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November 28, 1930

W. A. Mitchell, Esq.,
J. P. Morgan & Co.,
23 Wall Street,
New York.

Dear Mitchell:

I thought you might be interested in the enclosed paper, which I read before a small gathering on the evening of November 24th.

It seems to me that in high financial circles there is a complete misapprehension as to what is wrong with business. Our trouble in my humble opinion are mainly due to a faulty central bank policy and the chief factor is the United States. In order to give you my ideas on this particular phase of the subject I enclose copy of a letter which I felt like writing to The Annalist on October 4th, but actually did not send it, although I forwarded copies to a friend in New York who feels the same as I do and he put one or two of them where he thought they would do some good. - *Washington*

I have in recent months done a great deal of reading on the subject and it is my considered opinion that since the death of Benjamin Strong the Federal Reserve Bank has never been right in their policy. Had they been permitted to do so, they could have stopped the stock market from reaching such crazy heights. When the collapse came they could have prevented much of the severity of the present depression. As it is now being operated - in fact, since it has operated from the beginning, except during the years 1922-1927 when Mr. Strong seems to have realized his responsibility and the power of the Bank to stabilize prices - the Federal Reserve Bank has always operated to accentuate inflation and after the turn has always been the greatest single instrument in deflation. Of course, I know that all the great bankers in the United States, if

views such as I have expressed in the enclosed papers were set before them, would say that this is nothing but "inflation" and "artificial" measures are not to be thought of. If I had a sufficiently high opinion of their intelligence I would say that the whole thing is an organized swindle by which the money interests expect to take back the securities from the public after having sold them to them for billions more than their present values.

In case you may think my venom is the result of personal experience, I want to tell you that I was largely out of the market before the collapse last fall and that the rise engineered in the first of this year did not deceive me in the least; that I told everyone who would listen to me that it could only result in a further fall. If you want to take the trouble to look up our February and July Monthly Letters you will see that, alone among financial institutions on this continent, we foresaw the inevitable results of financial deflation.

But why should an intelligent policy of a central bank be regarded as artificial or unnatural? Why should we assume that the position we are in already is inevitable? It is quite certain that the Federal Reserve Bank by taking the initiative at the proper time to prevent contraction of currency and credit could have stopped the present decline. Had they done so then the people who now talk of artificial measures would have thought that was the natural thing to have done. In my opinion those who try to dismiss the matter by yelling "inflation" and "artificial measures" are only hoping to cover up their own lack of understanding of the problem. I am convinced that the best intelligence in the Federal Reserve Bank has been very keen to adopt the policies which I have outlined but have been prevented from doing so by the "practical members of the various Boards. Dr. Snyder, who has done some of the best work in political economy in recent years and who is certainly in the first flight

of American economists, even risks his job to point out the folly of the present situation.

After reading Dr. Burgess' book, "Federal Reserve Banks and the Money Market" or "Interpretations of Federal Reserve Policy" in the speeches and writings of Benjamin Strong, can anyone doubt that Dr. Burgess now feels the same way and that Mr. Strong, had he lived, would have saved the country and the world from the terrible nightmare through which they are passing.

I took the trouble to read twice the first article in the last number of the Saturday Evening Post in which Mr. Marcossou quotes the views of American business leaders. I think there is only one honest man in the lot and that is Mr. Sloan, who says he does not know what is wrong; it is perfectly apparent that none of them have the slightest idea.

It is, of course, the habit now to say that we are at the bottom of the slump and I hope that this is so, but there is certainly no assurance that this is the case. The question to my mind revolves on whether or not the depression burns itself out in the United States before an economic collapse overtakes other gold countries. But if we do temporarily get over this depression it seems to me as certain as anything that there is another one in the offing. I could understand the present folly if the United States were gaining anything by it at the expense of the world, but the net result is loss, misery and suffering to every country, and the only countries which are in reasonably good condition are those such as Argentine, Uruguay and Spain who have so far refused to stabilize their currencies on a gold basis but who have, as a result, maintained stable purchasing power. The United States coaxed all the principal countries of Europe back on a gold basis at a time when they had given a demonstration of their ability to control the price level. If Europe had had any idea how badly they were to be "sold" they would probably have continued to manage their currencies

and by this time the United States might have been in the position in regard to gold that China is in regard to silver.

Yours sincerely,

Encls.

June 19, 1931

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Mr. S. R. Noble opened the discussion with the following remarks:

"I wish first of all to congratulate Dr. MacIntosh on the able manner in which his subject has been treated. As an abstract discussion of the gold situation I have nothing to add or nothing to disagree with in what he has said.

Before I go any further I feel it necessary to ask indulgence of the audience on account of my lack of experience as a public speaker. I would feel fairly uncomfortable on my feet before any audience but when I consider that I am addressing a select company of the outstanding economists of the country I wonder at my temerity; nevertheless in a company of economists I can at least claim to be a practical banker although it is possible among a company of bankers I would have to maintain that I was an economist, and I should like to discuss some of the practical considerations which arise out of a discussion of the general theories advanced. First may I comment briefly on one or two of the statements in the paper which you have just read. Dr. MacIntosh has referred to the papers of Kitchen and Cassel published in the Report of the Gold Delegation of the Financial Committee of the League of Nations. These two great authorities point out that the price level in 1850 and 1910 was approximately the same. They argue from this that the increase in gold stocks must have approximated the increase in volume of business and then proceed to prove by statistics developed by the League of Nations and by Dr. Snyder in New York that this is approximately the case. It is possible that their conclusions are justified and it would certainly be presumption on my part to disagree with such great authorities but nevertheless I do not see how any such conclusion is justified. In 1850 there was only one country operating on the single standard, namely, the United Kingdom. The United States was a bi-metallic country in which

gold predominated and Europe had a bi-metallic standard in which silver predominated. The whole of Asia was on a silver basis although, of course, silver countries were not entirely without gold circulating as money. By 1910 practically the whole world was on a gold basis; but in the meantime the policies and methods of operations of central banks had undoubtedly changed materially. It must be mainly a coincidence which cannot be satisfactorily explained statistically that prices arrived at the same point sixty years apart. If this statement is not correct then the outlook for stability of prices is very poor because according to authorities there is practically no hope that the present volume of production of gold can be materially increased and it is anticipated that within a generation it will be declining at a rapid rate. It surely cannot be seriously contended that nothing can be done to change the volume of currency and credit which may be based on a given gold reserve. We know that since the war the uses of gold have greatly changed. Before the war, particularly in Europe, there was a large volume of gold coin in circulation and hoarded and reserves of commercial banks were largely held in gold coin. Since the war this has been practically altogether done away with. Later on I shall touch on the question of the extent to which central banks require to hold gold reserves in order to maintain always approximate parity of ^{their} money with other countries operating on a gold basis. I contend that intelligent understanding of this problem and proper co-operation between the principal central banks would make a gold shortage in relation to prices a matter which need not concern the present generation. I would not have you think that I believe Dr. Cassel does not understand the problem. He goes further than probably anyone else in his insistence that the general price level is controllable within narrow limits

and really the only inference we should take from his statement is that a shortage of gold will make itself felt in declining prices if the present charters and policies of central banks are continued without change. He has emphasized at great length the possibilities of economizing gold. Incidentally I think Dr. Cassel's predictions of falling prices certainly did not foresee the present debacle and he would be the last to admit that the shortage of gold had much, if anything, to do with the present predicament.

Dr. MacIntosh apparently accepts the claim outlined in a letter published by the National City Bank and also emphasized by Mr. Paul Warburg in his annual address to the Bank of the Manhattan Company that the gold which has come to the United States in recent years has not been sterilized. The National City Bank prove their case to their own satisfaction by pointing out that the increase in the credit extended within the country during the period of 1921-29 has been in proportion to the ^{previously} existing gold supply and is actually somewhat greater in relation to this gold stock than the credit outstanding in the United Kingdom. This sounds very convincing but on analysis seems to me to mean very little. Mr. Warburg says that the United States did not sterilize gold and proves it by saying that they have loaned more abroad since the war than their total receipts of gold. This argument seems to me even less acceptable than that put forward by the National City Bank. After all, why do central banks require gold? Certainly not in order that it may be exchanged for notes which circulate within the country. If there were any great tendency for the people to present notes for redemption in gold that of itself would be sufficient reason for suspending gold payments. In present theory and practice gold is only needed

to settle international payments and surely no one seriously suggests that the United States would be in the slightest danger of having her exchange break down if her total holdings of gold were only one-third of what they are at present. Any country under normal conditions can quickly adjust an exchange situation by appropriate rate or open market policy and in the event of war all the gold held by any country would quickly prove inadequate to her needs. As a matter of fact, the moment war broke out all the belligerent countries and many of the neutrals immediately suspended gold payments and "managed" their currency during the whole term of the war and for some time afterwards. I have never heard anyone attempt to explain mathematically the meaning of "sterilization" of gold. I should say it is impossible to do so. It is quite clear that some countries need much more gold or its equivalent, cash balances abroad, than others to ensure their ability to always maintain gold payments. Probably the countries which actually require the lowest reserves in proportion to the credit outstanding are precisely those which have cornered the gold supply, namely, the United States and France. London, as the central gold market and the settlement point for the bulk of international business and dependent as she is to a far greater extent than any other country on import and export trade, clearly might experience greater sudden drains on her gold reserves than perhaps any other country; however, as the only properly organized money market, she can undoubtedly counteract gold movements in either direction more quickly than any other market. I think at this stage I should say that ~~in~~ in my judgment the main factor in bringing about and continuing

the present world-wide depression has been the disastrous fall in the commodity price level and that this has been brought about not by over-production, tariffs, war debts, stock market collapse or any of the usual causes assigned but by a thoroughly stupid/^{central} bank policy with France and the United States as the principal villains in the piece. I hope that Dr. MacIntosh ^{→ (he was the previous speaker)} may be right in assuming that out of the present difficulties we can expect greater co-operation in the future between these central banks but I must say that to date I have seen very little evidence that this will be the case. It would seem that France does have some feeling of responsibility in the matter and is doing what she can, subject to the limitations of the thoroughly inadequate charter of the Bank of France and also subject to political considerations, to release some of her gold by assisting other countries financially. ^{XX (U)} The United States to date seems to me not only not to have realized their responsibility but to be still going ahead with a stringent policy of deflation. While it would undoubtedly have been ~~impossible~~ possible for the Federal Reserve Banks to operate within less restricted limits than is the case with the Bank of France, it also seems to me that the organization of the Federal Reserve Banks and the terms of their charter are quite inadequate and thoroughly dangerous for the future well-being of the world. France has on balance received a good deal more gold than the United States in the last couple of years and I would like therefore to analyze the cause and endeavour to ascertain what could have been done to prevent this movement, which it was thoroughly understood was clearly against the best interests not only of the world but of France herself. I need not tell you that the Bank of France is organized along different lines to the Bank of England and the Federal Reserve Banks. In the first place they have about 300 branches throughout the

country and compete actively for commercial business. As a result of this the larger banks conduct their affairs in a manner which makes it absolutely unnecessary for them to depend upon the Bank of France in the way of borrowing from them or selling their paper in the market. Therefore when they require additional cash their only means of obtaining it is by depositing gold. X 2

As you all know, there has been an enormous increase in circulation in France in recent years due primarily to the fact that the franc was apparently stabilized at too low a price and up to the middle of last year the price level was steadily rising. During 1930 this situation was greatly aggravated by financial difficulties leading to hoarding of bank notes on a large scale. Under the circumstances and under the terms of the new charter the Bank of France had no means of putting additional money into the market and therefore were absolutely helpless to stem the tide of gold. Why was the Bank of France so helpless? I have explained that competing banks will not borrow from them. There is no bill market of consequence in Paris and under the terms of the new charter they are prohibited from purchasing Government securities. They can buy foreign exchange and they did this to a very large extent but it is obvious they would not be justified in placing abroad a large proportion of their total assets. I suppose in 1926 it seemed the proper thing to do to prohibit the bank from buying Government securities. They were then in the course of crystalizing the depreciation in the franc brought about by enormous borrowings by the Government from the Bank of France during the war and after, and at that time it probably seemed necessary to promise they would never do it again if they wished the public and the world generally to believe that the franc was

to remain on a stable basis. Actually this appears to have been a great mistake. It might be necessary to have some such restriction in the charter of central banks in countries enjoying a third rate financial standing and irresponsible Governments. No serious Government under normal conditions would upset their internal economy by borrowing excessive amounts from central banks and no Government would hesitate for one second to do so if the alternative seemed to be to lose a war; therefore I say that until a reasonable charter is developed for the Bank of France she will always be a source of danger to the world gold supply. Moreover, there is a tendency in most countries to regard a large gold supply as something worth while in itself and once accumulated they will go to considerable lengths to retain it even though their best economic interests point in a different direction.

What then is the situation in the United States? Clearly she did not require the gold which has been flowing in that direction since 1927; but here again there are limits within which the Federal Reserve Banks must have confined their operations in an attempt to prevent this movement. At the risk of repeating something which you all know as well as I do, I should perhaps explain that the Federal Reserve Bank have only three ways in which they can affect the money market. These are (1) by increasing or decreasing their loans to member banks; (2) their holdings of eligible bankers acceptances and (3) holdings of Government securities. Obviously they cannot prevent banks from paying off their borrowings. The volume of bankers acceptances available is quite small and regardless of rates a large proportion of them will always be held as investments by local and foreign banks. Recently the Federal Reserve Banks have evidently been using the most strenuous means to increase their portfolio of bankers acceptances, actually cutting the rate

(as a matter of fact they cut it to 7/8 % per annum)

to 1% per annum but without materially changing their total holdings. It is therefore clear that practically the only initiative left to them is by varying their holdings of Government securities and it is precisely under this heading that I think they have entirely missed their opportunity to prevent the disastrous deflation which has been taking place for more than a year and a half. ^{x39} During 1928 and 1929 the total earning assets of the Federal Reserve System averaged about \$1,500,000,000. Early in 1930 member banks paid off no less than \$1,000,000,000 of their indebtedness and the funds received were replaced in the market by the purchase of Government securities to the extent of only about \$400,000,000. Had the Reserve Banks replaced the funds in the market by the purchase of Government securities as quickly as they received them through repayment of loans by member banks, it is clear that the decline in the volume of circulation and bank credit would have been largely arrested and the steady flow of gold to the United States stopped and possibly reversed. ^{9x4} Actually their holdings of Government securities have been kept at almost \$600,000,000 for the past eight or nine months. It is impossible to believe that this is the result of any scientific analysis of the situation. It looks to the outsider very much like a compromise between two schools of thought, one who believes in some attempt at management being responsible for the increase which took place and the other, and apparently dominating school, which believes that all that has happened is inevitable and that nothing should be done to prevent matters from taking their "natural" course. There is, however, a limit within which the Federal Reserve Bank could have acted. It seems that in framing their charter the legislators were obsessed with the same idea as was uppermost in the minds of the framers of the Bank of France charter, namely, that the

Government could not be trusted not to use the central bank for easy financing. It was therefore provided that cover for the note circulation must consist only of gold or eligible paper, eligible paper being paper rediscounted by member banks or bankers' acceptances bought in the open market. Therefore the limit of the possible holdings of the Federal Reserve Banks of Government securities is their so-called "free gold". Under the conditions which existed in the early part of 1930 when member banks practically paid off their borrowings it would have been barely possible for the Federal Reserve Bank to have purchased Government securities equal to the amount of repayment of member bank borrowings. This is surely a great weakness which might very well prevent the Reserve Banks from taking appropriate action during a period of deflation. ^{X 5} That it will not prevent them from financing the Government through the Federal Reserve Bank is clearly shown by the experience of the Federal Reserve Banks from 1918 to 1920 when borrowings of member banks on security of Government paper ran, if I remember correctly, to about \$2,000,000,000. It once again shows the folly of leading central banks adopting rigid restrictions which cramp their style in normal times but are easily surmounted if the necessity seems to arise in times of war or other great emergency. The old theory of gold holdings was that they should bear a certain relation to notes issued. The new idea is that the fluctuations in the member bank balances are more likely to affect gold movements than the fluctuation in circulation, and this is undoubtedly the case. Following this idea both the Bank of France and the Federal Reserve Bank provide for minimum holdings of gold reserves both for circulation and deposits. But why should rigid minimums be set? If the bank finds it impossible to reduce their reserves below a certain figure then the amount held, up to that figure, is entirely useless since it cannot

be used when needed. This is another feature of central bank charters which should certainly be changed.

Referring again to the Federal Reserve Bank, there are a number of other factors which make management very difficult. The Federal Reserve Bank is not a central bank but twelve autonomous regional banks. They are supposed to head up in the Board at Washington but actually the Governor and Directors of the Board have practically no authority, their initiative being limited to compelling regional banks to change rediscount rates or vetoing changes recommended by regional banks. ^{"#6" with initials} Thus divided counsels are inevitable. It is an open secret that the views of the Federal Reserve Bank of New York have practically always been opposed to those of the Directors of many other banks. The Federal Reserve charter provides that the member banks shall be represented on the Boards of regional banks and in virtue of their supposed financial knowledge it would not be unreasonable to expect them to dominate the Board. ^{#7} In comparison with this it is significant to note that no commercial banker has ever sat as a Director of the Bank of England. ^{8 L.} I may be wrong but judging by their published statement I would say the bank Directors are more responsible than anyone else outside of the Board for what I consider the mistaken policy which was followed. It seems to me another great weakness in the system is that they have depended on a change in rates to enforce Federal Reserve Bank policy. This system works all right in England where a change in the Bank of England rate changes the rate on practically all loans of commercial banks and all the deposit business from John o' Groat's to Land's End. ^{9 L.} In the United States interest rates change very slightly. For example:- Banks in New York City still pay 3% on Thrift Accounts, which are the equivalent of Savings Accounts. ¹⁰ Moderate-sized banks in the country practically never change their rates either

for discount or deposit. It seems to me that to have any prompt and effective influence on the situation the Federal Reserve Banks must depend almost altogether on open market policies; in other words, they must take the initiative in buying acceptances or securities when they wish to prevent deflation and in addition to raising rediscount rates they must adopt an aggressive policy of selling securities when inflation takes hold of the market. It is not an accident that the greatest changes in the price level in history have occurred at a time when the Federal Reserve Banks were in a position to dominate the world monetary situation. The great rise in prices at the end of the war until 1920 was clearly due to the wildest kind of inflationary methods which were used to finance Government business, the drop of 1921 to an altogether arbitrary and unreasonable policy of contraction. We then had a period of comparative stability under the management of Mr. Benjamin Strong, which ended with his death in 1928. We infer from his writings which have since been published that he foresaw the boom in the stock market which was likely to result from the policy which he had adopted to assist European countries back to the gold standard and that he anticipated meeting this situation when it arose by a policy of rigid control.¹¹ We all know that attempts along this line by the New York Bank were repeatedly vetoed by the Board. This suggests another idea, viz., that the Federal Reserve Bank as constituted is altogether too closely related to the Government.¹² The Secretary of the Treasury is ex-officio Chairman of the Federal Reserve Bank; the Comptroller of the Currency is an ex-officio member of the Board and the Governor and Vice-Governor are the appointees of the President. Under these circumstances, with a general election in prospect, can they be expected to approve of measures which might bring on a mild depression in order to avoid a major one later on? The very nature of their appointments make the principal officers of the Board unduly susceptible to

public opinion and in monetary problems it is clear that public opinion is not a reliable guide. It is, in fact, a problem which the ordinary man finds himself quite incapable of understanding.

To complete the picture, it should be said that the heads of the Federal Reserve Board, at least up to the present appointment, have admittedly never been men with any marked qualifications for the position. It seems to me until something is done to give centralized control, a better charter and more scientific management to the Federal Reserve Bank we can expect a continuation of the excesses of boom and depression which have been characteristic of the period since the end of the war."

*memo
sent to Prime
Minister Bennett
who replied advise*

(7)

October 4, 1931

NOTES ON THE PRESENT FINANCIAL SITUATION

If it were decided to make an effort to replace Canada on the gold basis, the recent experience of England would have to be borne clearly in mind. England arranged what at first glance would appear to have been sufficiently substantial credits but found that world-wide lack of confidence engendered by the present business depression had created such nervousness that an unexpectedly large flight from the Pound set it. The net result is that England is materially worse off than if she had suspended gold payments some months ago.

If our currency again approaches par, it would be argued by holders of Canadian funds that they could lose nothing by converting them into New York funds and might easily gain materially if Canada's effort was not a success. A very substantial outward movement would take place and, having in mind that any credit arranged should be far larger than the maximum which it was expected to use, I believe that \$200,000,000 would be the smallest amount which could be announced.

To the extent that withdrawals do take place the banking resources of the country will be reduced and curtailment of credit will be necessary to meet the demand, thereby adding to present business difficulties in this country. The only alternative would be for the Government to leave on deposit for an indefinite time proceeds of the utilized portion of the New York credit.

Assuming, however, that Canada definitely announced that she is off the gold standard and that a substantial premium on American funds is maintained, numerous advantages can be recited. For example:- A premium of twenty-five percent would, so far as export prices are concerned, approximately redress the average fall in price during the last two years and by this fact immediately complete the adjustment which is necessary to normal business. I think no intelligent man will attempt to controvert the statement that this depression, like all other depressions, consists of a drop in

the price level and that if all prices would again start upward we would quickly have normal business. Clear-thinking businessmen have realized from the first that the adjustment necessary to the resumption of normal business involved a reduction in all costs, including wages, in the proportion that the general average of prices has fallen. Some costs can never be adjusted. For example:- Interest charges as a result of capital issues made at a higher price level can only be avoided by bankruptcy; but a change upward to the old price level automatically adjusts them all.

Probably in Canada panic or other psychological considerations will have less effect than in almost any other country. In the first place we are already off the gold standard and, moreover, were off it during the whole of 1929, so that the public have not been taught to regard it as sacred, as is the case in England.

Advantages of a Twenty-Five Percent Premium

These are so obvious that it is hardly necessary to recount them. When we think, for example, of wheat and its importance to the three **Middle-Western** Provinces and realize that a twenty-five percent premium on American funds will probably at least double the net return to the farmer, nothing more need be said. But such a premium would also mean that cattle could again be sold in the Chicago market more profitably than in the European markets and all kinds of food products now debarred by the United States tariff would easily hurdle it. Not only would such a premium mean a bonus to Canadian exports to the United States but it would have the effect of an additional tariff to reduce the volume of our imports. Is it too much to suggest that the adverse balance of trade between the United States and Canada would be completely redressed by the circumstances of a twenty-five percent premium on American funds?

The second most important factor in our commercial life so far as export business is concerned is the pulp and paper industry. Newsprint is now worth \$52 a ton landed in the States. Under those conditions it would be worth \$65 a ton and since wages would not have to be increased, at least under present depressed conditions, and other

operation costs would increase infinitesimally, this extra \$13 would be practically all profit, sufficient, in fact, to place the operations of all the good newsprint companies on a thoroughly profitable basis. If competition between them reduced the price to, say, \$55 in Canadian currency, this would mean American mills would realize only \$43 for their output and they could not possibly continue on this basis. They might keep going at a loss of \$1 or \$2 a ton but they could not continue losing \$10 or \$12 a ton.

But it is not only in the United States market we would benefit in exports. There are any number of other articles in which we have a substantial export business. To take one example, rubber goods. Canada has been able to build up a very large business in markets such as the Argentine, South Africa, etc. in rubber boots, tires, etc. in competition with the United States. Under the new condition, the United States factories could not compete. In this connection we must also bear in mind another feature. At this writing, sterling is quoted at \$3.60 and the prospects are that the rest of Europe, outside of France and Belgium, will join the procession in suspending gold payments. How are we to keep what foreign trade is left to us in competition with a situation of this character? Surely only by taking similar action. Unless the United States can quickly reverse their present trends - and there seems no prospect whatever of it - their trade outside their own borders is in a fair way to extinction. Canada will be in the same position if she chooses to stay in the boat with the United States.

We have emphasized previously the benefit of export trade but internal trade would receive an even greater impetus. After all, why is internal business bad? Largely because of fear that it will be worse. If one should analyze any individual

case that he can think of it will be found that expenditures are being reduced. In some cases this is so because individuals have to make payments on debts incurred on securities which have greatly depreciated; in other cases because wealth which has been accumulated in the form of securities has been more than cut in two and fears of a total disappearance are always in the individual's mind. Labourers are saving against the possibility of losing employment, etc. Reverse the trend of prices. Securities immediately advance, particularly those which have had the most substantial depreciation. The whole psychology of the people changes and with any evidence of advancing commodity prices bare shelves will be replenished and consumers will return to normal accumulation and spending. I say it is not too much to hope that unemployment in Canada would completely disappear within a reasonable time under the stimulus which would come from increased prices that would follow under the circumstances we have been discussing. It should not, however, be assumed that the cost of living in Canada would increase in anything like the proportion of the premium on gold. Prices would certainly tend to rise but during a world depression this phenomenon would occur much more slowly than would be the case under reverse conditions.

We have probably said enough to show the enormous advantages which would immediately accrue. We do not believe we have overstated the case. We repeat for emphasis that a depression is nothing but a drop in prices and that a boom is nothing but a rise in prices and that social justice demands stability of prices. The movement of prices in countries operating on the gold standard is determined by the composite action of all of them; off the gold standard, each country has absolute control of its own price level. All the first-rate economists have pointed out that the mismanagement of the central banks of the United States and France is the real cause of the drop in the general price level.

With so many obvious advantages, there must surely be some disadvantages.

First, it is stated that Canada owes a large amount abroad and her interest bill will be increased by twenty-five percent. It is true that, where taxes are of a fixed character not easily changed, municipalities and to some extent Provincial Governments would suffer from this, but this will be nothing as compared with the benefits which would accrue to the taxpayers. Their ability to pay taxes or subscribe to loans to make up deficits would be increased in far larger proportion than the loss which would temporarily accrue to the taxing authorities. So far as the Federal Government is concerned, their receipts from sales and income taxes, etc. would, of course, increase as rapidly as business improved; but against this extra cost for interest abroad, municipalities, provinces and the Federal Government would be relieved of a weight of social service, principally in connection with unemployment, which would many times offset this factor. For the country as a whole, it is ^a complete fallacy to say that it would cost Canada any more in exportable commodities to pay amounts which may be due abroad because Canadian currency was quoted at a discount. Payments abroad are met not by Canadian currency but from proceeds of sales of wheat, paper, etc. and the value of Canadian currency does not affect the gold value of such products in the least. This objection then is a pure illusion.

The next objection which we find very prevalent has more substance. It is that Canada during, say, the next two or three years will have to borrow substantial amounts abroad. I am unable to make up my mind definitely as to the effect on our credit in the New York market of a twenty-five percent premium on New York funds as compared to, say, a five percent premium on New York funds. At first blush it would certainly seem that in the former case our chances of borrowing on a reasonable basis are not by any means as good, but I am not even sure that this is true for reasons which I shall state in a subsequent paragraph.

I have no idea how much it is estimated we may have to borrow outside the country. If there were heavy maturities abroad it would be practically impossible to repay them through transfer of funds from Canada unless business showed a remarkable improvement; but enquiries that I have made seem to indicate that the actual maturities are very small indeed, probably not even amounting to \$50,000,000 during the balance of 1931 and the whole of 1932. If this is so, then we can surely only contemplate borrowing extensively abroad to finance Government and railroad deficits. We shall certainly have to do this if we attempt to maintain gold parity or something near it but I venture the opinion that we should not have to borrow one cent abroad to finance deficits if we will give business the stimulus of adjustment in the value of her currency based on 1928 prices. Not only under such circumstances would we be able to borrow in Canada without further inflation enough to take care of such deficits (because such deficits will only represent the delay in readjusting our taxation to improved conditions) but the deficits themselves will be enormously decreased, and if this reasoning is sound I believe that a twenty-five percent premium on New York funds will not only not injure our credit in New York but will greatly improve it since it will mean eliminating the necessity for excessive borrowing. One should bear in mind the experience of England where an attempt to borrow, necessitated by Government deficits, precipitated the most momentous financial crisis of modern times.

The third objection which is raised is based on the feeling that we should play the game and endeavour to maintain a stability of exchanges, with the idea of helping world trade, etc., etc. - in other words - worship of the gold standard. This process of reasoning has pretty well disappeared within the last few days when Great Britain was forced to abandon the gold standard. The truth of the matter is that the world had been wrecked by mismanagement of the gold standard, principally

by the United States who, being in control of such a large proportion of the gold supply, should have been able to prevent the disastrous fall in prices. The cause of world stability has been enormously advanced by Great Britain suspending gold payments.

Outside of these practical considerations which appeal to everyone, it seems to me that the conditions which have produced such a large number of bank failures in the United States during the past two years will temporarily be accelerated. If this should reach alarming proportions it would be reasonable to expect some repercussions in Canada unless we make our plans ahead of time. I am convinced that not less than twenty-five percent of the outstanding circulation of the United States at the present time is locked up in Safety Deposit Boxes and this movement is going forward at an amazing rate. For example:- From the 1st of August to September 9th there was an increase in circulation of \$240,000,000; with business steadily getting worse, it is certain that every cent of this was hoarded. Only the inherent soundness of the Canadian banking situation and the past record of the banks have prevented this lack of confidence spreading to this country. It might possible still do so if business in this country should get steadily worse, which is inevitable if we are going to follow the United States. A general rise in prices and the feeling of buoyancy which must result therefrom, are the best insurance against such a contingency. We should not fear that by taking the action suggested we are necessarily off the gold standard for an indefinite period. The forces that produced the last inflation, once they again begin to operate, may very well be stronger than they have been in the past. The flood of hoarded currency in the United States which will be released with the return of confidence is bound to produce a strong upward trend in prices. I estimate the hoarded currency at an amount equal

to the total present earning assets of the Federal Reserve System. The movement of gold to the United States has by no means been arrested, so that when the turn comes the Federal Reserve System will be powerless to control inflation. If this opinion should prove to be correct, we shall have no difficulty in getting back on a gold basis painlessly within a short time after the turn comes in the United States. What I mean is that the premium on New York funds will be reduced as fast as the percentage rise in the general level of prices in the United States.

Canada's destiny for years to come will be profoundly influenced by the decision which is now made. If we will only shape her financial policy along sound lines instead of allowing the situation to drift in the hope that the play of so-called natural forces will in due course provide a cure, which is the policy that has proved so disastrous for the United States, and through them for the whole world, we can emerge from the present impasse with enormous financial and moral advantages as compared with our neighbours to the South and before unemployment in that country disappears we might well be repatriating Canadians at the rate of tens of thousands per annum.

SKR obley

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Author(s): S. R. Noble

Title: Address Given before Canadian Institute of International Affairs

Date: March 20, 1934

Page Numbers:

*Dr Coates
economist employed
by Imperial Chemicals
Close friends who
was present and
strongly approved with
my efforts* (6)

THE FEDERATION OF CHAMBERS OF COMMERCE OF THE BRITISH EMPIRE.

COPY OF A LETTER ADDRESSED BY LORD ELIBANK
TO MR. R.B.BENNETT, 25 APRIL, 1934.

Dear Mr. Bennett,

The Executive Committee of the Federation have now had an opportunity of discussing the request contained in your letter of 8th February for our views on the general financial and monetary situation following the steps which have been taken in the United States.

Dr. W.H. Coates, who, you will recollect, was Joint Chairman of the Federation's Preparatory Committee on Monetary Policy, the report of which was adopted by the Thirteenth Congress last year, was present at the discussion and the meeting had before them a memorandum which Dr. Coates had prepared.

This memorandum was accepted by the Executive Committee as a reasoned exposition of the broad considerations of the questions which you put and which the Federation would, in view of the conclusions reached by the Thirteenth Congress, be prepared to accept, in its wide aspects, as stating their views on the points raised.

In forwarding this to you, however, the Federation would like to revert to the memoranda on the subject of Canada and the Sterling Union, sent to you in August of last year, and also to the further private memorandum by Dr. Coates which it was understood reached you by another channel. The Federation remains strongly of the same opinion that the world is likely to wait for a very long time before a new monetary standard is accepted internationally and, therefore, that steps should be taken at once to establish Empire monetary co-operation in the form of a Sterling Union effected through the medium of the Central Banks of the Empire.

The Committee felt that the course of events since the submission of the previous memoranda only confirms and strengthens this view.

As you will I am sure appreciate, the subject is of very great interest to the Federation's member Chambers throughout the Empire, and the Committee would naturally wish to be able to let them know what is taking place. I am wondering, therefore, whether you would see any objection to the Federation's communicating this letter and the enclosure to its constituent Chambers?

Yours faithfully,
(Signed) ELIBANK
Chairman of the Council.

The Rt. Hon. R.B. Bennett, M.P.,
Prime Minister of Canada,
Ottawa.

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Author(s): W. H. Coates

Title: The Federation of Chambers of Commerce of the British Empire: The Effect on the
General Financial Situation of the Monetary Action Taken by the United States

Date: April 16, 1934

Page Numbers:

①
March 14, 1935

Memorandum for the Board

At the present time the banks which are members of the Federal Reserve System have surplus reserves of \$2,500,000,000. This surplus reserve, totally unused and unproductive, is just about equal to the average reserves of the member banks during the whole of 1929. In addition to the present surplus reserve, the Government have an unused profit of approximately \$2,500,000,000 and gold is flowing into the United States at an average rate of more than \$100,000,000 a month over the past fifteen months. It will continue to do so at least until the gold countries suspend or re-value and probably thereafter. Every bit of gold that comes to the United States is added to the surplus reserves of the banks. Of course, the basis of this increased reserve is the increased value of gold. There is no example in history of a similar situation, but to a modified degree the money situation is somewhat the same in all the countries of the world, except the gold bloc of Europe. There has never been a time in modern history where surplus bank reserves were not in due course brought into use, but it is clear that so far as the United States is concerned these surplus reserves can only come into use gradually as commercial banks increase their loans and investments and thereby increase their deposits. The present money base would justify an increase in bank deposits in the United States to a figure much greater than they have reached in history and, unless this base is destroyed by some at present unforeseen event, this is exactly what will happen; at least, it always has happened in the past. I think without any qualification that the gold countries of Europe cannot hold the present gold value of their currencies during the balance of 1935. If they do not re-value they will be compelled to suspend gold payments

and when this occurs their basic condition will resemble, if not parallel, that of the United States. The situation in England is already somewhat similar. Additional cash reserves have been created to the point where there has been a very large increase in deposits since the suspension of gold payments. There is, of course, no such surplus reserves as is the case in the United States but I believe they will be created as quickly as inflation takes hold in the United States. If not, sterling will go to a substantial premium. All previous experience indicates that the present situation would have been reflected in a greater improvement in the United States, but it is easy to explain the delay. Deflationary factors of great violence have been opposed to the inflation inherent in the basic monetary situation, the most important of which is the Securities Act, but all the measures of reform are deflationary and disturbing to business confidence, no matter what their value may be in the long run.

In predicting inflation in the United States I am not discussing an opinion but mathematics and it is mathematically certain to occur unless we witness a social revolution. It is clear, of course, that if the United States switch over to State Socialism or Communism, what we have previously regarded as the rules of the game will not apply, but I think it requires a good deal of imagination to believe in this or to believe that sooner or later - and probably sooner - the United States will not gradually drift back to its former methods of business and thinking.