet never have more than a few dollars currency in their pockets. The part played by media of exchange such as cheques, drafts and other instruments is of greatest importance in the modern commercial and industrial world, though these are media of limited acceptability. The acceptability of paper money rests upon confidence in its command over goods and services, and confidence in the government. The danger is that it may be over-issued, and every government faces that temptation at some time. History affords plenty of examples as warnings against inflation of the money supply above what is needed by the community for its ordinary business.

Had it not been for the increasing amount of trade carried on by chequing through the banks, the Dominion would have been faced with a great problem during the war years. As it was, the coining division of the Royal Canadian Mint operated 24 hours a day, including Sundays, for the major part of 1943, to keep the country supplied with coins.

Bank deposits make up the major portion of Canada's money supply. These are entries on the books of a bank, recording the obligation of the bank to pay legal tender currency to the persons in whose favour the entries are made. Normally, in the course of business, transfers of deposits are made without the actual turning over of currency, but this does not relieve the bank of its responsibility to pay currency, if required.

There has, naturally, been a substantial increase in bank deposits during the war. The average month-end total of Canadian deposits in 1939 was $2,630 million, and in October 1945 it was $5,578 million. The increase in savings deposits is particularly striking, as may be seen in the following table, compiled from the Statistical Summary of the Bank of Canada, which gives the increase in the number and amount of deposits in various groups between 1940 and 1944:

| Group: | Increase in Number of Accounts | Increase in Amount $ Million |
|---|---|---|
| $1000 or less............ | 742,000 | 291.1 |
| $1000 to $5000.......... | 185,500 | 342.9 |
| $5000 to $25,000........ | 12,700 | 106.0 |
| $25,000 to $100,000...... | 400 | 16.3 |
| Over $100,000.......... | 100 | 132.0 |

The total increase up to $5,000 was $634 million, compared with $254.3 million above $5,000.

Active note circulation is the term used to describe the total amount of notes in the hands of the public. The chartered bank note circulation is now about 78 per cent lower than it was on establishment of the Bank of Canada ten years ago. This is brought about by a policy adopted in 1934, culminating in 1950, when the chartered banks will vacate the note field completely. Replacement of the chartered bank notes and provision for enhanced demand due to war conditions raised the amount of active Bank of Canada notes from $67 million in 1936 to $981 million in October 1945.

The way in which the supply of money is made available in the quantity necessitated by business requirements is best explained in the words of Graham F. Towers, Governor of the Bank of Canada. The primary duty of a central bank, he said, "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." Then, telling how the central bank operates, he continued: "I wish to describe how the central bank, in fact, controls the supply of money. The bank does so through the medium of the other banks, and is, therefore, often spoken of as 'the bankers' bank'. Either by custom or by law, the commercial banks have to keep their cash reserves in the form of balances with the central bank, or in the form of the central bank's notes. In this way their reserves are all legal tender. In Canada, the banks collectively keep about 10 per cent of their deposits in these two forms, and by law must keep 5 per cent. Under existing conditions, the central bank has control of the amount of these reserves. By buying securities, or adding to its assets in any way whatever, the central bank increases the reserves of the other banks, because the cheques which it issues in payment for such securities, etc., are deposited in banks, and swell the deposits of the receiving banks at the Bank of Canada when the cheques are presented to the Bank of Canada for payment. In the same way, any sale or reduction of its assets by the central bank diminishes the commercial banks' reserve balances with it. This is the main way in which the central bank controls the amount of the other banks' reserves." Once the aggregate supply of money has been decided, its distribution is effected through the chartered banks in the form of bank credit. As a consequence, the public is far better served than it would be if everyone seeking credit had to apply through a political monopoly.

The principal liquid assets of most individuals and many businesses consist of the currency in circulation, demand deposits, savings deposits, victory bonds and war savings certificates. Totals have already been given for coin and deposits. Notes in the hands of the public increased between 1939 and October last year from $216 million to $999 million. There have been eleven war loans (nine of them victory loans) in which 23,242,753 individual applications were made, more than half of them in the payroll division. The total sum represented by purchases of bonds was $12,262,574,000. Redemption of war savings certificates will begin next year, their term being 7½ years from the time of issue. The total sum recorded at the end of the 1945 fiscal year was $262 million, and there was $7¼ million additional in war savings stamps. Additional funds will shortly be flowing into the people's pockets from the compulsory savings fund set up in the budget of 1942. This provision was unpopular in many places, but when repayment starts, not later than March 31, 1948, there will be a great deal of purchasing power released. The total amounts to $225 million.

Some people have the idea that a certain fixed volume of money should be available at a certain time, but Mr. Towers remarks on this point: "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 exchange'." This entered somewhat into the perplexities of 1929, when the speculative bubble was based on a money supply of only $2,314 million, compared with today's approximately $6,500 million. It would be difficult, indeed, to determine in advance a fixed amount of currency to be issued, because while one dollar may be changing hands in purchases twenty times a day, another may stay hidden for months in a child's bank. Canada has solved the problem very neatly: enough currency is issued to meet the current need. The volume at large falls and rises exactly as the transactions of the country demand.

An increase in the amount of money, with a view to creating conditions under which profitable spending may be resumed after a period of stagnation, may be of assistance if done with discretion. It is not, however, a cure-all, nor is it invariably effective. Answering questions by members of the Banking and Commerce Committee of the House of Commons in 1939, Mr. Towers commented: "Expansion of the volume of money in Canada *tends* to produce a rise in the level of prices by increasing the potential demand for goods and services. In general, however, an increase in the volume of money will increase the total amount of buying only if there has been previously an actual shortage of money. There may be important factors offsetting the effect of an increase in the volume of money, as the amount of spending is almost entirely a matter of individuals' decisions which are influenced by many other factors than the volume of money. I have omitted from consideration the type of price rise which follows the excessive issue of money when people through lack of confidence in the currency rush to convert their money holdings into goods — a situation which I am sure everyone will agree is thoroughly undesirable."

Huge backlogs of deferred demand and large volumes of wartime savings combine with inadequate supplies to produce a serious, though temporary, threat of inflation. It is not the available volume of purchasing power alone that counts so heavily, but the relation between purchasing power and what goods and services are available. The principal factor threatening inflation in Canada today is the danger of an attempt by holders of cash and other liquid assets to buy goods while the goods are scarce. This tendency may be seen in almost any store whenever a few lots of war-scarce goods are put out for sale. Paul Einzig, writing in the London "Banker", remarks: "We are accustomed to think of inflation in terms of an expansion of currency, credit, or purchasing power. Little attention has been paid so far to another type of inflation, brought about by a decline in the volume of goods and services instead of an increase in the volume of means with which those goods and services can be purchased. While expansion of purchasing power is inflation in a positive sense, contraction of the volume of goods and services on which the purchasing power can be exercised is inflation in a negative sense."

Only in contemplating the disasters which accompany an unrestrained inflation can it be realized how the stability of money goes to the very basis of life. The greatest factor in maintaining stability is public opinion, which is learning by experience to ask: "What will happen if money does not stay put?" To retain a feeling of security, people must be able to trust that contracts and obligations shall not become falsified by fluctuations in the value of money.

Stable money is not only necessary because of its internal effect. It is needed to help international trade. Whatever differences of opinion exist as to how it is to be achieved, all groups of theorists agree that a sound monetary policy can have a far-reaching effect on the economic structures of all countries. There is a growing feeling that establishment of a non-political, scientifically-motivated research and educational organization would be of immense value to those who are charged with determining long-range monetary policies. Only national fears, jealousies or apathy stand in the way of a beneficial approach to a question that is fundamental in consideration of world trade and domestic economic advancement. It is certain that debtor nations cannot solve their problems alone, and that it will be necessary for the creditor nations to help free international exchange of the difficulties standing in the way of easy trading of goods. International exchange has moved out of the realm where it was of interest only to bankers and exporters, because it is now widely recognized that the economic health of Canada, affecting every family, depends upon good adjustment of foreign trade.

Some persons still think references to index numbers and the price level are academic, and yet price is a very practical factor to be considered in the business of living. Prices obtained for the product of each stage of production are vital in keeping the factory wheels turning, and the amount paid for finished products is important in keeping the family expenditure within the budget. Producer, manufacturer, merchant and consumer depend upon approximate stability in the value of money, and if the dollar could be stabilized so as to have nearly the same purchasing power over a long period of time, it would be a most desirable thing. The virtues of stability would not be affected greatly by the incidental differences in prices brought about by normal competition. Yet, as one economist well phrased it: "The notion common to 90 per cent of the writings of monetary cranks is that every batch of goods is entitled to be born with a monetary price label of equivalent value round its neck, and to carry it round its neck until it dies." These people forget that there are many variable elements entering into the level of prices. There is, for instance, the law of supply and demand, ridiculed by many, but still a big factor in human dealings. No monetary policy will reverse the fact that if Canada and the United States produce a record crop of wheat, and the corn states produce a light crop of corn, there will be low prices offered for wheat and high prices for corn. Tariffs have their effect, too, because exactly similar goods from two countries may yield their producers less or more income according to the height of the tariff.

It is undoubtedly true that in times like these it is not always profitable, in fact it may not be practicable, for manufacturers to turn out goods. The costs of raw materials and labour press against the low prices established by the price ceilings. If other factors could be left out of account, a rise in the prices of consumers' goods would improve the position of the producers, and encourage them to increase their output by employing more labour. While it may be true that quite as good business can be done on one price level as on a level twice the height, this depends upon its being a stable level, with all factors adjusted to it. Buying and selling cannot be successfully carried on when the raw materials are bought on a high level, and the goods sold on a low level, and the fact that when the level is changing all prices do not change in the same degree, is attended by serious consequences. The worker's command over the commodities he needs is lessened under rising consumers' prices, because his wages do not ordinarily keep pace. It is in his interests to see that, so far as is in his power, production is kept at its peak, because if production maintains its position relative to expenditure, prices will not rise exorbitantly. In that event, those who have invested their savings in victory bonds and war savings certificates will have no cause to sell. They will benefit by easier living now and the assurance of a nest-egg that will be worth as much in buying power, dollar for dollar, as when it was saved.

As was shown in last month's Letter, the cost of living, based on retail prices, is straining harder at its bonds than is the wholesale price, though throughout the pre-war years the variations in both prices charted much the same course. On the base 1926 equals 100, wholesale prices showed an index of 95.6 in 1929, 75.4 in 1939, and 102.5 in 1944. The latest figure is for October 1945, 102.9, only 2.9 points above that of 1926, which was representative of the stabilization levels following the first world war.

Wages, while a problem alone, are woven in with prices and the value of money. Salaries and wages increased from $2,500 million in 1938 to $4,983 million in 1944. If reasonable and proper controls over prices are retained until the availability of raw materials and the completion of reconversion in industries have become facts, savings from higher wages will not produce inflation. Controls on prices, wages and materials are not the haphazard efforts of bureaucracy to impose unjust limitations upon free enterprise, but as - well - thought - out - as - possible plans to maintain standards of living and the ability to produce economically for consumption and export.

There will, undoubtedly, be some expenditure in excess of ordinary, but every person interested in real and continued prosperity devoutly hopes that the good sense of the people will prevent an orgy of spending. The Chairman of the Wartime Prices and Trade Board said in January that the situation across Canada shows almost as severe pressure against the price ceilings as in the worst period of the war. "We are today supplying more civilian goods than before the war, but it is the enormously increased purchasing power of the people that keeps the supply so far below the demand." If rational buying can be maintained until the flow of goods catches up with the demand, and if price controls are removed as fast as conditions permit, as supply and demand come into balance, there is every hope that Canada may escape the inflationary contortions that were experienced after the 1914-1918 war. To achieve this, the public needs to show restraint in buying, acceptance of the price ceilings, and patience to wait until manufacturers catch up in the making of scarce goods. This necessity was given support at the end of January by the Secretary of The Toronto Labour Council, when he said his Union favoured retention of control on both prices and wages.

To meet the changed face of economics today, three needs are mentioned by the economist, Stuart Chase: encourage private investment; encourage public investment, especially in low-cost housing and conservation; and see that frozen savings do not aggregate more than 10 or 12 per cent of the national income — in other words, keep money moving as a factor in the production of commodities, so that a large supply of goods flowing to the market will act as a safeguard against inflation. The miser, Silas Marner, set a bad pattern: he saved all his gold pieces, and took them out of their hiding place every night and counted them; then one night all his gold was stolen. If a person saves $250 out of his year's earnings, and buries it, he is hurting the economic machine. If, instead of hoarding it, he wisely decides to invest it, either directly or by depositing it in his bank account, he is adding lubricant to the machine. The banks are encouraging credit for constructive business building which will promote the expansion of production. It is through such new enterprise that prosperity must come, because one of the chief ways to get money into working circulation is through wide employment.

Canada's decision to pay a large part of the costs of the late war by taxation was of fundamental importance in the struggle against inflation. On the other hand, if all the costs of war had been paid by taxes, there would not now be the large reserve in the form of bonds, deposits and money. There would be the same shortages of goods, the same worn-out equipment, but there would not be the money available for private investment which will help restore and expand business. Now that production of war goods has ended, the primary function of invested money is to maintain the continuous maximum production of the kinds of goods consumers want. This is accomplished, in the first instance, by providing industries with capital in the form of durable goods, factories and machines which will get into action and continue producing for years. Proper operation of the economy requires a continuous and large flow of funds into producers' durable goods, and the amount spent on producers' goods in the next few months will return thousands-fold in the form of commodities to replenish the shelves of stores and warehouses.

Termination of the war has brought changes not only to the financial needs of the government, but to all the rest of the economy. Government deficits should shrink; business will be able to find uses for the funds available to it, with the release of hitherto scarce material. It is of paramount importance that policies should be so framed as to give enterprise the greatest freedom commensurate with over-all economic success in the transition.

In the past, financial crises have begun with misunderstandings which might have been avoided if the problems had been approached in a scientific spirit, rather than in partisan or selfish or narrow ways. The question awaiting answer now is: do people wish strongly enough to progress in and as part of the world to give serious thought to measures which, carried out by themselves individually and by governments, may lead toward the conditions they desire. More advance explanations, and fuller explanations of proposed economic measures, by the country's leaders, along educational lines, would be more effective than regulations explained after they have been imposed. The business of the country is everyone's, and the advice given on the United States Franklin cent is apt both in regard to money and the economy in general: "Mind Your Business."

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