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Central Banking in Canada

BY GRAHAM F. TOWERS,
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COLONEL JAMES MESS, presiding, said:—Gentlemen, in the unavoidable absence of the president, may I wish you all a prosperous 1936. I have a very happy duty to perform on behalf of the Canadian Club, and that is to welcome the Mayor-elect, Mr. Sam McBride, and I have asked him to say a few words.

THE MAYOR:—Mr. Vice-President, our guest, Mr. Towers, Gentlemen. Let me thank you very kindly for your wonderful reception, and also for the votes you gave me on New Year's Day. And to those who did not vote for me, let me say that I think you will before the year is over. Let me thank you also for the honor you have conferred on me, and I can assure you that I will endeavor to carry out the duties to the best of my ability. I will endeavor to look after the small as well as the large problems all I can, because, after all, you have elected me and I am your servant. I will scrutinize each and every detail that comes before the Board of Control and the Council. I represent all the people without class or distinction, whether Grit or Tory, Protestant or Catholic. I am your mayor, and not, I may say, a newspaper mayor, and I hope I shall have as many friends in the fall of the year as I have now. It is a wonderful start to appear here and have a few words with so many men, and I don't wonder at you turning out in such numbers, because I think you are going to hear something that will be food for thought.

COL. MESS, introducing Mr. Towers, said:—I am told that all bankers are modest and retiring, and I have found that the more complimentary you are towards them the

more retiring they become. I hope that if I am truthful in my introduction, and not just complimentary, that Mr. Towers will leave his shell and tell us much that we wish to know.

It is unnecessary to emphasize his rapid rise to prominence. You are all aware how he left McGill to go to the Royal Bank as an economist; of his services in Cuba as assistant inspector of branches; of his recall to Montreal and appointment as inspector of all branches; of his elevation to the position of assistant to the General Manager; and finally of the honor conferred on him in his appointment as Governor of the Bank of Canada. You may not be aware that he is one of the very few—in fact he is one of only two—university graduates who have attained the highest honors in the banking service.

He is a clear thinker, an able analyst and a capable organizer. He has travelled; he has written; and much favorable comment has come to Canada from British and European sources on his admirable formation and organization of the Bank of Canada.

I am sure (turning to Mr. Towers) you appreciate our interest in the subject of your address, and our desire to honor you today in the responsible position you hold. (Turning to the club) Gentlemen, it gives me much pleasure to call on Mr. Graham Towers.

MR. GRAHAM F. TOWERS:—Mr. Vice-President and members of the Toronto Canadian Club. It is not always essential for the speaker to extend publicly his thanks to the chairman, but in view of his very kind remarks, I feel I cannot forbear to thank him most sincerely. I should also like to say that while I was listening to his words, I was careful to bear in mind the very excellent practice of the Egyptians, in having a mummy carried around at their feasts to remind them that the span of life was short and that all was vanity.

During the last twelve months I have had the questions put many times, "What is the Bank of Canada?" and "What does it do?" These are not questions that can be answered in a few minutes, and I have usually found that after a few minutes my answers have had a paralysing effect on my

questioners, and they either change the subject rapidly, or say at the finish, "But what do you really do?"

I think it would not be out of place if I intimated why Central Banking is so much more prominent nowadays than it was before the war. In those days the gold standard worked, if not to perfection, at least very satisfactorily. If the business situation was such that there was a legitimate need for more currency, gold reserves could be increased for that purpose. The action took place in the ordinary course of business and was practically automatic. To the extent that guidance was required, London was the centre that exercised most influence. After the war, and again since 1931, the story is quite a different one. Of the forty-eight central banks in operation today, 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. All countries which did not possess a central bank might have found one very useful indeed, but there is always a certain inertia to be overcome before such a step can be taken. When that has been overcome, it can only be ascribed to the fact that in the ghastly conditions of the post-war years, it has come to be recognized that central banks were essential.

Take the case of Canada. Our currency laws provided for a certain free issue of Dominion notes against which a gold reserve of 25% had to be maintained. Additional issues could not be made without a hundred per cent. gold backing, a most unsatisfactory state of affairs when the gold standard had been abandoned.

Changes in the volume of business may mean that larger or smaller amounts of currency are required, and changes in the velocity of turnover are even more important. Elasticity is essential to business, and in our laws there was no elasticity when the gold standard had broken down; when we had reached the limit, provided by law, there we stayed, no matter what was transpiring in the business world. Even the Finance Act, which enabled the chartered banks to obtain currency through temporary borrowing, was inadequate. This act provided facilities to cover seasonal fluctuations, but, except for this purpose, could not be regarded

as a solution, since no bank would want to, or should want to, borrow except for temporary periods. The 1934 amendment to the Dominion Notes Act did provide a much needed elasticity by changing the fiduciary base 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 I mean only the legal tender in the country other than gold, and you will recall that this currency constituted the main cash reserves on which our banking institution stood. It was essentially the life blood of our whole system. Today we find that Dominion notes have been replaced by deposits with the Bank of Canada, and notes issued by the Bank of Canada. 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. I would like to read the preamble to that Act: "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 currency unit and to mitigate by its influence fluctuation in the general level of production, trade, prices and unemployment, so far as may be possible within the scope of monetary action, and generally to promote the economic and financial welfare of the Dominion: Therefore His Majesty, by and with the advice and consent of the Senate and the House of Commons, enacts as follows."

Gentlemen, if the men who wrote that left anything out, I am not aware of what it could be, and I think I may say that in the old days any central Banker would have been terrified to stand before you and read that preamble. And I should warn you that such preambles, if taken too literally, are dangerous things. This one says in effect, "We want prosperity, stability and peace of mind; see that you provide them." Only later came the sensible qualification, "So far as may be possible within the scope of monetary action."

But qualify it as we may, a very serious responsibility remains, and that responsibility we must endeavor to discharge to the best of our ability.

We know that monetary action will not enable us permanently to gain new foreign markets or to do many other things on which employment and prosperity turn, but the responsibility still remains with us.

From time to time you may examine the weekly statement which we publish. A recent one shows that the chartered banks have on deposit \$180,000,000. They also keep \$35,000,000 of our notes in their tills. These two assets of the chartered banks are their cash reserves against their deposit liabilities in Canada, and they bear a ratio to deposits of a little more than 10%. Banks have certain ideas as to the amount of cash they should hold in relation to deposits. If the ratio grows 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 they restore their cash proportions to normal. Subject to changes in the amount of Bank of Canada notes in circulation in the hands of the public, the only way in which the total amount of chartered bank reserves can be changed is by action on the part of the Bank of Canada. If we increase our assets by buying gold or securities, or by making advances, up go the reserves of the chartered banks.

There, as nearly 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. Let us suppose, for example, that while off the gold standard, bank cash was reduced by 50%, and banks were forced to reduce liabilities to approximately the same extent, you can well imagine that the repercussions of such a development would be very serious indeed.

Or let us suppose that we doubled the bank cash. The banks would, in all probability, not expand to that extent, but I know of no case where unnecessary enlargement of cash has not resulted in inflation. You may say that this is all very well theoretically, and ask, "But what do you

really do?" To that question I should have no answer because, in fact, the processes I have described represent to us, not theory, but part of the daily grind. The wide swings, I have instanced, are only examples so exaggerated that they are not practical possibilities. But the ordinary minor movements are of real importance. In charting our course of action the fullest possible information on business and financial conditions in Canada and other countries is essential. It may 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 I do agree that a Central bank in undesirable hands would be dynamite indeed. It could so easily become of real significance in ways which would constitute the greatest injustice. 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 a Central bank can have. Perhaps you may notice that in discussing the Bank of Canada I make no mention of the question of ownership. That 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 the institution is a new thing, I would like to say something about its physical characteristics. A little over a year ago we had no staff, no premises and no equipment. We had the advantage that we were 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 at Ottawa, an office at Montreal and adapt the Government offices to fit into the new system.

The most important matter of routine work we have to perform is in connection with the supply of Bank of Canada notes, of which some \$98,000,000 are now outstanding. These have a normal life of from nine months to a year, according to denomination, and as the entire supply wears out and has to be redeemed and re-issued within the course

of a year, a large reserve stock is carried both to meet current requirements and to provide the six months seasoning which bank notes should have before being issued. Since we opened we have issued forty-nine million separate notes, and have redeemed thirty-eight million.

We are the financial advisers of the Dominion Government, and as such we must give them the most impartial advice we are capable of giving. We act as issuing agents when Dominion loans are floated. In connection with these activities, and for the purpose of dealing with our own securities it was necessary to set up a securities department with representatives in Montreal and Toronto as well as in Ottawa. This department looks after the Bank's own large portfolio of securities and must, of course, maintain close touch with the securities markets both in Canada and abroad.

The Dominion Government has large dealings in foreign exchange. Foreign funds are obtained principally through the shipment abroad of gold purchased from the Canadian mines, which now amounts to \$115,000,000 a year. These funds are used to meet the Government's interest payments, and for the redemption, on maturity, of the Government debt. As bankers for the Government it was our duty to organize a department of foreign exchange. This operates in Montreal and Toronto and maintains close contact with the principal exchange centres of the world.

Lastly we set up a department of research and statistics. We refrained from setting up a very elaborate organization, for we were determined to avoid duplication in the compilation of statistics which did not serve a definite or useful purpose. And we have found there is a broad field for the accumulation of financial statistics not presently available elsewhere.

That ends the catalogue of our activities. I have tried to describe them so that you may have some idea of our organization. I have said something about the control of currency, and indicated the most important functions of the Bank of Canada. You can understand that a Central Bank would never claim it has power to work miracles. It should not point with pride to anything it has done. Still

less should it boast of what it hopes to do. Thus a Governor of a Central Bank is so limited that unless he can talk about something else he may not be found very interesting. That remark was made to me by the Governor of a Central Bank in one of the other Dominions.

And speaking of him reminds me of a story. A family living in the country of this other governor were in somewhat straitened circumstances. There was a son and through great effort they managed to provide for his education in the hope of making him a doctor. By much scraping and saving they sent him to London. He worked hard but failed in his examinations. They brought him home and he worked hard in the local university, and suffered a complete break-down. One day his mother met my friend, the Governor, and said to him: "Mr. Governor, you know our circumstances. Now the doctors have ordered that my son must have work that requires no mental effort whatever, do take him with you in the Central Bank."

Well, I have deprecated any claims to perfection on the part of Central Banks, but I think 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 we shall try to serve to the maximum of our capacity.

COLONEL MESS, in thanking the speaker, said:—Mr. Towers, the Canadian Club is limited in its means of showing its appreciation. Our attendance this noon is sufficient indication of our interest, and our applause is the only way we have of showing our appreciation of your address.

Before you go may I intimate that our next meeting is on Wednesday, January 8, when we have as the speaker Sir Alfred E. Zimmern, and the subject of his address will be "Britain's Foreign Policy." I should tell you that he is considered to be a great authority on international affairs.