

(November 14, 1932)

Currency and Common Sense

BY MR. PAUL READING.

PRESIDENT CHALMERS:—I think it can be truthfully said of this economic crisis that it has generated a great literature of its own and throughout most of the books and most of the addresses that have been rendered on the various aspects of this depression there is the one theme of money, and on two sides of that theme there have been ranged the debaters, on the one hand the inflationists and on the other hand the deflationists. It seems to me that about half the people in the world believe the way out of this depression will be found with the process of writing up and the other half believe the way out will be found in the process of writing down. So far as we can judge by the monetary policy of Canada this country has been to a certain degree neutral in that debate. But recently we indulged in what some people call a flutter of inflation and others call merely an attempt to ease credit. We felt on the executive of the Canadian Club it would be valuable for us to have someone to come to us and tell us something of the background of this recent monetary experiment of the Dominion. We did not want to invite a banker because bankers are by nature deflationists, although I think they would call themselves sound money men, and we did not want to invite an economist, a professor of political economy, because they are by nature inflationists, being definitely concerned with the theory, so we asked a banker and we asked a professor of political economy each to suggest the name of someone who could discuss this subject with intelligence and the name suggested in each case was the same, Paul Reading. And that explains why he is with us to-day. You have

read on your cards something about Reading and you have read the title of his address. Just for the benefit of those who are listening in we would like to state he is the economic writer for the Southam newspapers with headquarters in Montreal and his subject to-day is "Currency and Common Sense." Mr. Reading.

MR. PAUL READING:—Mr. Chairman and gentlemen, I should be a very dull person indeed, if I did not appreciate the honor and privilege you have accorded me to-day. For those of us who spend our daily life in contact with that cold and forbidding medium, the printed word, to meet an audience face to face is always a refreshing thing, and when the audience happens to be such a one as the Canadian Club of Toronto, it becomes also a stimulating thing.

Now, lest you are already asking yourselves, "can any good thing come out of St. James Street?" let me also mention that my pleasure to-day is enhanced by the fact that I am speaking in the town where I was born and where I knew the hopes and aspirations that go with being a small boy. It was with a good deal of trepidation that I approached the question of such a solemn subject as currency, but your chairman very adroitly convinced me there was really no one else in Canada so well equipped to deal with it as I was. I omitted to explain to him there is one other man in Canada who has just as perfect knowledge of the subject as myself, but he, unfortunately, for no reasons he has been able to advance, is located up in an institution and not allowed out even to address Canadian Clubs.

Now, as the Chairman has said, my subject is Currency and Common Sense. It might perhaps better have been money and common sense, because I would like to say now, the money I shall be talking about is the real money of business, the bank cheque, with which we pay ninety per cent or more of our payments, and just for the sake of being thorough let me also advocate common sense. Is it anything more than a sense of reality that comes with a sense of propriety and a willingness to act in the light of reality and with an eye to proportion?

One golden autumn afternoon some years ago I climbed

a ladder to the loft of a Buddhist temple in Peking and peering through the hall at the top got a sight of a group of Lamas at prayer. They were sitting around a drum which one of them beat rhythmically in time with their incantation of a phrase come down from the twilight of their religion. It was picturesque there in the shaft of sunlight breaking through the holes in the roof. It was picturesque in a spiritual sense. But the phrase they chanted was quite meaningless to us. It isn't Chinese. Probably it has come down to them from the ancient cult of Siva in India. But it has completely lost its meaning. All one can say of it is that it is a good prayer and with sufficient reiteration must produce tremendously beneficial results.

Now the attitude of our high priests of finance, in fact of all of us until quite recently, has sometimes reminded me of that prayer. In moments of great tribulation and peril we have been more or less satisfied to incant the phrase, "gold standard, gold standard, gold standard," but with no more meaning and perhaps not much more apprehension of exactly what it means. At any rate you will agree with me in the dark moments of recent years we have been rather content to reassure ourselves that gold is in its heaven, all is right with the world. It is a comforting phrase. But how far is it understood? I venture to say, outside a rather narrow circle into which I have been trying to crowd myself lately, it has not been very clearly understood at all. I do not propose to define the gold standard for you. That is not what I am here for. But I should like roughly and vaguely to define its purpose. It is nothing much more than a rule of thumb way of managing currency. I do not know whether you as schoolboys found the same fascination I did in that gadget known as a governor of a steam engine. But you know, probably, how the speed of the engine regulates it and is, in turn, regulated by it. That is my picture of the gold standard as it operated in the good old days when it did operate. Now it can happen that, if the governor of a steam engine is not properly regulated, it can become jammed, and that is precisely, I think, what has happened to the gold standard at present. For the moment it has

broken down. It has been, and I think again will be, tremendously useful as a means of regulating currency, but at present it is not working and the only evidence I need give you of that is the chaotic price conditions that exist throughout the world; and when the governor of an engine breaks down, it is time to take hold of the throttle and exercise some direct control over the engine, lest it slow down to nothing or shake itself to pieces. But let me clear myself of the charge that may form itself in your mind that I am a currency crank. I do not think I am. I do not believe there is any one panacea for our trouble of to-day. I would not even argue that currency is the sole cause of the depression. I would rather compare it with the fever that may accompany a disease in a human being. But I would like to point out that it is sometimes highly desirable to reduce a patient's fever in order to help him fight down his real troubles, and, reverting to the simile of a governor, since the gold standard is that sort of mechanism, since currency itself is merely a mechanism that enables us to exchange goods and services, I think that mechanism should be subject to regulation, in fact I think that the common sense of currency to-day is that we should adopt a policy of regulation, that we should make currency serve us rather than that we should become the slaves of currency.

I think you will agree that one of the gravest phases of the present depression has been the fall in prices. To put it simply, it has made it difficult and sometimes impossible for debtors to meet their creditors. I think you will agree with me that a general fall in prices can also be interpreted simply as a rise in the value of money. Obviously a dollar that will buy two bushels of wheat is worth more in the wheat market than a dollar that will buy one, and when a dollar will buy forty or fifty more of almost everything the dollar has risen in value. And the fact that the dollar has risen in value suggests at least it has developed a scarcity value. Will you at least concede with me that one of our troubles to-day is a shortage of money, and that if that shortage were ended we should feel better about it. I know I should, and I am referring of course to the money that we

actually use in most of our transactions, namely the bank cheque which has as its backing bank deposits. Now then, if money is only an instrument of exchange and if there is a shortage of it, isn't it reasonable to consider that an adjustment of that instrument to the needs of the occasion is merely common sense? At least in suggesting that, I am not offering you any new-fangled idea. In fact I am merely parroting the monetary arithmetic of 1932 and pointing to what will be undoubtedly one of the most vital issues before the approaching World Economic Conference. It was an issue at the Imperial Conference in Ottawa. But perhaps circumstances were not quite right for action then, and it has been passed on to the World Economic Conference.

Meanwhile, however, certain very important attempts at readjusting the currency machine have already been set on foot. The efforts of the federal reserve system at refraction have been sufficiently advertised and need very little discussion from me. Let me merely point out, they have consisted really in the actual creation of new bank reserves in order to strengthen the cash position of the American banks. It is true they have been offset, first by a passion on the part of American bankers for super-liquidity, and second by a first class monetary panic early last summer which involved heavy withdrawal of gold from the United States.

The results hoped for from this federal reserve plan of refraction have thus been delayed. But results have already begun to manifest themselves. As a matter of fact the injection of one billion dollars in new cash reserves into the American banking system has thus far been reflected in a rise in American banking deposits. Let me repeat, the real money of business is to the extent of a billion and a quarter dollars above the level of a year ago. Now it is less generally understood or realized that England has been pursuing a parallel and practically equivalent policy. It has been doing it without ballyhoo but with much more direct effects. And the evidence of that is in current Bank of England figures if you care to study them. I grant you that these figures are always something of an enigma and that one can

never feel that one has arrived at the absolute truth merely from looking at them. But certain things are very obvious and conspicuous. The things I refer to are these. The Bank of England, by no matter what policy, has been devoting itself to an increase in the cash resources of the London clearing banks which, as you know, are the banks with which the public deals directly. Now that increase in cash resources can be measured in this way. These cash resources reached their depression low last February at one hundred and seventy-two thousand eight hundred pounds. The September figure was one hundred and ninety-two million six hundred thousand pounds, a rise of about twelve per cent between February and September. And the reflection of that increase in the total deposits gained, the measure of business with the London clearing banks, is very direct. The bank figure was one million six hundred and fifty-eight thousand pounds. By July it had risen to one million eight hundred and three thousand pounds and the September total is one million eight hundred and sixty-four thousand pounds, again a rise of about twelve per cent, created, you might argue, out of thin air, but none the less representing the fact that the British business man has behind his bank cheque to-day a larger deposit than he had on the average in the peak years of the recent boom.

The results of both these policies must, of course, be relative. Economics, like medicine, is not a new science. You can never be sure that some new circumstance will not interfere with the remedies you have planned. But I think it is only sane to argue that this increase of cash resources to the banks and to the public must have tended at least to offset the fall in prices, and if you doubt the significance of that price fall let me just quote you one dispatch from the most authoritative document that has appeared on this subject in recent years, the MacMillan report.

He says:—"We are emphatically of the opinion that even if a further fall of wholesale prices be avoided their stabilization at approximately the present level would be a serious disaster for all countries of the world alike and the avoidance of such should be the prompt objective of international statesmanship."

This question of checking the price fall is almost a world question, one of the biggest of world questions. It is also a Canadian problem and as a Canadian problem it has certain special aspects. As the argument has raged to and fro for the past twelve months it has been something like this. We know that a depression of the Canadian dollar tends to raise prices in Canada, particularly the prices of export products, and therefore to narrow that dreadful gap between prices and debts. That is to say if the Canadian dollar were at fifty cents the Winnipeg price of wheat, reflecting as it does the Liverpool price of wheat, would be doubled in terms of the Canadian dollar simply because the Canadian dollar had lost half its value. And like wheat, our newsprint is mainly paid for in terms of a world—in fact of a gold currency, and therefore either the fall of the Canadian dollar tends to raise the Canadian price of newsprint and to make it so much easier for the newsprint mills to pay such debts as are recorded in terms of the Canadian dollar. You are quite as conscious as I am that there is a little quirk there but I am coming to it.

Now the other side of the argument is that Canada has very heavy gold obligations abroad, mainly to the United States, and that as her dollar falls it requires more Canadian dollars to meet these gold obligations. Quite true. But that is not the whole of the story. We have been told often enough that Canada's gold obligations amount to three hundred million dollars a year at present. That is not quite the figure but never mind. About half of those obligations are actually due to Canadians who hold the bonds floated in New York. But never mind that. Let us suppose that three hundred million dollars in gold a year is the figure. Where do we get it? As you know, our gold production, if that were what mattered, amounts only to about fifty-five million dollars a year. As you know, we have not been exporting gold and yet we have been keeping abreast of these gold obligations. It is quite obvious we have been doing so by exporting wheat, exporting newsprint, and, if you like, selling hot dogs to American tourists, and thereby establishing for ourselves indirectly claims

abroad which we convert into gold abroad and use to meet these other gold obligations. In other words it is preponderately exports that pay even our gold debts and obviously if that is the case the more we are obliged to export, the easier it becomes to meet those debts. And I could go further and point out to you that a change in the value of Canadian dollars does not influence in any way the export value of our chief export commodities for the simple reason that the price of them is a world price and has no relation to the Canadian market. Think of wheat and newsprint and you have the examples of that.

There is another class of commodities whose price is influenced by the Canadian market but in that case where there is no world price the principle effect on our dollar is that it becomes cheaper and that is so in some measure with our export prices. There are, I think, the two sides of the argument. I may have made some unskilled effort to transmute them into one side. I do not want to discount the serious considerations that attach themselves to our gold obligations abroad. But I do want to point out that they are not the only considerations and I think not the main consideration.

Let us come down to the recent situation. Our dollar was making a steady rise back to parity with gold, back toward gold standard, which has been discarded by all but about six nations of the world. That rise was in some measure at least depriving us of the export advantages we had gained from the earlier depression of our currency. But it was doing more than that. Coupled with the fall in the pound sterling it was widening the gap between our dollar and the pound in such a way as to imperil the results of the recent Imperial Economic Conference. What have we done about it? Now, believe me, I realize that it would be presumptuous for me to try and propound for our Canadian Government any of these policies. That is ground which I must not tread because it is the sole right of the government itself to explain what it means by its actions. But I think we have the privilege of examining the facts of recent developments, and the fact that has been most discussed

this past week or so has been the advance by the Government of thirty-five million dollars in cash resources to the Canadian bank system.

Just what was that operation? As you are doubtless aware, our Finance Act provides that the Cabinet may when it chooses, and I believe in any volume, advance cash to the banks against a certain list of proved securities which range from Dominion bonds down to such things as trade bills. And when these cash advances are made against these securities, gold backing for this new currency is not legally required. In other words we have in our Finance Act an instrument of inflation which can be used, if we choose, to almost any limit. It has now just been used in a generous measure. Unfortunately I think it has been in the main used at the wrong times. Let me just point out at the peak of the recent boom this advance, which represented a creation of new and unbacked currency, had risen above the level of one hundred million dollars. And in recent months when a policy of more plentiful money might have been suggested they have fallen as low as about six million dollars. Now what the government has just done is avail itself of this clause in the Finance Act, in this way. It has issued thirty-five million dollars worth of its own two-year notes, new securities, and sold them to the banks. It has borrowed thirty-five million dollars from the banks on these new securities. It has in turn accepted back from the banks these same securities as collateral for loans totalling thirty-five million dollars. By a peculiar but very common process of mutual indebtedness money has been brought into existence, thirty-five million dollars of new money poured into the financial veins of our banking system. Now that has been done before, particularly during the war for the purpose of financing government expenditure. I believe in the present case that had the government so desired the banks could have furnished that thirty-five million dollars out of their own reserves. Therefore one of the main troubles with the method is that it has been at the expense of the government. And one is quite justified, too, in recognizing the fact that, since this operation involves the raising of thirty-five million

dollars of new money, it is in its character reflationary. It has probably been at least partly responsible for a check in the rise of the dollar, in fact for a considerable and for the time a rather marked fall in the dollar.

My discussion of that point has probably been sufficient. I regard that fall in the dollar as a wholesome thing. I told of the cause that brought it about. But lest you be disposed to burden yourselves with the word inflation, let me ask you what you mean by inflation. My guess would be that in most of your minds it would be defined in somewhat these terms: an extension of money out of proportion to the gold reserves of the country. Well now, if that is how you think of it, let me give you a picture of normal money conditions. What do we do when we are on the gold standard with generous gold reserves? Take forty cents of gold and we base on it one dollar of the Dominion note issue. That Dominion note issue forms the sole raw material of the Canadian bank system. It produces double the Canadian bank deposits, which, as I have already said, constitute the real money of business, and bank deposits are produced in the ration of about eleven dollars to one dollar of Dominion currency. Therefore with forty cents, that amount of gold, we base one Dominion dollar note and eleven dollars of bank deposits. And if the ratio startles you let me reiterate that it is the normal sound figure on which we operate on the gold standard, and that we thus inflate our currency, simply because it is the best and most convenient way to operate currency. The trouble is that when we speak of inflation we think at once of Germany and Russia, two poor broken countries who let their currencies go to the wall. Perhaps we forget France, whose devaluation of the franc to one-fifth its former value was nothing more than crystallization of the effects of tremendous and beneficial inflation. The real defence of inflation is its abnormal expansion of total purchasing power and, if that is the case, reflation is an expansion back to normal of a purchasing power that has abnormally shrunk. If I were to offer you some sort of a dose that would raise your temperature two degrees, you would probably look on me as a poisoner but if on the other

hand you were in an advanced state of hemorrhage and in danger of bleeding to death and your temperature had fallen two degrees below normal, and if I offered to inject what doctors call a glucose solution in order to replace the required blood you had lost, I would not be a poisoner but a physician. Now the world business of late years has shown signs of bleeding to death. The question we must face is whether we shall trust the old formula of *laissez faire*, let the flow continue, and chant some charm of witchcraft in order to stop it, or apply what economic science deems to be the remedy. The signs that we are becoming prepared to apply these remedies are quite visible. I trust they will become more manifest as the world economic conference approaches.

Gentlemen, we have been living in a wonderful age. I sometimes think our generation more perhaps than any other preceding it should have the gift of common sense, because after all it is vicissitude and adventure that tend to develop common sense. We have seen a great flowering of scientific achievement and invention, including if you will the discovery of halitosis, athletes' foot and B.O., or if not their discovery at least their introduction to society. We have witnessed a war to end war, followed by a peace to end peace, followed in turn by what was to be an evergreen boom. And now we survey the spectacle of a world that, as I have illustrated, is threatening to bleed to death. But at the moment there are some signs that that world is ready to trust the doctor. And the many doctors, who are attending it, are at least approaching something like definite and accurate diagnosis. Now that sign that the world is getting ready to apply some common sense to currency struck me as the most cheering thing that has occurred in the great depression. For my own part it gives me the feeling that, after long watching, I have caught sight of a real rift in the clouds that cover us and through them have glimpsed again the beautiful blue that is heaven.

PRESIDENT CHALMERS:—With Mr. Reading I see ranged about me at this head table a select group of gentlemen, each of whom would like to stand on his feet and

participate in a debate, some of them agreeing with what you say; some agreeing in part, and perhaps one or two disagreeing entirely, but I can assure the audience, as I assure you, they will not have the opportunity. You have given us a very clear picture of a very difficult subject. I think it is one of the most interesting talks I have listened to since this economic crisis came upon us and I think we have all gained a great deal from it. We thank you for the attention you paid to the preparation of your address. We appreciate very much the charming and graceful manner in which you have delivered it. Thank you.