DEPOSITED BY THE FACULTY OF
GRADUATE STUDIES AND RESEARCH

IXM .1R73.1939

UNACC. 1939

THE CANADIAN DOLLAR, ITS VALUATION AND CONTROL

A thesis submitted to the Faculty of Graduate Studies and Research, McGill University, Montreal, in partial fulfilment of the requirements for the degree of Master of Arts in Economics.

By

Charles Alexander Ross

April, 1939

CONTENTS

Chapter		Page
I	Canada's Dependence on Exports	1
II	Canadian Currency and Exchange in the Past	
	1. Currency	11
	2. Exchange	17
III	The Effects of Exchange Depreciation on Exports and Exporters	26
IV	The Effects of Exchange Depreciation on Imports	40
V	The Effects of Exchange Depreciation on Domestic Prices	49
VI	The Effects of Exchange Depreciation on Foreign Indebtedness	64
VII	Some General Considerations of Canadian Dollar Depreciation	83
VIII	A Fixed Exchange with Sterling	98
IX	A Fixed Exchange with the United States Dollar	103
X	Purchasing Power Control; The Dollar used as a Means of Regulating the Canadian Price Level	113
XI	Conclusion	125
	Bibliography	133

TABLES

Number		Page
1	Total of Canada's Imports and Exports	4
2	Canada's 15 Leading Imports and Exports for the Year 1937	5
3	Percentages of Individual Items to Total Imports and Exports in 1937	5
4	Yearly Averages of Wholesale Prices in Canada and the United States, 1929-1937	55
5	Classification of Canadian Industries in which American Capital is Invested	74
6	Tourist Trade 1930-1937	77
7	Canadian Foreign Indebtedness 1913-1936	79
8	Net Interest and Dividend Payments on Canada's Foreign Indebtedness 1913-1935	80
9	British and Foreign Capital Invested in Canada 1913-1936	80
10	The Bonded Indebtedness of Canada	81

CHARTS

Number		Page
1	Canada's Imports and Exports in Millions of Dollars, 1900-1937	10
2	The Canadian Dollar and the Pound Sterling in New York, 1914-1938	24
3	The American Dollar and the Pound Sterling in Montreal, 1930-1937	25
4	Purchasing Power of the Canadian Dollar and the American Dollar 1926-1937	53

CHAPTER I

Canada's Dependence on Exports.

Canada is still a young country with a comparatively small population of about eleven millions scattered over a very large territory of 3,690,043 square miles. This is approximately three persons per square mile.

Spread over this large area, natural resources of many different kinds are to be found and it is upon this abundant wealth that Canada's economy is based. For, the exploitation of these resources has led to the output of commodities of many kinds and far in excess of the consuming power of the existing population. This excess production has to be disposed of, and therefore, Canada has had to find markets abroad for a considerable proportion of her production. This is a condition common to all young and growing countries which are in the process of development. Peoples engaged in the exploitation of natural resources must concentrate on the production of foodstuffs and raw materials and only the early stages of manufacture. The production of highly manufactured goods is of necessity postponed for a later period of development. Hence, during a country's youth these latter must be imported and their cost, as well as the interest and dividend charges on foreign borrowing, must be met largely by an export trade which necessarily must be in quite a large proportion.

In the early days of Canada's history all her exports were sent to the Mother country, first to France and then after 1759 to England. The reason for this was the strict trade

regulations placed upon Colonies at that time. The Colonies were <u>intended</u> to be producers of <u>raw materials</u> for the Homeland, while the latter would supply the Colonies with all the manufactured goods they needed. With the abolition of the Navigation Acts and the Corn Laws towards the end of the first half of the nineteenth cnetury, Canada found it necessary to search for markets other than England. With the repeal of the Corn Laws in 1846 Empire preference in Grain was abolished and this affected Canadian exporters adversely even at that early date. With the granting of fiscal autonomy to Canada (Ontario and Quebec to-day) at or about this same time, the search for foreign markets for her produce began. In 1854 the first bilateral trade treaty in which Canada participated was negotiated with the United States of America. This came into effect in 1855 for a ten year period. In 1859 we find Canada raising its first tariff barrier against imports with the idea of fostering manufacturing within her borders for home consumption.

From the consummation of Confederation in 1867 until the election of Sir Wilfrid Laurier's Liberal Government in 1896, Canada maintained a moderate tariff barrier. In 1897 Laurier re-opened the policy of giving preferential duties to the United Kingdom and other countries. This points to the fact that exports were still considered of utmost importance to Canada's prosperity. As a result of most favoured nation treaties which Great Britain had signed with many countries of the world, the preferential rate which Canada gave to the United Kingdom had to be automatically extended. Canada's trade was freer than it

had been since Confederation.

The policy of trade agreements, with the exception of the Canada-United States Reciprocity Treaty, which was in existence between 1855 and 1866, was inaugurated by Sir Wilfrid Laurier and for the most part this policy has been continued until to-day. However, it is interesting to note that for a period of seventy years, from 1866 - 1935, no such agreement was signed with the United States, one of Canada's best customers. The one big exception to this policy was during the regime of the Bennett Conservative Government from 1930 to 1935 when tariffs on imports were raised to a very high level, the highest in Canada's history. This policy was undertaken for the purpose of relieving the unemployment situation of these depression years together with the influence which the Hawley-Smoot Tariff, in existence in the United States at that time, exerted on the Canadian public. The Conservative Government was elected in 1930 with higher tariffs as one of the planks in its platform.

During the post-war period, trade agreements have been in effect at one time or another between Canada and France signed in 1923, Belgium (1923), Italy (1924), the Netherlands (1925), Czechoslovakia (1926), Cuba (1927), Spain (1928), British Empire agreements signed at Ottawa in 1932, France (1934), U.S.A.(1935), The United Kingdom (1936), Uraguay (1937), Germany (1937), this was a provisional one, Haiti (1938), Guatamala (1938), and finally on November 17th, 1938 a new Canada-United States Treaty was signed.

Reviewing Canadian import and export trade since Confederation, we find a steady increase in the value of our foreign trade. In 1868 our foreign trade valued $119,791,879. while by 1929 it had reached an all time high of $2,659,074,625. With the arrival of the Great Depression, foreign trade fell off to $941,361,120. in 1933, but by 1937 it had again risen to $1,746,119,786. It must not be forgotten, however, that these latter two figures are based on a dollar vastly different from pre-depression days. The Canadian dollar was in a depreciated condition relative to the United States dollar and other gold currencies from 1931 to 1934, and until a later date in the case of the gold block countries.[1] In the case of Great Britain and the sterling area, the Canadian dollar was at a premium. Also, it must be remembered that although Canada's foreign trade fell off by 64.5 percent in value (from $2,659,074,625. to $941,361,120.) world prices had fallen greatly. This accounts for at least 30 percent of the loss in the value of trade and so not more than 34.5 percent of the decrease in value could have been due to a decrease in trade volume.

Table No. 1[2] Total of Canada's Imports and Exports.

Year	Imports	Exports	Total	Trade Balance
1868	$ 67,090,159.	$ 52,701,720.	$ 119,791,879.	-$14,388,439.
1929	1,265,629,091.	1,393,445,534.	2,659,074,625.	+127,816,443.
1933	406,383,000.	534,978,120.	941,361,120.	+128,595,120.
1937	671,875,566.	1,074,244,220.	1,746,119,786.	+402,368,654.

(1). A depreciation of about 10 percent on the average.
(2). Source: The Canada Year Book.

MANUFACTURED BY. RENOUF PUBLISHING CO., MCGILL COLLEGE AVE., MONTREAL

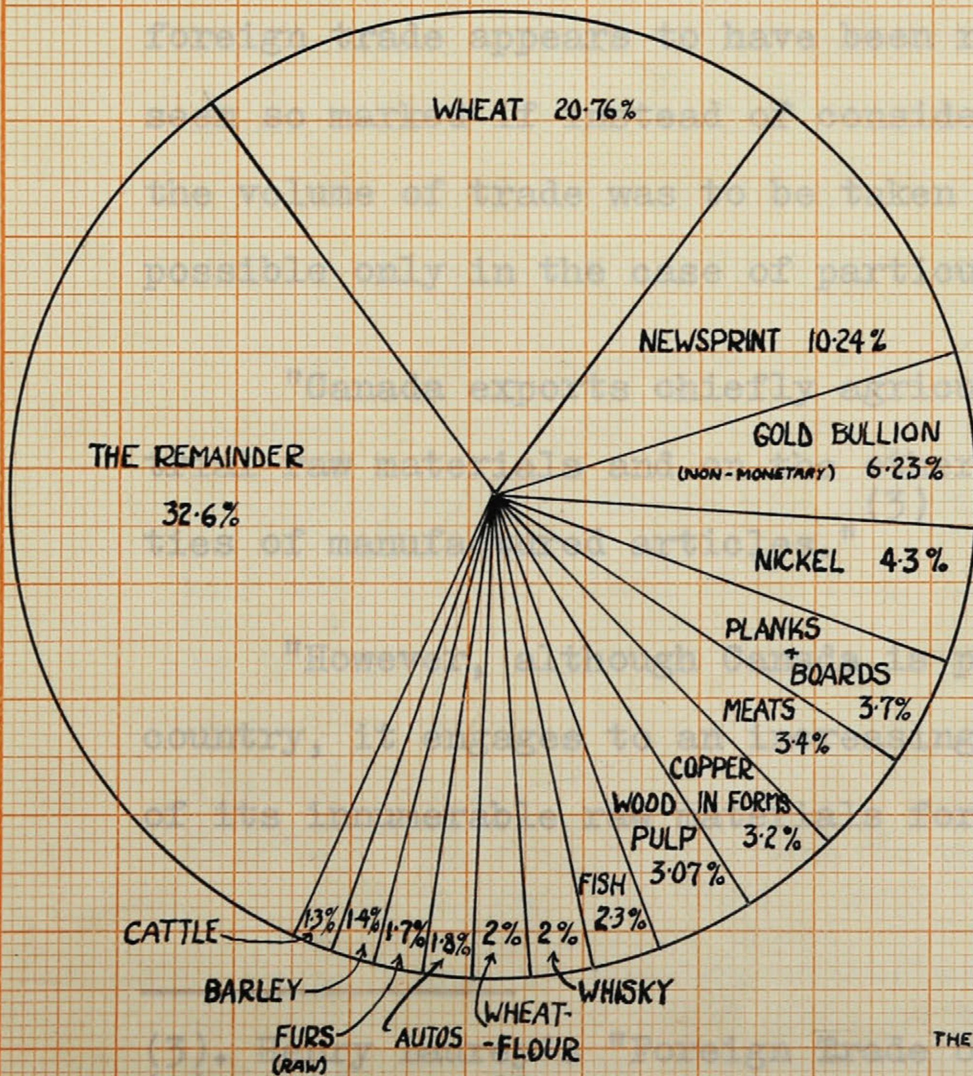
TABLE NO. 2 CANADA'S 15 LEADING IMPORTS AND EXPORTS FOR THE YEAR 1937

NO.	IMPORTS	VALUE	EXPORTS	VALUE
1.	Crude Petroleum	$ 39,704,808	Wheat	$ 223,461,009
2.	Coal	34,854,726	Newsprint	110,176,448
3.	Rolling Mill Products	31,351,446	Gold Bullion - non monetary	67,667,209
4.	Machinery (except farm)	31,086,819	Nickel	45,882,184
5.	Automobile Parts	27,379,705	Planks and Boards	40,284,864
6.	Fruits	24,796,265	Meats	36,114,497
7.	Sugar and Products	20,440,887	Copper + in forms	34,873,145
8.	Raw Cotton	19,905,775	Wood Pulp	33,201,237
9.	Woollen Goods	16,784,767	Fish	25,087,602
10.	Cotton Goods	14,636,551	Whisky	21,777,246
11.	Grain and Grain Products	14,209,382	Wheat Flour	21,587,038
12.	Rubber and Products	13,284,292	Automobiles	19,425,730
13.	Vegetable Oils	12,686,869	Furs - raw	18,444,030
14.	Books and Printed Matter	12,330,352	Barley	14,901,211
15.	Electrical Apparatus	11,991,038	Cattle	14,000,092

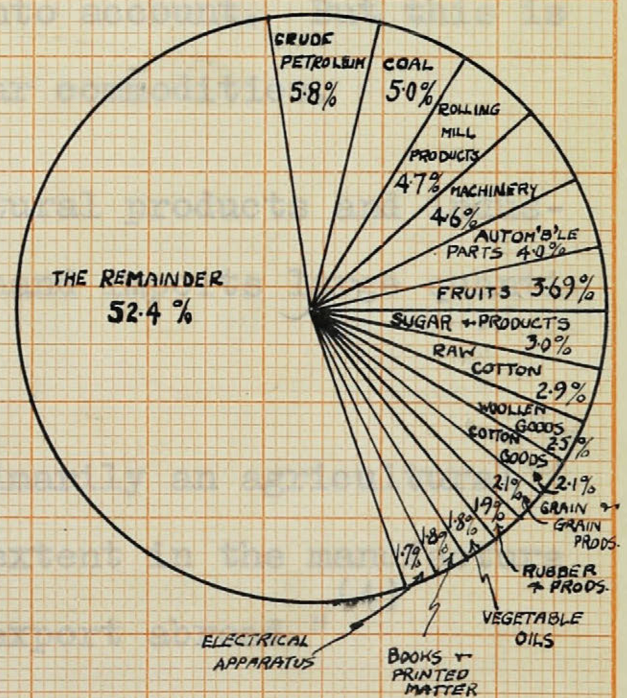
SOURCE: THE CANADA YEAR BOOK

TABLE NO. 3 PERCENTAGES OF INDIVIDUAL ITEMS TO TOTAL IMPORTS AND EXPORTS

EXPORTS



IMPORTS



THE DIAMETERS ARE SCALED TO THE TOTAL VALUE OF THE IMPORTS AND EXPORTS

TOTAL VALUE OF IMPORTS = $671,875,566; EXPORTS = $1,074,244,220.

Note that of the fifteen leading imports and exports listed in tables number 2 and number 3, the imports are mostly manufactured goods, while the exports are predominantly primary products or manufactured goods of the lower stages of production.

To show what an important part export trade plays in the economic life of Canada, it is interesting to compare the total net sales made by wholesalers proper and total export value. In 1936 exports were to the value of $862,473,076. while net sales by wholesalers in domestic trade totalled $1,181,543,000. Total foreign trade (imports plus exports) was $1,425,191,139. The value of exports was 77% of the net sales made by wholesalers in domestic trade. This certainly points to the immense importance of exports to Canada. However, although the growth of foreign trade appears to have been rapid, the rapidity would not seem so marked if instead of considering the value of trade, only the volume of trade was to be taken into account. But this is possible only in the case of particular commodities.

"Canada exports chiefly agricultural products and industrial raw materials and on the other hand imports large quantities of manufactured articles."(3)

"However, although Canada is primarily an agricultural country, it engages to an increasing extent in the manufacture of its innumerable raw materials for export abroad."(4)

---

(3). Henry Laurey's "Foreign Trade of Canada", p. 20.
(4). ibid,, p. 21

"Nevertheless, out of a billion and a quarter's worth of exports in 1928 almost sixty percent were vegetable and animal food products which had gone through no other process of transformation than harvesting or slaughtering."(5)

Canada as yet is not highly industrialized, even in Ontario, the most advanced of the nine Provinces. She is, therefore, dependent upon imports from other countries for many commodities. In order to pay for these imports it has been necessary to export. Here is the importance of Canada's export trade. If we sell less abroad, then we must buy fewer imports, since in the long run our only means of payment is with what we ourselves can produce.(6) Also, unless Canada has the favourable balance of merchandise trade required to meet current international payments, and the interest and redemption costs of bonds and debentures maturing abroad, her economic equilibrium is bound to be greatly disturbed. During the early years of her history and until 1914, the usual situation was for Canada to have an adverse (or unfavourable) balance of merchandise trade. However, that part of the necessary balance which the export trade failed to make up was met, in the final reckoning of the balance of payments, by the great influx of foreign capital. Since 1914 there has,

---

(5). ibid., p. 27.
(6). As well as exports paying for imports, there are also various invisible items in the balance of payments which help to pay for them. Some of these are receipts from shipping, tourist trade, interest on loans and repayment of loans by foreign countries. But, note that these items appear on the debit side as well as the credit side of the balance sheet. Foreign loans to Canada also help to make up the balance of payments temporarily, but these eventually have to be repaid with exports, so that fundamentally exports alone pay for imports.

with the exception of one or two years, always been a favourable balance of merchandise trade, but this was absolutely necessary in order to meet the interest and capital repayments of previous loans.

In the report of the Royal Commission on Banking and Currency in Canada, 1933, it was stated, - "Canada presents a number of prominent economic characteristics which determine the special nature of her financial position.

"1. Excess production in relation to population.

"2. Dependence on international trade.

"3. Specialized production and local diversity.

"4. Heavy cost of development.

"5. The burden of debt, internal and external.

"6. Relative economic instability."(7)

Of particular interest to us at this moment are points 1. and 2.

The report further stated that, "Variability in the physical volume of agricultural production may be offset to some extent if the alterations of supply have their expected effect on prices. But Canada must sell a very large part of her products in the world market and her exports form only a part of the world supply. It may happen then that world price changes may accentuate the uncertainty of return arising from the vagaries of the weather. When they do so the industries dependent on the farmers' purchasing power are also

---

(7). "The Report of the Royal Commission on Banking and Currency in Canada", 1933, p. 48

affected. All business thus becomes more speculative through the enormous importance to the Canadian economy of the prices of a few export commodities."(8)

In quoting this passage from the report, what I wanted particularly to point out was that the Royal Commission saw that Canada's economy depended to a very large extent on its export trade; as it was stated in the report, ".......the enormous importance...... of the prices of a few export commodities."

"The importance of exports in the Canadian economy can, indeed, scarcely be over-emphasized. For ten years, 1924 to 1933 inclusive, approximately 30.9 percent in value of Canada's production was exported."(9)

---

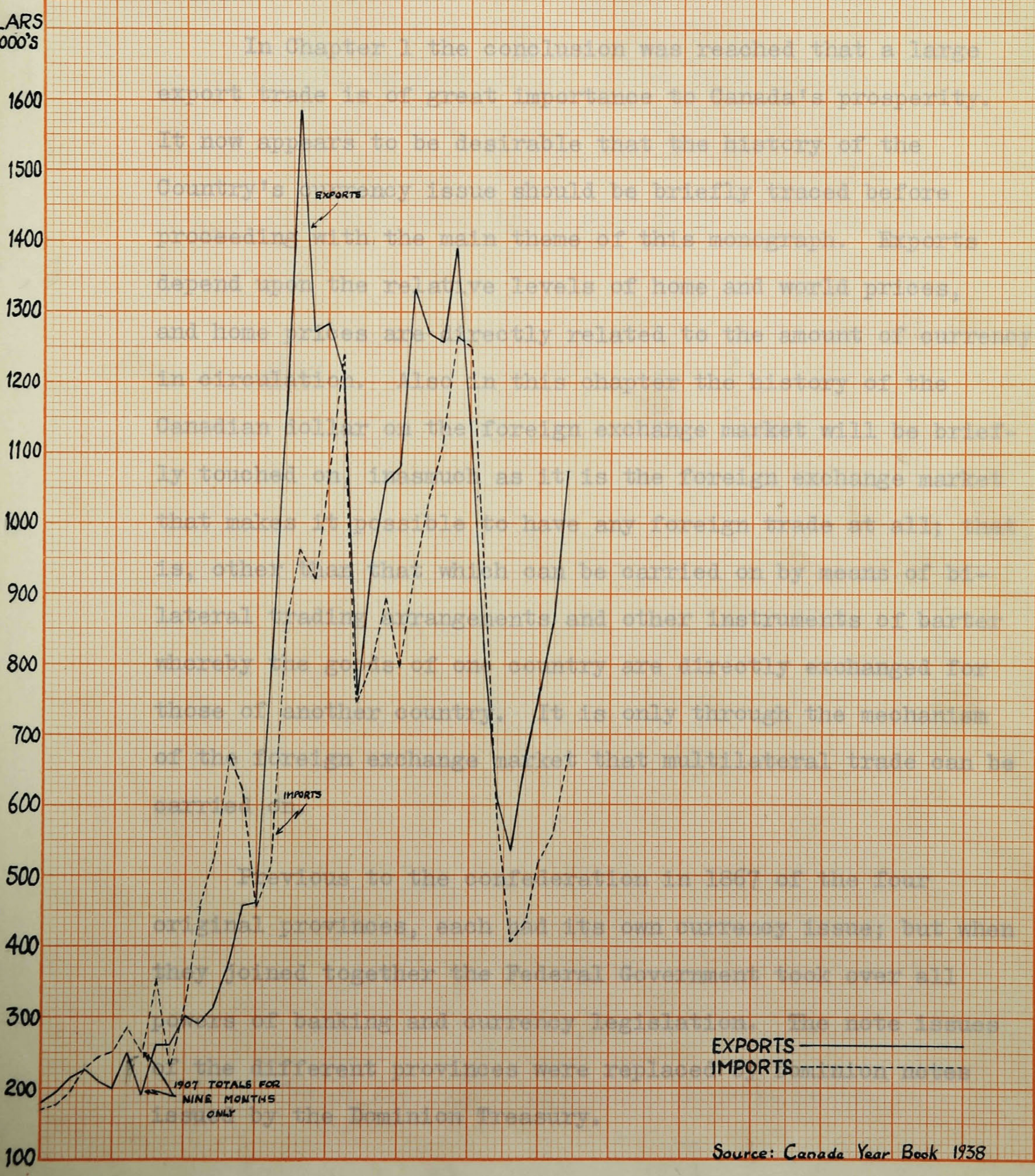
(8). ibid., p. 54.
(9). R.A.MacKay and E.B.Rogers "Canada Looks Abroad" p.15.

1900 1901 1902 1903 1904 1905 1906 1907 1908 1909 1910 1911 1912 1913 1914 1915 1916 1917 1918 1919 1920 1921 1922 1923 1924 1925 1926 1927 1928 1929 1930 1931 1932 1933 1934 1935 1936 1937

CHART NO.1.

CHART OF CANADA'S IMPORTS AND EXPORTS IN MILLIONS OF DOLLARS

1900 TO 1937



CHAPTER II

Canadian Currency and Exchange in the Past.

1. CURRENCY

In Chapter 1 the conclusion was reached that a large export trade is of great importance to Canada's prosperity. It now appears to be desirable that the history of the Country's currency issue should be briefly traced before proceeding with the main theme of this monograph. Exports depend upon the relative levels of home and world prices, and home prices are directly related to the amount of currency in circulation. Also in this chapter the history of the Canadian dollar on the foreign exchange market will be briefly touched on, inasmuch as it is the foreign exchange market that makes it possible to have any foreign trade at all; that is, other than that which can be carried on by means of bilateral trading arrangements and other instruments of barter whereby the goods of one country are directly exchanged for those of another country. It is only through the mechanism of the foreign exchange market that multilateral trade can be carried on.

Previous to the confederation in 1867 of the four original provinces, each had its own currency issue; but when they joined together the Federal Government took over all powers of banking and currency legislation. The note issues of the different provinces were replaced by Dominion notes issued by the Dominion Treasury.

The first Dominion Notes Act, passed in 1868, limited the issue to $8,000,000. of which the first $5,000,000. required a twenty percent reserve, and from $5,000,000. to $8,000,000. a twenty-five percent reserve in specie.(1) All notes issued by the Dominion Government over and above this amount were to have dollar for dollar gold backing. By 1913, various changes having taken place during the interval since 1868, a twenty-five percent reserve was required for the first $30,000,000. with one hundred percent gold backing for anything over this amount.

In the war session of August 1914, Parliament raised the partially covered issue to $50,000,000. Subsequently an issue of $16,000,000. was made against a deposit of railway securities guaranteed by the Dominion Government, as well as an uncovered issue of $10,000,000. for governmental purposes. In 1917 an emergency issue of $50,000,000. of Dominion notes was made to finance war purchases by the British Government in Canada. The notes were secured by Imperial Treasury Bills. In due course, this indebtedness was liquidated by payments from the British Treasury and all of this issue had been redeemed by 1927.(2)

Banks also issued notes, the first limit of which was to the amount of their unimpaired paid up capital plus their rest funds. Five percent of this issue had to be kept in a redemption fund and all notes over and above this amount had

---

(1). Report of the Royal Commission op. cit. p.21.
(2). ibid. p. 22.

to have one hundred percent backing in gold or Dominion notes. There was one exception to this; a fifteen percent increase was allowed during the crop moving season, from October first until January thirty-first.(3)

The Finance Act of 1914 provided for advances to be made to the chartered banks in the form of Dominion notes against deposits made by the banks with the Minister of Finance, of such securities as the Minister might approve. The Act also empowered the Governor-General-in-Council in circumstances of emergency and by means of proclamation to (a) authorize the chartered banks to make payments in their own notes instead of in gold or Dominion notes, and to use the excess issue for crop moving twelve months of the year instead of merely the six months of the crop moving period; (b) to suspend the redemption of Dominion notes in gold; (c) to establish a general moratorium temporarily.(4)

A special Act passed in 1919 provided for the continuance in force of these emergency measures until two years after the final conclusion of peace of the Great War.(5) Thus these powers were extended to 1923.

In drawing up the Finance Act of 1923 it was decided

---

(3). The excess issue for the crop moving season was to be taxed not more than five percent. This maximum was the rate usually charged. It was an amendment to the Bank Act in 1908 which first introduced the "Crop moving issue". The Bank Act of 1913 extended this period to six months, from September 1st to the end of February.
(4). Statutes of Canada, 1915; 5 George V, C.3, S.4.
(5). Statutes of Canada, 1919; 9-10 George V, C.21.

to include the power to issue Dominion notes against approved securities, as extensive use had been made of this power and it was felt that it would be to the great advantage of the Canadian financial system if it were to be included as part of the normal mechanism.

The Finance Act of 1923 provided that "At any time when there is no proclamation in force under the authority of paragraph (A) of section four of the Finance Act, 1914, the Minister of Finance may make allowances to the chartered banks and to the savings banks to which the Quebec Savings Bank Act, 1913, applies by the issue of Dominion notes upon the pledge of securities - - - - -"(6) The Act then proceeds to list the types of acceptable securities. These securities were to be deposited with the Minister of Finance or with the Assistant Receiver General. This was the note issuing situation in Canada until 1934.

On June 20, 1934 bills were passed providing for the repeal of the Finance Act and the 1915 Statutes, such repeal to become effective when the Bank of Canada began operations.(7) Then, on June 28, 1934 an Act to amend the Dominion Notes Act was given the Royal Assent. It stated the following: "The Minister of Finance shall always hold as security for the redemption of Dominion Notes up to and including $120,000,000. issued and outstanding at any one time, an amount equal to not less than twenty-five percent of the amount of such notes

(6). Statutes of Canada, 1923; 13-14 George V, C.48, S.2.
(7). Statutes of Canada, 1934; 24-25 George V, C.35 and C.30.

in gold. As security for the redemption of Dominion notes in excess of $120,000,000. the Minister shall hold an amount equal to such excess."(8) This Act also repealed the Dominion Notes Act, Chapter forty-one of the Revised Statutes of Canada, 1927, as amended by Chapter twelve of the Statutes of 1932-33 and by this Act. The repeal was to take place on and from a date to be fixed by proclamation and published in the Canada Gazette. Thus the partially backed issue was increased by $54,000,000. (from $66,000,000. to $120,000,000, the uncovered $10,000,000. issued under the Dominion Notes Act of 1915 having been previously written off).

On July 3rd, 1934, the Royal Assent was given to the Bank of Canada Act. Upon coming into force, it provided for the founding of a central bank in Canada. It was set down in the Act that, "On and after the day on which the Bank is authorized to commence business the Bank shall, except as provided in the Bank Act, have sole right to issue notes payable to bearer on demand and intended for circulation in Canada."(9) The reserve required to be maintained was to be in gold coin and bullion in the unrestricted ownership of the Bank and equal to an amount not less than twenty-five percent of the notes and deposit liabilities. In addition the reserve might include silver and certain approved securities, bills of exchange and foreign exchange.

---

(8). Statutes of Canada, 1934; 24-25 George V, C.34
(9). Statutes of Canada, 1934; 24-25 George V, C.43, S.24.

The Bank Act, 1934, repealed the conditions for bank note issue set down by previous enactments and amendments. It then went on to state that, "Notwithstanding anything contained in the next preceding section, on and after the day on which the Bank of Canada is authorized to commence business, the maximum amount of notes of a bank in circulation at any time shall not exceed the amount of the unimpaired paid-up capital of the bank on the said day on which the Bank of Canada is authorized to commence business, and on the first day of January in each year for a period of five years commencing on the first day of January nineteen hundred and thirty-six the said maximum shall be reduced by five per centum, and on the first day of January in each year for a period of five years commencing on the first day of January nineteen hundred and forty-one the said maximum shall be reduced by ten per centum and thereafter until Parliament further enacts, the amount of notes of a bank in circulation shall not exceed twenty-five per centum of the amount of the unimpaired paid-up capital of the bank. In the event of any reduction or impairment of the paid-up capital, the maximum amount of notes of the bank which may be in circulation shall be reduced to the amount which would have been authorized if the reduction or impairment aforesaid had occurred on the day on which the Bank of Canada was authorized to commence business."(10) This is the currency issuing situation as it exists in Canada to-day.

---

(10). Statutes of Canada, 1934; 24-25 George V, C.24, S.61 (2).

2. EXCHANGE

Canada (Ontario and Quebec to-day) adopted the gold standard in 1853 and upon the formation of the Dominion of Canada in 1867 it was retained as the monetary standard of the Canadian dollar. By 1914 when gold payments were suspended for the first time, the gold standard had been in operation for sixty years. Under such a standard gold was imported and exported freely, and all obligations payable in gold were redeemed in gold. The gold points in terms of American dollars were fixed at approximately 3/32 of one percent from the exchange parity. In 1914 the monetary structure of Canada consisted of a free stock of gold, the Dominion note issue and the banking system with its note issue. The working of the system was almost automatic, gold was exchanged for Dominion notes and Dominion notes for gold. The issue of Dominion notes grew or diminished according to the supply of gold in the reserve fund. Also, as gold flowed out of the country credit was restricted, resulting in the stresses and strains of such a policy. When gold flowed into Canada, the credit structure would be expanded and prices would tend to rise; in the case of an outflow of gold prices would tend to fall. By this process domestic prices were kept in harmony with world prices and gold movements kept the exchange rate within the gold points.

During the decade preceding the outbreak of the Great War a great expansion was taking place in Canada. This was financed by the heavy flow of foreign capital into the country.

Any stresses and strains caused by the adherence to the gold standard were easily borne. However, with the outbreak of the war the capital inflow stopped, adding greatly to the crisis in Canada. The country found itself with a very heavy burden of fixed charges, exchange rates fluctuated widely and eventually had to be pegged. To prevent a heavy outflow of gold the Government decided to suspend gold payments; that is, Dominion notes were no longer to be redeemable in gold. By this action Canada abandoned the gold standard.

But export trade came to Canada's rescue. During the war great demands arose in England for raw materials, foodstuffs, munitions and other war-time necessities. By 1918 Canada's export trade had risen to an alltime high of $1,586,169,000.(11) and, even with allowances for the extremely high price level at that time, this represented a large volume of exports. Imports during the same fiscal year were to the value of $963,532,000. This left a considerable balance on the credit side of the ledger which could be employed for the payment of fixed charges where often in pre-war days capital inflows had been used. Canadian capital imports had dwindled to practically the vanishing point.

In order to divert a larger proportion of Canadian production to its own uses, the Canadian Government like the Governments of all the belligerent countries resorted to inflation. This was not done by an increase in the fiat issue of Dominion notes, but by the Federal Government borrowing from

---

(11). Supra, chart number 1, p.10

the banks through the sale of Treasury Bills and then repaying the banks from the proceeds of the bond sales to the general public.

Under the provisions of the Finance Act, 1914, the banks were able to borrow Dominion Notes,—— Cash reserves——which were used to provide a base for credit expansion which the financial operations of the Government made necessary.

The essential difference between the pre-war and post-war financial structure in Canada was the addition of that part of the Finance Act of 1914 which permitted banks to borrow Dominion notes from the Department of Finance. This clause of the Act of 1914 was made permanent in the Finance Act of 1923.(12)

Canada returned to the gold standard on July 1st, 1926 with only one addition to the monetary system; - the Finance Act. The obligation assumed at this time to maintain the convertibility of the Canadian dollar into gold, presupposed a means of regulating the credit base so as not only to permit expansion but also to act in a restrictive way.(13) The Finance Act was supposed to accomplish this.

In its report, the Royal Commission on Banking and Currency in Canada, 1933, wrote with regard to this matter; "An examination in the light of contemporary conditions of the rates charged from time to time on Finance Act advances suggests that these rates were not used as an instrument of expansion and contraction, but were mainly varied to meet the exigencies

---

(12). Report of the Royal Commission, op.cit.,p.59
(13). ibid., p. 59

of the Dominion Government's finances. The volume of advances was not subject to the restriction of a gold reserve. The Treasury Board did not assume the responsibility of ensuring that the uses made of the Finance Act were consistent with the requirements of a convertible currency. The banks, on the other hand, which could take the initiative of expanding the credit base through advances of Dominion notes under the Finance Act, were under no obligation to use the initiative in maintaining the gold standard. Thus the Finance Act did not provide Canada with the organization needed to undertake the task which the maintenance of the restored gold standard implied."(14)

As long as Canada remained on the gold standard, exchange rates were kept stable. During and after the war because of inflationary measures the Canadian dollar depreciated in terms of gold currencies. With the return to the gold standard in 1926 it was possible once more to maintain stability of the exchanges, but from the end of 1928 until the early part of the summer of 1930, the premium on New York funds was well over the gold point in Montreal, going at one time as high as two and one quarter percent. One asks why there were no exports of gold during this period. The answer, according to Professor C. A. Curtis, is that the Department of Finance directly or indirectly, had practically effected a prohibition of the redemption of Dominion notes in gold. Thus the country unofficially, but quite effectively abandoned the gold standard, a fact which was well recognized outside of Canada.(15)

---

(14). ibid., p.59.
(15). C. A. Curtis, "Canada and the Gold Standard" The Queen's Quarterly - Winter 1931, Vol.38, No. 1, p. 109.

Mr. S. R. Noble has written, "Canada was definitely on the gold standard until about the end of 1928. In November, 1928, the Dominion Government held against the note issue of $236,650,000. a total of $109,000,000. in gold representing coverage of 46.3 percent. Two months later, by the end of January, 1929, gold reserves had decreased to $59,000,000.

"While the Government did not admit it, and exchange was kept at approximate parity with United States funds until shortly before Great Britain suspended gold payments in September, 1931, Canada was technically off a gold basis from the beginning of 1929."(16)

The Department of Finance had to follow either one or the other of two possible courses in 1928. They had either to restrict the rediscounting operations of the commercial banks with the Department of Finance and so slow down the boom, or they had to abandon the gold standard, actually though perhaps not nominally, and continue to rediscount freely for the banks and continue to assist the general upswing in business. The latter course was followed. During December 1928 and January 1929 gold was exported to the value of $50,000,000. but the credit structure was not influenced as it should have been due to the rediscounting operations of the Department of Finance. Professor Curtis writes that this as much as anything led to the situation in 1929-30 when the gold points had to be widened.(17)

---

(16). S. R. Noble, "The Monetary Experience of Canada during the Depression"; The Canadian Banker, April 1938, p. 270.

(17). C. A. Curtis, op. cit., p. 115.

In regard to this same question, J. M. Keynes writes as follows in his "Treatise on Money"; "The gold points between Canada and the United States are for geographical reasons particularly narrow with the result that gold movements between the two countries are frequently brought about by transient causes. In September 1929 the combined effects of a slow movement of the Canadian wheat crops out of the country and of the high rates for short term loans on Wall Street led to a tendency for gold to flow out of Canada on a greater scale than was convenient. The position was dealt with by lowering the gold export point in virtue of an informal agreement between the Minister of Finance and the ten chartered banks not to export gold for the sake of a small arbitrage profit. The rate of exchange inevitably went outside the lower gold point presumed by the terms of Canada's adherence to the gold standard; but the expedient was justified by the event, since the high rates for short term loans in New York proved to be temporary and by the summer of 1930 when they had evaporated, the Canadian exchange had not only recovered to parity but had gone beyond it to the gold import point. Thus the informal widening of the gold points was probably the wisest way of preventing the abnormal position in Wall Street from reacting unduly on the domestic credit conditions in Canada."(18)

The exchange rates of the Canadian dollar remained comparatively stable until Great Britain left the gold standard on September 21st, 1931; then it fell in New York along with

---

(18). J. M. Keynes, "A Treatise on Money" Vol.2,Book 5,p.329.

sterling, but not proportionally. Canada, herself, formally left the gold standard on October 19th, 1931, when, by an order-in-council, the export of gold from Canada was prohibited except under license.[19] Chart number 2 shows the Canadian dollar and the pound sterling in New York since 1914. It shows the percentage variation of each currency from par in New York. We find that the Canadian dollar took a position on the exchanges roughly midway between the pound sterling and the American dollar. From 1931 until 1933 the Canadian dollar maintained itself at this level, but since the devaluation of the American dollar in 1933, it has kept close to parity with New York exchange, no diversion from parity since that date exceeding three percent either way.

In Canada to-day there are several different trends of thought with regard to the monetary policy that ought to be followed. Some people,particularly in the Western Provinces, believe that the Canadian dollar should be linked up with sterling, that is, that Canada should join the sterling area. An opposing body of opinion believes that the link up should be with the United States dollar. A third policy which is put forward by some people is that the Canadian dollar should be managed entirely free of other currencies, the aim being stability of domestic prices. Each of these possibilities will be dealt with in succeeding chapters.

---

(19). C. A. Curtis, "The Canadian Monetary Situation", The Journal of Political Economy,June 1932,p.322.

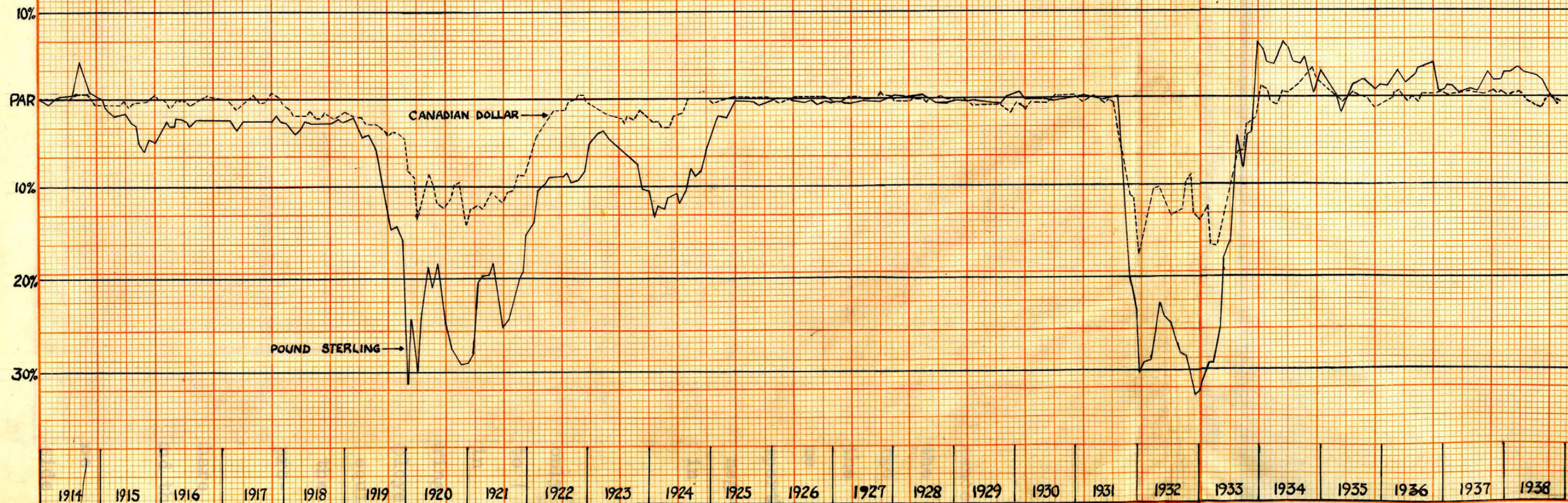
CHART NO. 2.

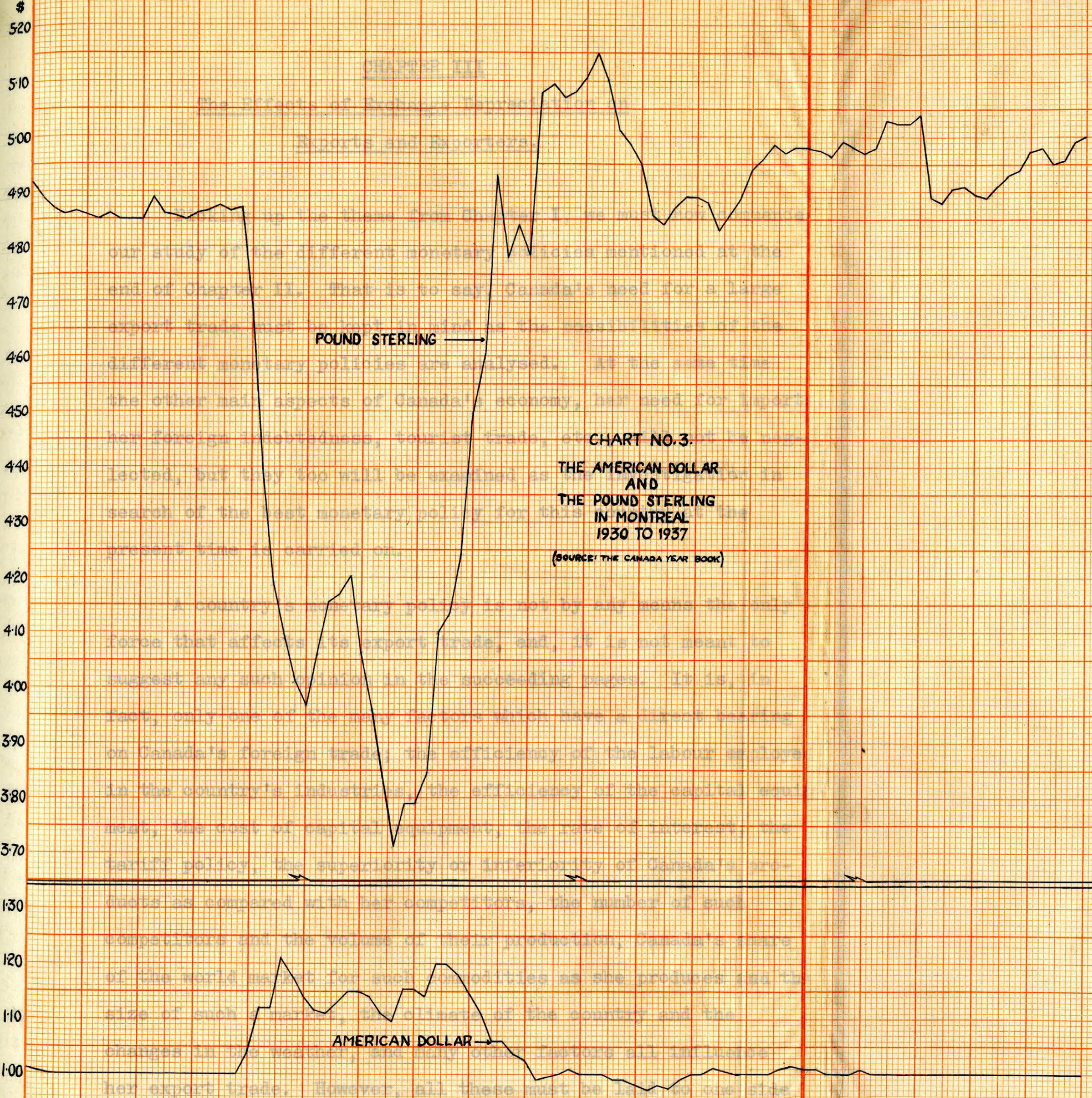
THE CANADIAN DOLLAR AND THE POUND STERLING IN NEW YORK

1914 TO 1938

(SOURCE: THE BANK OF CANADA STATISTICAL SUMMARY----- SEPTEMBER 1938)

AVERAGE MONTHLY QUOTATIONS




1930
1931
1932
1933
1934
1935
1936
1937
J F M A M J J A S O N D
$
5·20
5·10
5·00
4·90
4·80
4·70
4·60
4·50
4·40
4·30
4·20
4·10
4·00
3·90
3·80
3·70
1·30
1·20
1·10
1·00
POUND STERLING
AMERICAN DOLLAR
CHART NO. 3.
THE AMERICAN DOLLAR
AND
THE POUND STERLING
IN MONTREAL
1930 TO 1937
(SOURCE: THE CANADA YEAR BOOK)

CHAPTER III

The Effects of Exchange Depreciation on Exports and Exporters.

Picking up the theme from Chapter I, we must now commence our study of the different monetary policies mentioned at the end of Chapter II. That is to say, Canada's need for a large export trade must be kept in mind as the possibilities of the different monetary policies are analysed. At the same time the other main aspects of Canada's economy, her need for imports, her foreign indebtedness, tourist trade, etc., will not be neglected, but they too will be examined as the investigation in search of the best monetary policy for this country at the present time is carried on.

A country's monetary policy is not by any means the only force that affects its export trade, and, it is not meant to suggest any such opinion in the succeeding pages. It is, in fact, only one of the many factors which have a direct bearing on Canada's foreign trade; the efficiency of the labour employed in the country's industries, the efficiency of the capital equipment, the cost of capital equipment, the rate of interest, the tariff policy, the superiority or inferiority of Canada's products as compared with her competitors, the number of such competitors and the volume of their production, Canada's share of the world market for such commodities as she produces and the size of such a market, the climate of the country and the changes in the weather, and many other factors all influence her export trade. However, all these must be laid to one side

as irrelevant to the present discussion. For, although each in itself is of profound importance and could easily be made the subject for a thesis, the immediate problem of this inquiry is in the field of monetary policy as it relates to foreign and domestic trade, and to discover that policy which would be of most benefit to Canada, an exporting country and a debtor country, under the present world conditions.

The Government of the Province of Manitoba, in its brief submitted in the early autumn of 1937 to the Royal Commission on Dominion-Provincial Relations, made a strong argument showing that if the Canadian monetary policy during the early part of the depression, 1929-1935, had been one of deliberate depreciation of the Canadian dollar on the foreign exchanges to the level of the Australian pound, or even only to parity with the pound sterling, Canada would have recovered from the bog of depression sooner, and more rapidly, and would be a more prosperous country to-day. Such a policy was discussed in Parliament during the sessions of 1931 and 1932, but was voted down. Manitoba's argument was based on the policies that were adopted by the Governments of Australia and Argentina, and the success in holding foreign markets which these two countries had under their policies. This was important to Manitoba and the other wheat producing provinces because Australia and the Argentine are Canada's two strongest competitors in the world wheat market.

When dealing with a deliberate depreciation brought about by means of internal action, it must be noted that the currency

of the country undertaking the policy of depreciation will depreciate in terms of all other currencies. The author would not wish it to be inferred that when speaking of a depreciated Canadian dollar he means only relative to certain other currencies such as sterling, the United States dollar, the Argentine peso, and the Australian pound. Any internal action by a country to depreciate its currency relative to certain other currencies will cause it to decline on the exchanges in relation to all other currencies.

"Exchange depreciation over the period 1931-35 has so far done the world more good than harm. It is conceivable that the future may reveal unfavourable effects of depreciation that are not at present evident. I think, nevertheless, that depreciation has helped rather than hampered recovery, though the advantageous results that may be obtained through a resort to depreciation may by now (January 1936) largely have been obtained. If, however, the economic system retains the rigidities of recent years, and if economic forces tend to introduce further deflationary movements, a continuance of the policies of 1931-1935 may be necessary. The persistence of large declines in prices may require frequent resort to inflation, but we must be certain that the decline in prices is of such serious proportions as to threaten our economic institutions, and, therefore, to justify extreme measures; for exchange instability also sets in motion forces that threaten our economic institutions."[1]

---

(1). S.E.Harris, "Exchange Depreciation" Introduction pp. XXII - XXIII

Professor Harris appears to be of the opinion that what depreciation there was during the depression years was, on the whole, beneficial. In this respect it seems that he would support the claims of Western Canada.

But there <u>was</u> exchange depreciation of the Canadian dollar during the depression; that is, in relation to some currencies at least, for it appreciated in terms of some others. The Canadian dollar declined on the foreign exchange market to a low, in New York funds, of approximately 82 cents for the average quotation during the month of December, 1931;[2] this was a depreciation of 18 percent. But, during the same month sterling fell in New York to 3.3737 dollars[3] or a 31 percent depreciation. Here lies the grievance of the West. With the Canadian dollar at a discount of 18 percent in New York and the pound sterling at a 31 percent discount, the Canadian dollar was at a premium in London; i.e. the Canadian dollar had appreciated in terms of the pound sterling. In this same month of December 1931 the pound sterling was quoted at 4.10 dollars in Montreal, or a depreciation of 15.8 percent, and in October 1932 it fell to a low of 3.72 dollars or a discount in Montreal of 23.62 percent.

The Westerners claim that the Canadian dollar should have been depreciated, as the Australian pound and the Argentine peso were, to a position below the pound sterling.[4]

---

(2). United States Federal Reserve Bulletin, 1932, p.56.
(3). ibid., p.55.
(4). The Australian pound and the Argentine peso were depreciated at an even earlier date than sterling was. There are people who claim that this should have been done with the Canadian dollar too, instead of putting so much effort into holding it at or near par from 1929 to 1931.

For, as long as sterling was below parity with the Canadian dollar this acted as a tariff on Canadian products entering the United Kingdom. The United Kingdom is Canada's best customer, and particularly is this so in the wheat trade, inasmuch as England is the World's largest importer of wheat. Wheat is also Canada's largest single export commodity, the value of wheat exports in 1937 being 223,461,009 dollars,(5) which was 20.76 percent of Canada's total export trade for that year.(6)

"To the seller of goods abroad, there are two factors that determine the price the seller receives for his product. They are: first, the price of goods in the foreign import country, and second, the rate of exchange."(7)

Mr. S.R.Noble has written, "Canada reached a crisis in September 1931, when it was no longer possible to keep up the fiction that the country was on the gold standard, and the currency began to show fairly substantial depreciation in terms of gold. By December 1931 the premium on New York funds touched 25 percent, but as the premium declined within a short time to less than ten percent the relief was short-lived."(8)

The point of greatest interest to us in this passage is that Mr. Noble calls the 25 percent depreciation of Canadian funds in New York a relief. This seems to be in agreement with the position taken by Western Canada.

---

(5). Canada Year Book, 1938, p.523.
(6). Supra, Table No. 3.
(7). "Manitoba's Case"; A Submission by the Province of Manitoba to the Royal Commission on Dominion-Provincial Relations, part III, p. 1.
(8). S. R. Noble, op. cit., p. 270.

"As early as the middle of 1930," Mr. Noble writes, "There was in Canada a considerable body of opinion in favour of deliberately depreciating the Canadian dollar to an extent roughly corresponding to the price level in the United States. This would have been analogous to the policy already pursued by Australia, but it would have been a more scientific experiment. Against the fulcrum of gold prices, through an increase in the note issue, which would have been used to purchase gold or gold exchange, we could have applied the leverage which would have kept our price level approximately stable. Of course, we would have had disequilibrium as between agricultural prices and industrial prices, but this was inevitable in any event.

"There can be no reasonable doubt that under such a scheme Canada could have avoided the worst features of the depression and started recovery many months earlier than actually occurred."(9)

The grain growers of Manitoba claim that their annual income from 1930 to 1933 was six million dollars less than it would have been if the Canadian dollar had been depreciated to the same extent as the Australian pound, that is, by about 25 percent.

"The prairie provinces export to foreign countries about 45 percent of the value of their total net production. For Manitoba the proportion of total production exported is ----- about 22 percent."(10) To this may be added the fact that

(9). ibid., p. 271.
(10).Manitoba's Case, part III, p. 1.

Manitoba also depends upon the carrying and handling of the export trade of Saskatchewan and Alberta, and this therefore tends to increase its own dependence on export trade. The rest of Canada exports only about 10 percent of its total production,[11] most of its industries being dependent on home markets.

The rate of exchange to an exporter is as important as the price of his goods abroad, and for the producer of raw materials, especially grain, even the home price for his product is set by the world price.

Although the grain and meat producers of Australia, New Zealand and the Argentine suffered income losses of the same nature as those suffered by the same type of producers in Canada, these losses in income in terms of Australian, New Zealand and Argentine money were kept to a level considerably lower than that in Canada by means of the currency policy that was adopted in each of these countries.[12]

The rate of exchange between the Australian pound and sterling was changed from par (1:1) to 125:100, a depreciation of 25 percent below sterling. The purpose of this deliberate depreciation by the Australian Government was that with the world price for wheat and wool set in England, Australian producers would receive this price in pounds sterling and then when this was exchanged for Australian currency, they would receive 25 percent more than if the exchange had been maintained at a parity with sterling.

"That depreciated exchange in its immediate effect tends

(11). ibid., p. 1
(12). ibid., p. 2

to retard imports into the country and to stimulate exports thence has long been established in economic theory and is generally regarded as self evident."[13] Thus, the purpose of the extremely high tariff policy instituted by the Bennett Conservative Government in 1930 might have been accomplished to some extent by a currency depreciation and as well as diminishing imports this latter policy would have increased exports, which is something a tariff on imports will never accomplish.

The Manitoba brief to the Royal Commission on Dominion-Provincial Relations claims that as a result of the fall in the value of the Australian pound in terms of the British pound during the period 1931-1936, the producers of wheat in Australia secured upon their average exports of about 25,000,000 bushels an annual increase in returns of about 18,000,000 dollars in Canadian money, or about fifteen cents per bushel.[14] The argument of the Manitoba Government on behalf of the grain growers and exporters thus resolves itself into a belief on their part that the Canadian dollar should have been kept in line with the Australian pound.

The losses to the grain growers of the prairie provinces resulting from this policy of not deliberately depreciating the Canadian dollar to a level considerably below that to which it fell due to ordinary causes have amounted to an annual average of 47,000,000 dollars since 1931. This has been measured by

---

(13). Choh-Ming Li, "The Effect of Depreciated Exchange upon Merchandise Movements"; The Quarterly Journal of Economics, May 1935, p. 495.
(14). Manitoba's Case, part III, p. 3.

calculating the difference between the amount actually received for wheat exports and the amount that would have been received if the relation of the Canadian dollar to the pound sterling had been kept in line with the rate Australia maintained, always assuming that such action would have had no effect on the sterling price of wheat.(15)

The average total exports from Canada over the six year period 1931-1936 was to the value of $710,380,259.(16) If there had been a depreciation of 25 percent this would have been increased to $887,975,323, a gain of $177,595,064 per year in Canadian funds to the Canadian exporters and producers of export commodities. However, some of Canada's exports are dependent upon imports of raw materials and semi-manufactured goods from other countries, and to the extent that this is the case this gain to exporters can be diminished, inasmuch as the depreciated exchange value of the Canadian dollar would make imports that much more expensive to Canada. If we take 25 percent as the amount of Canadian exports which are merely re-exports of previous imports (this figure I believe to be considerably higher than is actually the case) then the average annual additional amount Canadian exporters would have realized as a direct result of the depreciation of the Canadian dollar would amount to $123,196,298. Added to this there is the possibility that as a direct result of the currency depreciation Canadian exports

---

(15). Manitoba's Case, part III, p. 3.
(16). Average calculated from the annual totals for these six years listed in the Canada Year Book, 1938, p. 528.

would increase. Manitoba pointed out in its brief that to the prairie provinces alone there would have been an annual average increase in the value of grain exports of $47,000,000 since 1931. This leaves a balance of $76,000,000 for the rest of Canada although this excludes the prairie provinces from having any gain due to their exports other than grain, but in any case these are not very important items.

However, the competitive advantage that Australia and the Argentine gained by means of depreciating their currencies had begun to disappear by the beginning of the 1933-1934 Canadian crop year (August 1st, 1933). For, in the early Spring of 1933 the United States abandoned the gold standard and embarked upon a policy of currency devaluation. Their objective was a dollar devaluated to about 60 percent of its old gold parity. As the gap between the pound sterling and the United States dollar closed, the Canadian dollar, still holding to a middle position between the two, approached parity with the United States dollar. Then when the United States dollar and the British pound reached a position of parity with each other, the Canadian dollar was at parity with both. The American dollar was devalued by raising the price at which the United States Government would buy gold bullion, and when the price of gold had reached 35 dollars per fine ounce, it was pegged at that level. This occurred in 1934. The American dollar was then at about 60 percent of its old gold parity, and since the British pound and the Canadian dollar were at approximate parity with the United States dollar, both were worth in gold about 60 percent of their old gold values. A "de facto" though not a "de jure" stabilization of the three

currencies had been effected. With this devaluation of the Canadian dollar to about 60 percent of its old gold value, and its "de facto" stabilization with sterling, most of the competitive advantage Australia had gained in the British market, through currency depreciation, disappeared.

One might infer from this that as a result all arguments in favour of Canadian dollar depreciation would no longer be heard. For a time, perhaps, this was the case. However, in 1938 the question cropped up again. Once more sterling began to depreciate relative to the American and Canadian dollars, standing in December 1938 at $4.70 in Montreal. This was a six percent depreciation from the $5.00 mark at which the "de facto" stabilization had existed, and near which the pound had stood since 1933. The Australian and Argentine currencies also depreciated during 1938. In February 1938 the Australian pound stood at $3.9981; by October of the same year it had fallen to $3.7989 in Montreal. The Argentine peso fell from 33.451 cents in Montreal during February 1938 to 31.793 cents in October 1938. Much the same situation still exists now, in the Spring of 1939. Would it not, then, be advisable to depreciate the Canadian dollar by an equal or perhaps an even greater proportion, say eight or ten percent. The arguments in favour of such a policy remain the same as previously; it would be of benefit to the Canadian export industries, especially to the Western wheat-farmers, who are still in much the same difficult financial position they have been in since 1930. Such a policy would prevent the exporter from having to take a reduced price, in terms

of Canadian dollars, in order to compete successfully in the markets of the world, and especially in the United Kingdom.

The difficulties of the Western wheat-farmers have been due, to a large extent, to the low price of wheat on the world market. At the present time it stands at about sixty cents per bushel. A Canadian currency depreciation would not raise the world price for wheat, or any other commodity for that matter, but it would raise the domestic price in Canada and would give the Canadian exporter a competitive advantage in the British market. The fact that British Empire preference in wheat in the United Kingdom has been abolished in this period of over-production of wheat in the world also gives support to the present day advocates of exchange depreciation of the Canadian dollar. For, the abolition of this preferential tariff rate will mean that the competitive advantage in favour of Canada, Australia, and other Empire wheat producers over the Argentine, United States of America, Soviet Russia, and other foreign producers has been lost. Canada could regain some of this competitive advantage by depreciating the Canadian dollar.

Under ordinary productive conditions a preferential tariff rate has little effect on world trade other than to change the channels of trade. For, what additional wheat Canada might ship to England she would have to stop shipping elsewhere, say France, while whatever Argentine wheat was displaced from the English market would replace the reduction in Canadian wheat shipped to France. The situation is different under conditions of over-production the world over. If Canada loses part of her English

market to the United States, the latter country does not have to reduce its shipments elsewhere in order to supply this additional market, it simply ships part of its wheat surplus. The increased American wheat shipments to England do not leave a gap in the world market to be supplied by the Canadian wheat which has been displaced from the British market by the American wheat, for, in increasing her shipments to England the United States has done so from surplus, and not by contracting her shipments elsewhere. Canada then, under such world conditions has to put up a more strenuous fight for the markets of the world. A deliberate depreciation of the Canadian dollar would be a good weapon in this struggle for world markets.

Professor S. E. Harris has written "We may conclude that a country gains an export advantage if its currency depreciates."[17]

It might be appropriate at this time to point out that if a country deliberately depreciates its currency in order to raise the price received for exports, and in order to restrict imports, to increase its markets and its volume of exports, and if there is a sizeable increase in such markets and in the total volume of exports so that an export balance is acquired, then one cannot expect the currency to remain depreciated to that level in face of this balance; it would tend to rise again on the exchanges. However, if after it had risen the total of exports decreased to any great extent, and imports increased by such an

(17). S. E. Harris, op. cit., p. 13.

amount that the export balance was changed to an import balance, then without any internal action on the part of the country's monetary authorities, but as a result of the natural tendencies of trade and the exchanges, the currency would once again tend to depreciate. These fluctuations might be expected until such a time as some kind of equilibrium position had been reached with the debit and the credit sides of the balance sheet being equal without any recourse to loans being necessary. You cannot deliberately depreciate your currency so as to increase exports, and then, having accomplished this, hope to keep the two at those levels permanently. If Canadian exports are greatly increased and there is an increased demand for Canadian exchange, then the value of that exchange will rise. That is, the dollar will appreciate.

CHAPTER IV

The Effects of Exchange Depreciation on Imports.

As pointed out in Chapter one, Canada's economy depends on a relatively large export trade, and therefore, Canada must have a relatively large volume of imports. From this it follows that although a currency depreciation would benefit the exporters and the producers of goods for export, it would, at the same time, mean that importers and industries depending upon imports would have to face a certain disadvantage because of the rise in the price of imports in terms of Canadian dollars. Hence, before one can come to any conclusions as to the advisability of such a monetary policy, he must weigh the disadvantages accruing to the importer as against the advantages accruing to the exporter. The interests of the one cannot be considered while the interests of the other are neglected; both must be considered together.

The average annual imports to Canada for the six year period 1931-1936 inclusive were to the value of $568,408,197.[1] Now, if as in the case of exports we allow for a 25 percent depreciation of the Canadian dollar on the foreign exchange market, the value of these imports in Canadian currency, assuming that Canadian domestic prices had not risen, would be $710,510,236. This would mean a loss to the importer, or it would force him to raise the domestic price of imports by an aggregate amount of $142,102,039 per year. Thus although the

---

(1). Calculated from annual statistics given in the Canada Year Book, 1938, p. 528.

receipts in Canadian funds from the exports sold by Canadians would increase by $177,595,064, so also would the payments made by the importers in Canadian dollars be increased, and by $142,102,039; therefore, the net gain to the country (export gain minus import loss) would be only $35,493,025.

However, this makes no allowance for an increase in exports, nor for a decrease in imports, for these are two of the primary effects of a currency depreciation. Thus, one might truthfully say that this $35,493,025 is a very conservative estimate.

This brings up the question of the barter terms of trade. It is quite obvious that with the depreciation of a country's currency, that country will find the barter terms of trade turned against it. For, if the price of imports increases and the price of exports decreases, the country will be giving more exports for the same amount or for less imports. That is, she will be giving more for less; the barter terms of trade will have turned against her. But during the last few years, "The losses suffered by paper countries in less favourable terms of trade," writes Professor S. E. Harris, "have not been so serious as might at first be assumed. They were, for example, in a position to obtain commodities from other countries at relatively low world prices: first, because the number of countries off gold steadily increased and they in turn sold commodities at low world prices; second, because trade relations among paper countries were close; and finally, because depreciation tends to shut out foreign commodities, thus putting pressure on foreign exporters to quote

paper countries lower prices in stable currencies."[2]

"Losses from less favourable terms of trade (when numerous countries are off gold)[3] are not likely to be large; but the gains from a more favourable balance of payments and more liberal monetary and spending policies are most likely to prove to be large."[4]

To-day there are few countries still on the gold standard.[5] Ignoring these relatively unimportant exceptions, one might freely make the statement that the countries of the World of to-day are paper countries. When France, the centre of the group of countries known as the "Gold Bloc", was finally forced off the gold standard in September 1936, being no longer able to withstand the deflationary effects which the maintenance of that standard was exerting on her economy, the influence of gold standard countries on the world economy was at an end.

"Import prices of paper countries will not rise (relatively)[6] to the full extent of depreciation; ----- since paper countries have close trade relations with other paper countries and since the latter offer commodities at relatively low world prices, it might be expected that import prices of paper countries relatively to those of gold countries would not be fully adjusted to exchange depreciation."[7]

---

(2). S.E.Harris, op. cit., p. 6.
(3). Brackets inserted by Professor Harris, himself.
(4). S.E.Harris, op. cit., p. 7.
(5). Only Belgium and Albania in November, 1938.
(6). The same as footnote #3 on this page.
(7). S.E.Harris, op. cit., p. 10.

It has been pointed out thay when a country's currency depreciates, its imports tend to diminish, its exports tend to increase, and the barter terms of trade become less favourable to that country. For, when a country A's currency depreciates on the foreign exchanges, foreigners can buy that currency cheaper and so, as far as they are concerned, the goods they import from A fall in price, while the exports from country B to country A rise in price. The result is that for one unit exported by B, where B used to receive only one unit in return from A, B may now receive two. The barter terms of trade have turned against A and in favour of B.

But that is not the end of the story. What if the goods exported by A and imported by B are what is known as international goods with a price not determined in any domestic market, but a world price set in a world market ? Briefly, if the goods which A exports are such, a depreciation of A's currency on the foreign exchange market will not affect the world price which is most usually determined in the importing country, in this case B. If, before the depreciation of A's currency, the price of wheat in B was 4 units of B's currency per bushel, the price after the depreciation of A's currency would in all probability remain at 4 units. For, with the price determined in B, a change of price in A would not likely be of much influence on the world price unless A produced and exported a very large percentage of the world production of that commodity. If this was the case, however, it is quite probable that the world price would be set in A, the producing country. The price would then be not so much a world price as an A monopoly-price. Now, going back to the case of

wheat production. The amount of this commodity that A can produce will not likely be enough to affect the world price in B. So what happens? The people in B continue to pay 4 units per bushel, but the people in A who produce the wheat, instead of receiving only 4 units as they did when the two currencies were at parity, receive 5 units of A's currency if A's currency depreciates by 25 percent. Thus, the world price remains the same, while the domestic price in A rises. Although the A producers of wheat for export may not sell any more wheat than previously, they receive additional money for the same amount of wheat when the payments for it are exchanged into the currency of A. This is precisely the situation in Canada to-day. Canada normally exports about 75 percent of her wheat production; a depreciation of the Canadian dollar is not likely to greatly affect the world price of wheat but would realize more in Canadian dollars to the Canadian wheat producers.

"The larger the percentage of production normally exported, the more the price of the export commodity will tend to rise at home when the currency depreciates."(8) For, if the normal flow of the commodity is mostly out of the country, and only a small proportion of the country's production of the commodity is consumed at home, then, if the producer's currency depreciates, a larger proportion than ever will be demanded by other countries because in terms of their own currencies which will have appreciated relatively to the producer's currency, they will be able

---

(8). S. E. Harris, op. cit., p. 53.

to buy the commodity cheaper. If the people of the producing country want to consume as much of the commodity as previously they must offer a higher price in terms of their depreciated currency in order to keep the commodity from being exported. In other words, the larger the proportion of production normally exported, the less the home market is of importance to the producer,and hence, the more the home consumer must offer in order to induce the producer to sell at home and give up possibilities of extending his foreign markets.

It may well be noted too that if the currencies of several countries who are all large exporters of a particular commodity are depreciated, the world price will be affected. The world price will fall. Because if a foreign buyer has several sources from which to purchase his goods, and all the sources have a large supply of which to dispose, the several producers, unless they are selling under a mutual price fixing agreement, will try to induce the foreign buyer to purchase the goods he requires from them. They will do this by offering him lower prices. Each producer will meet the others' prices, and so with the price level of these supplies being reduced, the world price level will fall.

Returning to the case of countries A and B; it is quite possible that B's demand for goods which A produces is elastic, and that a fall in price may greatly increase the volume of such goods that B imports. Or, even if such is not the case and B's demand has very little elasticity, B might have been importing these commodities from several other countries. B would then buy a larger proportion from the country offering goods at the lowest

price, and this country as a result of its depreciated currency would be A. If either of these conditions obtains, then one might find that although the barter terms of trade have turned against the exporter A, A would export more than enough to pay for the imports it requires. There would be a favourable balance of trade set up in favour of A, the country with the depreciated currency, so that it could have more imports than it had previously enjoyed; or, it would be able to use this surplus to meet its service of foreign loans or to extend it as a foreign loan to other countries.

We have assumed only two countries A and B between which there has always been trade. Let us now assume a third country C to which A has never sold many exports, possibly because of the long distance betwen these two countries and the resulting high costs of transportation; C having other good sources of supply nearer at hand. Now, since A's currency has depreciated on the foreign exchanges, she can sell her goods to C at a lower price and still receive as much as previously in her own currency. So, because of A's currency depreciation she can overcome the transportation disadvantage and C will start to buy her goods. Thus, the losses which A would have to suffer because of the barter terms of trade turning against her may be overcome by the new markets which she can capture as a result of her depreciated currency, as well as by the increase in the volume of her exports to her old customers.

The following statement taken from Professor Harris's "Exchange Depreciation" is worth noting in regard to our present

discussion. He writes, "Between 1931 and 1935 countries off gold captured an increasing share of the world's trade; and with depreciation, the decline in world trade was not only interrupted, but, in fact, the volume of trade once more tended to rise."(9)

J. E. Meade has written, "As the value of the pound depreciates in terms of dollars, American goods will become more expensive in England, since less dollars can be obtained for one pound, and English goods will become cheaper in America since a pound can be obtained with less dollars. In consequence English imports will diminish and English exports will increase."(10)

We may conclude that the magnitude of the disability which exchange depreciation of the Canadian dollar would cause Canadian importers would depend upon whether there was any change in the world prices of commodities which Canada imports. If these prices should fall then the losses due to higher prices in Canadian money would be less. It is unlikely that a depreciation would affect world prices of the goods which Canada imports, for the Canadian market is not large enough to have much influence, if any, on world prices. On the other hand, a Canadian dollar depreciation might have an effect on the world price of Canada's principal exports, particularly wheat and newsprint; but this too is unlikely to any great extent.

There are two main causes of exchange depreciation; (a) depreciation as a result of higher prices caused by inflationary

---

(9). ibid., Introduction, p. XXIII.
(10).J. E. Meade, "Economic Analysis and Policy", p. 304.

monetary measures, such as the issuance of a large quantity of additional fiat currency; (b) a loss of confidence in the currency of the country, in which case there is no rise in prices until after the currency has depreciated unless the loss of confidence itself is due to inflationary monetary measures; however, as well as the inflationary cause there are many other causes of a loss of confidence.

Even if the currency depreciation is caused by a rise in prices, this rise will be spread over all goods in all sections of the country; the export and import goods will not be the only ones affected. Hence the gains from exchange depreciation will tend to be greater than the losses from higher prices because of the impetus that will be given to business as a whole by the rise in the general level of prices.

CHAPTER V.

The Effects of Exchange Depreciation on Domestic Prices.

In Manitoba's Case presented to the Royal Commission on Dominion-Provincial Relations it was strongly emphasized that Canada should have depreciated its currency during the early years of the depression in order to compete the better with Australia and the Argentine in the world wheat market by making her currency cheaper abroad. The Canadian farmers and other producers for the export market did compete, but as the Canadian dollar had appreciated rather than depreciated relatively to sterling, (and it must not be forgotten that Great Britain is the world's largest single wheat importer) they had to compete by means of a price deflation. This necessity in face of the automatic deflation in prices all over the world due to the influence of the depression itself made it doubly difficult for the exporters to make ends meet.

It has been pointed out in previous chapters that a currency depreciation will lower the external price of our products for export and will raise the internal price of our imports. This theory has been proved in practice, for the devaluation of the American dollar tended to cause the price of American imports to rise in terms of the United States dollar and the price of American exports to fall in terms of the currencies of the countries to which the exports were sold.[1]

---

(1). Ralph Cassidy Jr. and A.R.Upgren, "International Trade and Devaluation of the Dollar", The Quarterly Journal of Economics, May 1936, p. 415.

The depreciation of currency of a country which trades goods internationally assures only a divergence in price between the importing country and the exporting country, and the extent of the divergence is determined by the effective depreciation of the first currency depreciated in terms of the second.(2)

So far we have dealt with only those goods which are internationally traded; the prices of goods which enter only into domestic trade must now be examined. With one of the primary results of a currency depreciation being a reduction in the volume of a country's imports, the people of that country will turn to the purchase of home produced goods with the result that the prices of these goods will tend to rise. Also with the currency depreciation resulting in an increase in the volume of a country's exports, the domestic price level will tend to rise because the receipts from export trade will have increased. Further, if the currency depreciation is caused by the injection of additional currency into circulation the price level of commodities sold in the home market will rise. Thus summing up the situation quickly we find that a currency depreciation on the foreign exchange market will be felt internally by a rise in prices in internal trade, and in fact it is quite possible that if a currency depreciation occurs, a rise in prices may have been its cause.

One of the chief reasons for the devaluation of the American dollar as one of the measures taken in the pursuance of the New Deal policies was to raise the level of prices in the United States. The idea in the United States was that if prices

---

(2). ibid., p. 417.

rose, profits would increase, and this in turn would have a stimulating effect upon business and enterprise generally. Thus it was hoped that the country would be lifted out of the doldrums of depression. When extra money has been injected into the economic system of a country and has had time to circulate, prices will be higher than before. Assuming that a 20 percent increase in the amount of money has taken place, it is very unlikely that when it has circulated all prices will have risen by the same proportion or that the general level of prices and the foreign exchanges will be higher than before by exactly 20 percent.(3)

Professors Warren and Pearson have written, "Since prices in gold throughout the world are about half of what they were before the depression, only those countries that have more than doubled the price of gold have restored the pre-depression price level."(4) Further, "If any country continues the policy of varying the price of gold, such as England is now following (1935) it can establish whatever price level it desires and avoid violent fluctuations."(5)

Although the Canadian dollar depreciated in 1931 by 25 percent in New York funds, it did not stay at this low point for long but soon rose to within 10 percent of parity with the American dollar. This small depreciation did not have any noticeable effect on the level of domestic prices in Canada. One

---

(3). G.v.Haberler, "Theory of International Trade", p. 55.
(4). G.F.Warren and F.A.Pearson, "Gold and Prices", p. 454.
(5). ibid., p. 454.

cannot deduce from this, however, that because the Canadian price level did not rise, currency depreciation will not cause prices to rise. There were, at that time, many deflationary forces acting upon the price levels of the world and their combined effect was much in excess of the 10 percent depreciation. But, it is not improbable that the depreciation kept the Canadian level of prices from falling more than it did.

Ralph Cassidy Jr. and A. R. Upgren have written, "It appears that the total effect of price making forces other than devaluation, in the period considered,[6] have exceeded the effect on prices arising from dollar devaluation alone."[7]

From 1931-1933 the United States dollar was kept on the gold standard, and we find that when the low point in the level of wholesale prices was reached in both Canada and the United States in February 1933, the American level had fallen more than the Canadian level by nearly 4 percent. Chart number 4 shows the purchasing power of the Canadian dollar (wholesale and retail price levels) and the American dollar (wholesale price level) from 1926 to 1937.

In 1932 a plan for depreciating the Canadian dollar was rejected in Parliament. However, two years later by the Amendment to the Dominion Notes Act, 1934, the same effect was accomplished by increasing the amount of the Dominion Note issue with 25 percent backing to $120,000,000. During 1933 the American

---

(6). 1933-1935 inclusive.
(7). Ralph Cassidy Jr. and A. R. Upgren, op. cit., p. 435.

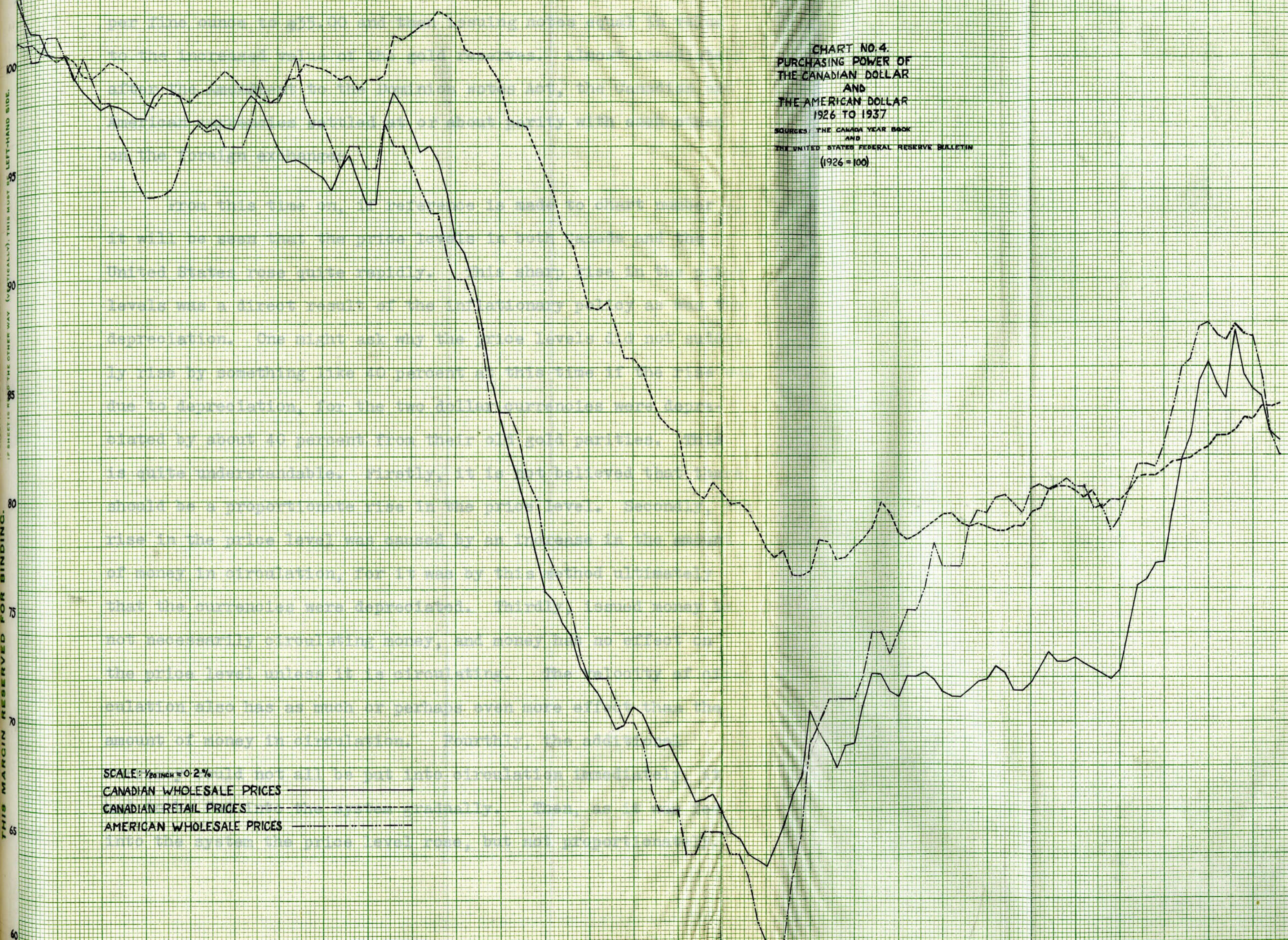


CHART NO. 4.
PURCHASING POWER OF
THE CANADIAN DOLLAR
AND
THE AMERICAN DOLLAR
1926 TO 1937
SOURCES: THE CANADA YEAR BOOK
AND
THE UNITED STATES FEDERAL RESERVE BULLETIN
(1926 = 100)
1926
1927
1928
1929
1930
1931
1932
1933
1934
1935
1936
1937
100
95
90
85
80
75
70
65
60
SCALE: 1/20 INCH = 0.2%
CANADIAN WHOLESALE PRICES
CANADIAN RETAIL PRICES
AMERICAN WHOLESALE PRICES

dollar was depreciated by raising the price of gold from $20.67 per fine ounce to $35.00 and then issuing notes equal in value to the increased value of the gold reserves. Almost immediately after the Amendment to the Dominion Notes Act, the Canadian and American currencies settled at or about parity with each other on the foreign exchanges.

From this time on, if reference is made to chart number 4, it will be seen that the price levels in both Canada and the United States rose quite rapidly. This sharp rise in the price levels was a direct result of the inflationary policy as was the depreciation. One might ask why the price levels did not suddenly rise by something like 40 percent at this time if the rise was due to depreciation, for the two dollar currencies were depreciated by about 40 percent from their old gold parities. This is quite understandable. Firstly, it is not believed that there should be a proportionate rise in the price level. Secondly, the rise in the price level was caused by an increase in the amount of money in circulation, for it was by this method ultimately that the currencies were depreciated. Thirdly, issued money is not necessarily circulating money, and money has no effect on the price level unless it is circulating. The velocity of circulation also has as much or perhaps even more effect than the amount of money in circulation. Fourthly, the additional currency could not all be put into circulation immediately, it had to be fed into the system gradually. Then, as it was fed into the system the price level rose, but not proportionately.

Precisely the same thing happened on the foreign exchanges. As additional money with no dollar for dollar gold backing was fed into the system, the currency fell on the exchanges. Currency cannot be depreciated overnight to the full amount desired; it takes a little time. Reference to charts number 2 and number 3 (at the end of chapter 2) is enlightening at this point; they show that although the object in the United States was to devalue the dollar by 40 percent, it took nearly a year before the process had been completed. That is, from the time when the price of gold in the United States was first raised, until the time when the United States dollar and sterling were at or about parity with each other, a period of about twelve months elapsed. It should be remembered, too, that exchange rates react much more quickly than prices do.

TABLE NO. 4 (8) YEARLY AVERAGES OF WHOLESALE PRICES IN CANADA AND THE UNITED STATES, 1929-1937. (1926 - 100)

Year	Average in U.S.A.	Average in Canada
1929	95.3	95.6
1930	86.4	86.6
1931	83.0	72.1
1932	64.8	66.7
1933	65.9	67.1
1934	74.9	71.6
1935	80.0	72.1
1936	80.8	76.4
1937	86.3	84.6

Table number 4 shows statistically what chart number 4 shows graphically. It is quite evident that the United States wholesale price level fell more rapidly from 1931-1933 than did the Canadian level of prices. Then in the year 1933-1934 the

---

(8). Sources: United States Federal Reserve Bulletin and The Canada Year Book.

American level rose more quickly than did the Canadian. One reason for this might be that in the United States the full depreciation was undertaken during this year, while in the case of Canada the depreciation had partly taken place previously, 1931-1933, and the remainder then would not have had as much effect on prices as the complete 40 percent devaluation that was undertaken in the United States during the same period.

In Great Britain, exchange depreciation was a very important factor in the improvement of business conditions for it contributed to a relative stability of prices there when prices in other industrial countries continued to fall.

How does exchange depreciation maintain a price level or cause it to rise higher? A possible answer to this question is that the increase in the prices of imported commodities, and the larger receipts of the exporter, in terms of the depreciated currency of his country, for those commodities that he sells abroad account for a rise in the general level of prices. However, the increase in the general price level would not approach the increase in prices of international commodities; the latter would rise considerably higher.(9)

What effect will the elasticity of supply and demand have on the level of prices when a currency depreciation occurs? If the demand and supply at home are inelastic while the demand and supply abroad are elastic, then the domestic price will tend to rise when there is a depreciation in the value of the currency,

---

(9). S.E.Harris, "British and American Exchange Policies, The British Experience". The Quarterly Journal of Economics, May 1934, p. 486.

and the more this is the case the more prices will rise at home. However, if the demands at home and abroad are elastic while the supplies are inelastic, there will be little tendency for prices to rise when a currency depreciation occurs.

Prices at the present time are too low relative to the costs of production. Emphasis ever since the great deflation occurred from 1929-1933 has been placed on raising prices in order to bring about more prosperous times. The spending policy in the United States is being carried on for the purpose of getting more money into circulation and so raising prices. It is also to encourage individuals and corporations to follow the Government's lead in order to realize the same end.

Lionel D. Edie has written, "When price levels had drifted to a point where some countries went Fascist and others were threatened with social revolution, the exponents of do-nothingism lost their hold on officialdom. Social pressure, nothing else, has forced a recognition of price level responsibility. This is one of the momentous consequences of the depression."(10)

A depreciation of a country's currency will raise domestic prices, it has in the past, and it will in future. But this depreciation must be controlled. If the currency is allowed to depreciate too quickly, it is quite possible that people may lose confidence in the economic stability of the country and instead of spending the additional money which comes into their possession on consumers goods or on new capital investment, they

---

(10). Lionel D. Edie, "Dollars", p. 230.

may hoard it. In such a situation prices will not rise as they should in order that the country will reap the benefit from the increase in the amount of money, or from the depreciation or from the combined effects of both. The recession which started in the United States during the summer of 1937 was due to the low level of profits and in some industries the near absence of them. This in turn was partly due to the lack of new capital investment. For, out of every four dollars spent for capital goods in the United States during the semi-boom period in 1936-1937, only one dollar was raised by means of selling new securities.(11) During this period the United States government was pursuing its spending policy, but private individuals and corporations did not catch hold after "the pump had been primed" due to the lack of confidence in the government's plan and in the general economic stability of the country. The people of the United States took a short-term point of view when a long-term viewpoint would have been more to their own interests in the end and to the interests of the whole nation.

The British policy of raising prices was not so hasty as that adopted in the United States. The British plan was to gradually instill confidence in the people by means of a slowly rising price level, and not to frighten them by any measures aimed at getting the price level back to pre-depression heights very rapidly. However, the armament race in Europe with the much speeded up rearmament program in England has forced the British government to spend large sums of money. The effects of this have been somewhat analogous to the spending policy in the United

---

(11). Sumner H. Slichter, "Profits and Prosperity" Atlantic Monthly, November 1938, p. 635.

States, and the earlier program of trying to have a gently rising price level has had, in a large measure, to be abandoned. Large expenditures have had to be made without regard to what would happen to the price level, and prices may now rise more rapidly than the government had originally intended, or people may become wary of England's economic condition and commence to hoard. This has not been a deliberate change in monetary policy but one which was unavoidable. The need for a strong military and naval defence in face of the present unsettled conditions in Europe has unintentionally relegated all other national policies to a secondary position. Thus the internal policy aiming at a gradually rising price level has been demoted to a position of secondary importance for the time being at least.

Canada failed to depreciate her currency along with her competitors in the early thirties, now in 1938-1939 when these countries' currencies are again falling on the exchanges, would it not be wise for Canada to depreciate her dollar to at least an equal extent ? Surely the resulting rise in prices would be a benefit to Canadian prosperity and an encouragement to people to invest in new capital goods.

One must not shut his eyes to the fact, however, that an increase in prices means a higher cost of living. This in turn leads to demands for higher wages, and to labour strikes. More especially is this the case if the cost of living rises quickly, for the more rapidly it rises, the more likely it is that there will be strikes. When there are labour troubles and demands for higher wages the less likelihood there is that business will catch

hold on the upswinging prices and swing up with them into a period of comparatively stable prosperity. Hayek believes that it is relative changes in prices rather than changes in the general level of prices that are important.(12) If the price of wage-goods (those goods which an average wage earner buys) rise proportionately more than other goods, then a rise in the general price level will not do much good, for any confidence that it might have given to investors in new capital goods will be destroyed by the wide-spread labour troubles since the cost of living will have risen proportionately more than the cost of other goods. But, the prices of wage-goods will not all rise relatively more than the prices of all non-wage-goods. Some may rise more while other wage-goods may rise little in price, so that the case of a rise in the cost of living removing all the benefits from a rising general price level may be considered as the exception to the rule.

N. L. Silverstein has written in consideration of the American dollar devaluation, "Analysis of price data revealed no automatic rise in the general level of prices corresponding in degree to the increase in the price of gold. There was, however, a fairly close correspondence between the rise in prices of commodities important in international trade and the increased price of gold."(13)

Notice that he did not say that there was <u>no</u> rise in the

---

(12). cf. F. A. v. Hayek, "Prices and Production" pp.5-7.
(13). N.L.Silverstein, "Effects of American Devaluation on Prices and Export Trade." The American Economic Review, June 1937, p. 279.

general price level but that there was no rise corresponding in degree to the increase in the price of gold. Though the rise was not in degree yet there was a rise and this was something accomplished and should have been of some impetus to enterprise. Further, he states that the rise in the prices of commodities important in international trade was in close correspondence with the rise in the price of gold. The commodities produced in Canada's most important industries are important in international trade, and Canada, as was shown previously, is dependent upon international trade. A rise in the internal price in Canadian dollars of these international goods which Canada produces would certainly benefit the country.

All those people who have been in support of currency devaluation have not believed that the prices of all commodities would rise by an amount proportionately equal to the degree of devaluation. They did believe, however, that prices of most basic products, and especially those which enter into international trade on a large scale as exports would rise by an amount almost directly in proportion to the increase in the price of gold.(14) Canada is, in the main, a producer of basic products; agricultural products, newsprint, wood-pulp, lumber, minerals, furs, and so forth. If the producers of these were to receive higher prices in Canadian dollars for their product, the whole country would benefit by their increased income when they put it into circulation as a result of their purchases of consumers' goods, supplies, capital equipment, etc.

---

(14). ibid., p. 281.

Currency depreciation has a very complex effect upon the price level and because of this it is difficult to make any generalizations which will apply in all cases; especially is this so in the case of large countries like the United States of America, Great Britain and France. Because of their size these countries each consume a considerable proportion of the world's supply of basic commodities. If then, any one of them was to depreciate its currency on the foreign exchanges, the effect upon world prices might be considerable. However, generalization with regard to a country of Canada's size (from the point of view of population) is much easier and safer, for its power of consumption of any individual commodity is almost a negligible part of the world's production of that commodity. Because of this one can expect the internal prices of Canada's export products to rise by an amount commensurate to the degree of depreciation of the Canadian dollar.(15)

In a country with a population the size of Canada's the prices of manufactured goods react very differently to currency depreciation than to raw materials and other basic products, inasmuch as depreciation of a currency has the effect of imposing trade restrictions on the products of foreign countries. Foreign manufacturers must then lower the prices of their products if they wish to retain their markets in the country with the depreciated currency. It is possible that domestic producers of the

---

(15). A. H. Hansen, "A Submission upon behalf of the Manitoba Government before the Royal Commission on Dominion-Provincial Relations at Ottawa 1938, pp. 13A-15.

same goods will be tempted to raise their prices behind the wall of protection which the exchange depreciation of their currency has set up, but this is a secondary or tertiary effect rather than a primary one and will not likely occur until domestic manufacturers have nearly reached the limits of their productive capacities. Their first interest will be to take up the slack in the market which the retirement of the foreign producers has left, and to get their plants operating full time at the prevailing prices. When this has been accomplished then they will attempt to raise prices.[16]

---

(16). ibid., p. 28.

CHAPTER VI.

The Effects of Exchange Depreciation on Foreign Indebtedness.

Canada is a trading nation; she is also a debtor nation owing more to other countries than they owe to her. The effects of a currency depreciation have been discussed with regard to exports, imports and the level of domestic prices; what then would the effects of such a policy be on a country such as Canada with comparatively large debts owing to foreigners ? The best argument in favour of a policy of depreciation is that it would give large benefits to the producers for the export market, against such a policy the best argument is that the cost of servicing foreign debts would be greatly increased.

When the question of depreciation first came up in the Federal Parliament during the sessions of 1931 and 1932, it was a question of exporters as against debtors. That the debtors won in that controversy is now history, but what is important to-day is whether the course that was then taken was correct. If it was, then assuming no changes in general circumstances, the same policy as was followed then should be followed to-day in the face of a new depreciation of Canada's competitors' and customers' currencies. If, however, that course is now deemed to have been an error, then such an error should certainly not be made a second time but a depreciation of the dollar should be undertaken immediately there are signs that Canada's chief competitors' currencies are depreciating. That is to say, the

currencies of Canada and her competitors should be kept in alignment. Mr. S. R. Noble in writing about the Parliamentary discussion in 1932, said, "The advantages (of a currency depreciation) were obvious. That the suggestion was not adopted, notwithstanding the opposition of many financial leaders on general principles was due, I think, to one condition peculiar to the Canadian economy. I refer to the fact that a very large body of our corporation, municipal, provincial and federal government securities were payable at par of exchange in two or three currencies, namely, in Canadian dollars and sterling; in Canadian dollars and American dollars; in Canadian dollars, sterling and American dollars." He goes on to state that, "According to statistics supplied by A. E. Ames and Company, Limited, approximately $2,200,000,000 of Canadian government and municipal securities were payable in two or three currencies and more than $1,000,000,000 were payable only in sterling or United States currency, these two classifications accounting for nearly 50 percent of our public debt."(1)

This rather long quotation brings out clearly what it was that swayed the monetary authorities against a policy of depreciation in the early thirties. If the Canadian dollar had been depreciated to a position considerably below parity with the United States dollar and even below the pound sterling as some people desired, it would have meant that instead of having to pay $4.86-2/3 for sterling exchange and 100 cents for American

(1). S. R. Noble, op. cit., pp.271-272.

exchange in order to make the interest and principal payments, more than this would have had to be paid. It would have meant that the rate of return in Canadian funds on foreign loans to Canada had risen. As the situation existed in 1932 however, the pound sterling had depreciated in terms of Canadian dollars and this meant a gain to certain Canadian debtors, because as a result, the actual rate of return to the holders of Canadian securities in England had fallen. On the other hand, Canadians were already paying a premium of about 10 percent for New York funds (an actual rise in the interest rate on American held securities payable in New York funds) and they did not wish to have this premium become greater and the amount payable higher still. It was a case of the benefits to the government as against those which producers might have realized, the benefits to the eastern Canadian corporations, where there was the most private foreign indebtedness, as against those benefits which western wheat producers might have realized through higher prices and a larger export volume.

Was this not, perhaps, a false economy ? If as a result of depreciating the dollar producers had received more for their goods in Canadian dollars and prices had risen leading to a general recovery in business, then the producers would have been able to pay more in taxes to meet the additional cost of servicing the debt. Moreover, assuming the same results of the depreciation, corporation profits would have been higher and they could have met their increased debt payments.

"If the Canadian dollar had been depreciated to the full extent of Australian currency, that action would have stimulated exports and restricted imports. It would have tended to yield an increased supply of foreign exchange needed to service Canada's indebtedness abroad."[2]

The Westerners argument was that it would have put no additional hardship upon the eastern people with foreign debts to service other than what they had sustained when the pound sterling, the United States dollar, and the Canadian dollar had all been at parity. The increase in prosperity in Canada as a result of the depreciation would have been more than enough to make up the increased cost in the servicing of the foreign debt. The West claimed also that the benefits which accrued to the East, from the maintenance of what was called a sound money policy, in the cheaper servicing of foreign debts, was at the expense of the western wheat producers and other producers for the export market. For, with such a policy they had to lower the price of their products in order to meet their competitors' prices in the world market. Thus these producers were beset with all the difficulties of an additional deflationary movement in the midst of a world wide price deflation. Their competitors, Australia, New Zealand and Argentina in particular, depreciated their currencies, thus putting their own producers in a much better competitive position.

Hence, the Westerners position boils down to a complaint of unjust discrimination in favour of the East. Why should the primary producers be handicapped by a policy which helps another

---

(2). Manitoba's Case, part III, p. 2.

section of the country at the West's expense ? Rather they say wouldn't it be better and fairer to pursue a policy which would be beneficial to the primary producers but which would add no additional real burden to any other section of the country. That is to say, a depreciation of the Canadian dollar would be beneficial to the West, but would not in the end be any additional burden to the East. It would be hard on the East at first, perhaps, but the secondary and tertiary effects would alleviate this.

Those who lay great stress on the increased debt burden which would have fallen on Canadians with obligations payable in United States funds had there been a re-alignment of the Canadian dollar with sterling, overlook altogether the terrific increase in the weight of the domestic debt burden resulting from the deflationary process which reduced seriously the income of all producing groups.[3]

During the 1931 and 1932 parliamentary discussion, the post-war results of the war-time inflations were bound to be brought forth as a strong point against depreciation, as Mr. S. R. Noble put it, currency depreciation -----"might start a train of events which could easily get beyond control and visions of post-war European inflations were quoted."[4]

The classical example people have in mind is the German hyperinflation. However, inflation does not necessarily lead

(3). A. H. Hansen, op. cit., p. 39.
(4). S. R. Noble, op. cit., p. 273.

to the currency becoming worthless; the inflationary movement can be controlled, and there are cases in history to prove this. There was inflation in England during the Napoleonic Wars, yet sterling survived; it also survived the Great War inflation. The United States dollar was still comparatively sound after the Civil War period, and the Italian lire did not become worthless after the Great War nor after the Fascist revolution. During the past decade there have been innumerable examples of controlled inflation, none of which has gone out of control and made the currency worthless. When we pray for rain we do not expect a flood, when we pray for dry weather we do not expect a drought. Similarily, when a controlled currency depreciation appears to be an advisable monetary policy, there is no reason why it cannot be undertaken without the occurrence of a period of inflation, that is, inflation to such an extent that the currency loses its value and becomes worthless.

Mr. E. J. Garland, member of parliament for Bow River, said in the House of Commons in 1931, when speaking in favour of a currency depreciation, "----- the very last thing we would suggest would be a policy of inflation. What we are recommending is a policy of anti-deflation. We are recommending a policy of depreciated exchange, an altogether different policy (so he claimed) from that of inflation."(5)

The fear that the Canadian dollar might become worthless had it been depreciated in 1932 was quite unfounded as later events proved. For, an inflation was actually undertaken with

(5). House of Commons Debates, 1931, p. 2791.

the amendment to the Dominion Notes Act in 1934.[6] The dollar depreciated as was expected and as was desired, but it was not a disastrous inflation. It was a controlled depreciation.

"The farmer is not as wild as he seems. His demands (for a currency depreciation) have been directed toward relief from a violent overdeflation. If the time were to come when the politicians proposed to print currency ad infinitum, it is a fair guess that the farmer would prove to be a stone wall of resistance."[7]

"I see no reason to leap to the conclusion that if a little expansion occurs there is no stopping point short of making the dollar completely worthless."[8]

As to the advisability of a new depreciation of the Canadian dollar, certainly it should not be objected to on these grounds. There has been ample proof during the last few years that a controlled depreciation or inflation will not get out of hand and lead the dollar to a condition of worthlessness. But there still remains the question of the cost of debt servicing. This was taken as a sufficient reason for not deliberately depreciating the Canadian dollar in 1932 when the United States dollar was still undepreciated. Was this a justifiable reason then ? Would it be a sufficient reason to-day?

---

(6). Supra, p.14.
(7). Lionel D. Edie, "Dollars" p. 151.
(8). ibid., p. 152.

During the early years of the Great Depression, Canadian monetary policy was directed toward maintaining the dollar at a value on the foreign exchanges that it was believed would facilitate the continuance of payment of the service of debts held abroad.[(9)] But the difficulties of the problem have frequently been exaggerated by applying the increased cost of payment of interest and principal to the entire sums paid annually by Canada to the foreign holders of Canadian investments. As well as including payments on debt service, this total sum includes the payments of profits by subsidiary companies to their parent organizations in other countries, it includes also dividend payments on investments by foreigners in Canada. The increased burden of payment does not apply to these latter, but only to the payment of interest and amortization on direct loans and mortgages wherein there are fixed contracts and of these it applies only to those whose annual payments are contracted to be paid in foreign currencies.[(10)]

The Dominion Bureau of Statistics estimates that the total of all investment in Canada in 1936 was approximately $18,000,000,000.[(11)] Of this total amount $11,200,000,000 was Canadian owned and $6,800,000,000 was foreign owned. The foreign owned investment was mostly held in Great Britain or the United States, $2,725,000,000 of investments being held in the former country and $3,984,400,000 in the latter. Investment from

(9). Manitoba's Case, part III, p. 7.
(10).A. H. Hansen, op. cit., p. 35.
(11).Canada Year Book, 1937 ed., p.871.

other countries amounted to only $124,200,000.(12) It is the British and American capital investments in Canada which are the important ones, the total of all other countries' investments is almost negligible in comparison. The interest and amortization of all this $6,800,000,000 does not have to be paid in sterling or in New York funds at a fixed rate, it is only on that portion which Professor A. H. Hansen calls portfolio investments (bonded loans, mortgages, etc.) as opposed to direct investments, that such payments have to be made. For 1936 the Bureau of Foreign and Domestic Commerce (U.S.A.) estimates that portfolio investments in Canada by Americans, representing mainly debt obligations of governments and private corporations, amounted to $1,647,000,000 with an income of $70,000,000. British investment in Canada is about 2/3 of the American, so working on this basis British portfolio investments should be approximately $1,098,000,000 with interest payments amounting to about $47,000,000. So, in 1936 total interest payments made on a contractual basis to British and American holders of Canadian investments was approximately $117,000,000.

Let us once again take 25 percent as the amount of our assumed depreciation.(13) This 25 percent depreciation will amount to approximately a 33 percent increase in the interest burden on these obligations of a contractual nature. The increased burden would be about $38,000,000, the total interest payment about $155,000,000 in Canadian funds. The additional

---

(12). Sources of Statistics; R.A.MacKay and E.B.Rogers,"Canada Looks Abroad", p. 23, and A.H.Hansen, op.cit.,p.37A.

(13). This is the same percentage of depreciation as was assumed in Chapter 3, supra, p.34.

$38,000,000 has to be paid in Canadian funds as a premium in order to obtain the necessary $117,000,000 in British and American funds which will have appreciated on the foreign exchanges relatively to the 25 percent depreciated Canadian dollar.

The question then is, would the increase in Canadian prosperity through increased exports and increased receipts from the exports in terms of Canadian dollars as a result of the currency depreciation be sufficient to warrant such an increase in the cost of servicing the foreign debt ? The governmental authorities and private corporations which had debts payable abroad at fixed rates of interest, in the United States in particular, but also to some extent in other countries, believed that such would not be the case when they made their decision in 1932 that what they called a "Sound Money Policy" should be maintained. But, in its brief submitted to the Royal Commission on Dominion-Provincial Relations, the Manitoba Government claimed that there would have been a large enough increase to do this, and still more. It was claimed that there would have been a net increase in the national income of Canada.

As far as debts owed abroad by private corporations are concerned, account must be taken of the nature of the industries which owed these debts. For the most part these industries are the ones which are engaged in producing for the export market, the same industries that would receive the first stimulus in the way of increased receipts in terms of Canadian dollars, and increased demand for their products as a result of the depreciation of the Canadian dollar. The industrial investments of

American capital in Canada amount to $1,191,000,000.[14] The following table shows that it is mostly in the industries producing for the export market that this capital is invested.

TABLE NO. 5[15] CLASSIFICATION OF CANADIAN INDUSTRIES IN WHICH AMERICAN CAPITAL IS INVESTED.

Industry	Amount in Dollars
Wood and Wood Products	$360,000,000
Metal Industries	334,000,000
Mining	224,000,000
All other industries	273,000,000
Total	$1,191,000,000

Now, since it is the same industries which would benefit from increased exports and higher prices for their products as would have to pay the higher rates of interest on their loans in terms of depreciated Canadian dollars, it seems unlikely that the exchange depreciation of the Canadian dollar would hurt them very much, if any. It would appear more likely that the benefits would greatly outweigh the disabilities.

Manitoba based much of its argument on what seems, over a short period at any rate, to have been a successful experiment in Australia. In "Manitoba's Case" one finds written the following statements, "The increase in the burden of service on Australian government debt held abroad which may be directly attributed to the rise in the London rate of exchange actually proved to be almost fully offset by the interest savings derived

(14). A.H.Hansen, op. cit., p. 38.
(15). ibid., p. 38 and the Canada Year Book, 1937 ed., p.872.

from the refunding operations made possible by the favourable trade balance resulting from exchange depreciation. Moreover, the monetary policy in Australia clearly resulted in higher prices to farmers than would otherwise have prevailed."(16)

In chapter four the conclusion was reached that if an exchange depreciation of the Canadian dollar occurred, net receipts from Canadian foreign trade would be increased by $35,000,000 in terms of Canadian dollars if a 25 percent depreciation occurred. This would be the increase even in the event of no change in the volume of exports and imports. It was a rather conservative estimate. With the occurrence of a Canadian currency depreciation on the foreign exchanges, exports from Canada would increase and imports would decrease, so that this figure would be considerably higher than $35,000,000.(17)

In 1938 a minimum price of eighty cents per bushel was guaranteed by the Dominion Government for number one hard northern wheat, delivered at Fort William; minimum prices for other grades were set according to this standard. The world price for number one hard northern wheat after previous fluctuations finally settled at about sixty cents per bushel, delivered at Fort William. Thus the Federal Government paid the wheat grower twenty cents per bushel as a direct subsidy. Estimates of what this subsidy will cost the government have varied from $10,000,000 to $60,000,000 for the 1938-1939 crop year, the most recent estimate putting the figure at about $50,000,000.

---

(16). Manitoba's Case, part III, p. 4.
(17). While exchange depreciation will have the effect of making exports increase, the increase in exports will in turn tend to make the dollar rise on the exchanges.

However, if the Canadian dollar had been in a depreciated condition on the foreign exchange markets then the price for wheat in terms of Canadian dollars would have been higher. The aggregate subsidy would accordingly have been less, assuming that the minimum price had in any case been set at eighty cents per bushel. What the government saved from this subsidy to wheat growers could have been used to pay the premium on foreign exchange purchased to pay the interest and amortization on the country's foreign indebtedness.

Exchange depreciation has its effect on tourist trade too. If there is a premium on New York funds in Canada, Americans will be increasingly induced to spend their vacations here, where their own money has an increased value. There is every reason to believe that tourist trade in Canada would increase as a result of there being a premium on American money. Emphasis is placed upon American tourist trade in Canada because it is far greater in both volume and value than the aggregate of all other tourist trade to this country. Expenditures of tourists entering Canada by ocean ports amounted to $16,972,000 in 1937 while expenditures by tourists entering from the United States via automobile amounted to $181,332,000; via rail or boat, $69,751,000; and via bus, aeroplane, etc., $26,627,000. That is, a grand total of $294,682,000 was spent in Canada by tourists entering from the United States. Canadians, on the other hand, spent only $124,422,000 in all other countries of the world during the same year.(18) The excess spent by tourists from other countries in

(18). Source of the tourist trade statistics; Canada Year Book, 1938 ed., p. 587.

Canada over what Canadian tourists spent in other countries during the same year was $170,260,000. This is quite a large item in the Canadian balance of payments.

If the Canadian dollar was depreciated by 25 percent, assuming that only the same number of tourists came to Canada as did in 1937 (there would probably be an increase), and assuming that the same number of Canadian tourists travelled in other countries (there would probably be a decrease), and assuming that all these tourists, both Canadian and others, spent the same amount of money in terms of their own currencies as they did in 1937, then in terms of the depreciated Canadian dollar Canada's favourable balance on tourist trade would be increased by $42,565,000. That is, the balance would amount to $212,825,000. Thus a currency depreciation would be a boon to the tourist trade in the same manner as it would be to the export trade.

TABLE NO. 6 (19) TOURIST TRADE 1930 - 1937

Year	Expenditures in Canada by foreigners.	Expenditures by Canadians in other Countries.	Excess of expenditures of foreigners in Canada over expenditures by Canadians abroad.
1930	$279,238,000	$100,389,000	$178,849,000
1931	250,776,000	76,452,000	174,324,000
1932	212,448,000	57,403,000	155,045,000
1933	117,124,000	50,860,000	66,264,000
1934	145,974,000	63,658,000	82,916,000
1935	214,778,000	95,600,000	119,178,000
1936	251,299,000	110,400,000	140,899,000
1937	294,682,000	124,422,000	170,260,000

It will be noticed that the Canadian excess of receipts

(19). Source: Canada Year Book, 1938 ed., p. 587.

from tourists over expenditures by Canadians abroad held up fairly well during the depression years 1931 and 1932, but fell off by approximately 58 percent in 1933, the year in which the United States devalued its dollar. The Canadian dollar had as a result of the United States devaluation begun to rise on the New York foreign exchange market, and as it did so, much of the inducement for Americans to travel in Canada, a considerable distance from their homes, was gone in that year of depression. The rise in the excess figure from 1934 - 1937 may be attributed to the improvement in general business conditions in the United States which was due in part at least to the effects of the depreciation of the American dollar.

Mr. G. G. Coote, member of parliament for MacLeod, said in the House of Commons on March 17th, 1931; "Millions of dollars of debt hang over farmers of western Canada which cannot be paid. Many of these debts are not worth 50 cents on the dollar; many of them are not worth 25 cents on the dollar, but if this depreciation in our currency were permitted, I believe it would increase the price of wheat sufficiently so that the bulk of these debts could be paid in full."[20]

In 1938 the situation in the West is almost as bad as it was in 1931. True, business conditions over the whole country are better, but as well as suffering from low prices for wheat, the western wheat growers have undergone an eight year drought in numerous areas. The 1938 crop was good, far in excess of those of immediately preceding years, but the price of wheat

(20). House of Commons Debates, 1931, p. 94.

even considering the government subsidy was extremely low and farm debts in the West are still nearly as high as they were in 1931. Hence, what Mr. Coote said in 1931 probably holds true to-day.

It has been said that in 1930 Canada's foreign indebtedness, public and private, was greater than any other country's except Germany, and her per capita indebtedness was only surpassed by New Zealand.(21)

Foreign capital invested in Canada, as pointed out above, is principally of British and American origin. Previous to 1914 British investments were in the lead, but since the Great War the leadership has been taken over by the Americans. Table number 7 shows the trend of Canadian foreign indebtedness 1913 - 1936.

TABLE NO. 7(22) CANADIAN FOREIGN INDEBTEDNESS 1913 - 1936

Year	British and foreign investment in Canada.	Canadian Capital Investments abroad.	Net foreign Indebtedness of Canada.
1913	$3,529,300,000	$237,200,000	$3,292,100,000
1918	4,535,600,000	919,700,000	3,615,900,000
1922	5,207,500,000	771,500,000	4,435,500,000
1926	5,965,500,000	1,352,800,000	4,537,900,000
1930	7,195,900,000	1,652,600,000	5,543,300,000
1934	6,965,100,000	1,605,400,000	5,359,700,000
1935	6,897,500,000	1,639,900,000	5,257,600,000
1936	6,833,700,000	1,656,500,000	5,177,200,000

(22). Source: R.A.MacKay and E.B.Rogers, op. cit., p. 25.

TABLE NO. 8[23] NET INTEREST AND DIVIDEND PAYMENTS ON CANADA'S FOREIGN INDEBTEDNESS 1913 - 1935

Year	Payments	Receipts	Net Payments
1913	$137,200,000	$ 8,700,000	$128,500,000
1918	217,200,000	32,400,000	184,800,000
1922	249,900,000	40,000,000	209,900,000
1926	285,300,000	45,200,000	240,100,000
1929	330,100,000	110,600,000	219,500,000
1933	278,800,000	88,200,000	190,600,000
1934	219,000,000	95,000,000	195,000,000
1935	317,000,000	98,000,000	219,000,000

TABLE NO. 9[24] BRITISH AND FOREIGN CAPITAL INVESTED IN CANADA 1913 - 1936

Millions of Dollars

Year	British Capital	United States Capital	Capital of Other Countries	Total
1913	2,569.3	780.0	180.0	3,529.3
1918	2,729.0	1,630.0	176.2	4,535.2
1922	2,463.8	2,593.0	150.2	5,207.0
1926	2,597.8	3,161.2	131.7	5,890.7
1927	2,628.3	3,423.8	132.2	6,184.3
1928	2,693.6	3,664.6	140.7	6,498.9
1929	2,764.2	3,926.5	145.0	6,835.7
1930	2,766.0	4,298.4	121.5	7,195.9
1931	2,687.1	4,254.5	126.2	7,067.8
1932	2,631.7	4,198.3	124.2	6,954.2
1933	2,674.4	4,115.2	124.3	6,913.9
1934	2,729.5	4,112.1	123.5	6,965.1
1935	2,729.3	4,044.6	123.6	6,897.5
1936	2,725.1	3,984.4	124.2	6,833.7

(23). ibid., p. 25.
(24). ibid., p. 22.

TABLE NO. 10[25] THE BONDED INDEBTEDNESS OF CANADA 1926-1935

Year	Net Federal Debt.	Provincial[26] Debt (Gross)	Municipal Debt (Gross)	Total
1926	$2,389,731,099	$ 708,677,426	$1,050,206,121	$4,148,614,646
1927	2,347,834,370	742,388,684	1,100,591,994	4,190,815,048
1928	2,296,850,233	769,270,373	1,134,144,398	4,200,255,004
1929	2,225,504,705	817,940,202	1,193,971,195	4,237,416,102
1930	2,177,763,959	919,142,905	1,271,389,941	4,368,296,805
1931	2,261,611,937	1,016,647,165	1,341,684,446	4,619,943,548
1932	2,375,846,172	1,148,323,084	1,384,792,777	4,908,962,033
1933	2,596,480,826	1,224,372,824	1,384,545,300	5,205,398,950
1934	2,729,978,141	1,329,684,651	1,452,850,565	5,612,513,357
1935	2,846,110,958	1,373,321,604	1,446,120,276	5,665,552,838

These tables give some idea of what is meant when it is stated that Canada is a debtor nation. They also show the general trend over the past decade; a rather rapid growth in foreign indebtedness. The bonded government debt has increased by approximately $1,500,000,000 from $4,148,614,646 to $5,665,552,838.[27] However, the bonded indebtedness of Canada shown in table number 10 is not all foreign indebtedness. Much of this government debt is owed to Canadian nationals. It is also interesting to note that investments by other countries in Canada grew by 100 percent from 1913 to 1930 when the peak was reached at $7,195,900,000, only to decline during the depression years to $6,833,700,000 in 1936. Investments abroad by Canadians on the other hand, which in 1913 amounted to only $237,200,000, totalled $1,352,800,000 in 1926 and by 1936 had reached an all time high of $1,656,500,000 after slight declines during the early depression years 1930-1934.[28] These statistics show the magnitude of payments made from Canada

---

(25). Source: Canada Year Book, 1938 ed., pp.861,877,883.
(26). "Net" figures are not available for provincial and municipal debt burdens.
(27). Supra, table number 10.
(28). Supra, table number 7, p. 79.

to other countries, and why it was believed in 1932 that to allow the dollar to depreciate any more than could be prevented would have been to the disadvantage of the nation as a whole.

However, it now appears that this may have been an erroneous belief and that by not allowing the dollar to depreciate when its natural tendency was to do so, was to keep it overvalued and resulted in unnecessary deflationary movements in prices. These deflationary trends would have been avoided if the Canadian dollar had been depreciated, and it is quite probable that they might have been reversed if the dollar had not only been allowed to depreciate, but had been forced to do so.

CHAPTER VII

Some General Considerations of Canadian Dollar Depreciation

The subject of Canadian currency depreciation as it would effect the Canadian economy has by no means been examined exhaustively in the foregoing chapters. The influence which a depreciated monetary unit would exert on that country's economy is very far reaching. The most important of the primary effects have been dealt with at some length, but neither time nor space will permit more than a word or two to be said about some of the more obvious and more important secondary and tertiary effects.

Income and employment will be affected by the effects which exchange depreciation exerts upon imports, exports and production. If imports decrease those people engaged in the importing business will undoubtedly be adversely affected, their incomes will decrease, they will endeavour to reduce the wages of their employees, and they may be forced to dismiss some of them.

On the other side of the picture are the producers for home consumption, the producers for the export market and of course the exporters themselves, the people who do the actual handling and selling of Canadian products in other countries. As imports decrease due to the protective action of the exchange depreciation, producers of the same commodities in Canada, if there are any, should take up the slack made available by this

decrease, Canadian production for home consumption should increase, the incomes of people engaged in these industries should increase and more people should be employed by these producers. With regard to the producers for the export market, the whole argument of the West has been based upon the increases exchange depreciation would cause to occur in the incomes of the western Canadian farmers. The increased prices in terms of Canadian dollars would directly benefit these producers and any increase in the exports of their products would directly result in increased employment both in the field of production and in the numbers employed by the exporters. Industries dependent upon the export industries, such as the producers of machinery and other capital goods, would benefit, since much of the equipment in use to-day is out-moded or practically worn out and is, therefore, in need of replacement. Purchasers of these capital goods, as well as improving conditions in the capital goods industries, would increase the demand for iron and steel, coal, lumber and so forth. The effects are cumulative starting with the producers of goods for export and travelling down to the earlier stages of production, the heavy industries. It seems quite probable that the benefits received by industry as a whole would greatly outweigh any disability which the importer would have to sustain. In fact, after the process of improvement really got into motion the importers too should receive some benfit, because, if the demand for most of the commodities which a country can produce is increasing, so too will the demand for goods which she cannot produce, or which she cannot produce profitably, tend to increase.

In order not to be too optimistic about the whole process it might be well to point out that for some individuals who have to continue to buy as many imports as ever there will be difficulties. With the prices of imports somewhat higher in terms of the depreciated currency, those who still buy as many imports as ever have to divert more of their available purchasing power to this purpose. They will therefore have less left to expend on domestic goods and will accordingly buy fewer. This will tend to slow up the process of improvement in domestic business conditions but not nearly enough to dissipate all the good results that may be obtained from the depreciation of the currency, and in the end even these people should be affected favourably too.

On the other hand it must be remembered that an exchange depreciation deliberately carried out through the efforts of the monetary controlling body of the country might lead to a war of currency depreciation. With other countries in competition with Canada for the markets of the world, especially the wheat markets, it is very unlikely that they would stand idly by while Canada gained a trade advantage through a forced depreciation of her currency. How then could a program of exchange depreciation increase incomes and employment under such conditions of retaliation ? It could not. But the situation in Canada has not been one of taking the leading step, it has been more in the nature of following far behind. Canada is in the position of the one needing to retaliate and of not allowing other competitor countries to gain trade advantage over her. The situation from 1930 to 1933 was that with other countries, notably Australia and Argentina, having depreciated currencies, Canada lost some of her part of

the world wheat markets. In order to hold as much of her share of these markets as possible, she had to sell her wheat at ruinous prices in terms of Canadian dollars. This resulted in decreased incomes and decreased employment. An exchange depreciation at that time would have helped to prevent this growth in the volume of unemployment, and incomes generally in Canada, though they might not have tended to increase, would not have fallen nearly so much as they did under the influence of a world wide deflationary movement and a depreciation of her competitors' currencies relative to her own.

To-day, with the British and Australian pounds and the Argentine peso having once again depreciated on the foreign exchanges, and tending to fall even more, though to a less extent as yet than in 1930, 1931 and 1932, Canada may again find herself in a disadvantageous position. In such an event Canada should be prepared to meet the difficulties in a vigorous manner.

There is another point that can be made in defence of the policy that Canada followed in 1931 and 1932. At that time people were quite unaccustomed to depreciated exchange and because of this they were still wary of it. If Canada had allowed the dollar to depreciate more than it did, the prestige of the Canadian dollar throughout the world would have diminished and Canada's credit would have suffered. During those years of intense depression Canada needed a good credit rating. To-day the situation is quite changed, the world has had exchange fluctuations of a varying nature for nearly a decade and the man on the street has become more or less resigned to them. Within reason,

then, a depreciation of the Canadian dollar would not tend to harm Canada's credit standing to-day in a manner anything like what it would have done in the years 1931 - 1932.

The question of taxation may be linked up with foreign indebtedness. If it is granted that exchange depreciation would increase the personal incomes of producers, the national income, and employment, (or prevent them from decreasing further, which amounts in the end to the same thing as an increase) much of the increase in the national income would have to be acquired by the government in order to meet the increased cost of servicing the foreign debt, payable in foreign currencies. This, as far as the governments (federal, provincial, and municipal) are concerned, would have to be acquired by means of increased returns from taxation. Returns from taxation are increased in two ways, only one of which can be directly manipulated by the government, that is, changes in the rates of taxation or in the number of taxes. The other is increased returns as a result of improved business conditions with increased profits (from which the business income tax is paid), increased sales (sales tax), higher salaries and dividends (personal income tax), increased land and property values (real property assessment), and so forth.

Increases in the rates of taxation or in the number of taxes add to costs in business, and may so burden an enterprise that it cannot compete profitably in many of its markets. "----- the experience of several countries since the close of the war suggests that a high level of taxation tends to increase

the costs of business to such a degree, that the ability to compete in world markets is seriously impaired."(1)

Taxation, and especially any new increases have an effect upon business enterprise. If a man with some money to invest has a choice between two courses which he may follow, (a) to invest in an enterprise offering a high return on his money but which appears to be a risky investment, or (b) to invest in a safe enterprise offering a very low return, he will most likely invest in the safer of the two when he sees taxes being increased. Often this is unfortunate for the country, for many of these risky enterprises become quite sound in time if they can get enough financial backing to start with. When this occurs the risk pays a dividend not only to the actual investors but also to the nation as a whole in the nature of a new industry, increased productive capacity, and a higher national income. As far as concerns employments and professions, however, it is stated in the "Colwyn Report"that the income tax has no important influence on work and enterprise. It has some effect in inclining the wealthy or established professional man to undertake rather less work than he otherwise would, but this only means that a certain amount of additional opportunity is handed over to those with smaller incomes or to those at the beginning of their career.(2)

With regard to the effect of taxation on the price level, the following statement is to be found in the Colwyn Report;

---

(1). F.C.James, "The Cost of the New Deal" The Annals of the American Academy of Political and Social Science; Vol.176, November 1934, p. 142.
(2). Report of the Committee on National Debt and Taxation,1928, p. 167.

"With unimportant exceptions, the Income Tax is not passed directly into the price of goods and services. Whether prices are indirectly affected is another question depending on the total effect of the tax on saving and enterprise. Saving and enterprise are undoubtedly diminished to some extent as a result of the physical transfer, under progressive taxation, from the larger to the smaller income; they are further diminished on account of the psychological reactions set up by the inroad which the tax makes into the pure interest yield and into the reward for work and risk. So far as the income tax, operating in these ways, has any tendency to reduce the volume of production, it must also have a tendency to increase prices."(3)

But further on page 164 of the report it is stated, "We are satisfied that when the application of the tax revenue is taken into account, the higher level of post-war income taxation has not had anything approaching a commensurate effect on the level of prices. It appears to us that over the whole field its influence on prices has been of little relative importance, and that it has not, in this aspect, tended to reduce materially the power of the public to purchase consumable goods."(4)

In the case of those debts which are payable in Canadian dollars, whether at home or abroad, exchange depreciation would not increase the number of dollars it is necessary to pay - i.e. the interest rates in Canadian dollars would remain the same - so that in so far as Canadian debts are of this sort, taxation need not be increased. Also it is worth while noting that under these

---

(3). ibid., p. 1.
(4). ibid., p. 164.

conditions the debt burden really becomes less.

One might say that in asmuch as people had increased incomes as a result of the exchange depreciation they would be able to bear the burden of heavier taxes, and even without changing the tax rates income tax payments would be larger because of the increased incomes. This is quite true, but it must not be forgotten that there are many whose incomes would not rise, or at least not for some time, for there would be a lag between the time of the actual depreciation and the time when the general level of incomes became higher. The exporting industries would feel the effects of depreciation first and the dependent industries later. For those people then, whose incomes do not immediately rise there would be an increased tax burden during the time-lag, while for the importers, any increase in taxation would add to the distress first caused by the depreciation and the resulting curb on the demand for imports. In any measures undertaken by the government there are bound to be some who suffer while others gain, but so long as there is a net gain to the nation as a whole then such a policy is worth all the hardships which certain individuals may have to undergo. This is the old Utilitarian theory of the greatest good for the greatest number, but there should be no persecution of minorities even if it is for the good of the greatest number.

Perhaps the Canadian government made a mistake in pursuing its "Sound Money" policy from 1931 - 1933, but since that time there has been a change in the general trend of world trade which might possibly make it more difficult for Canada to embark on a policy of deliberate currency depreciation. World trade to-day

is working toward a somewhat freer trade through the use of bilateral trade agreements. This trend towards freer trade has been particularly noticeable in the Anglo-Saxon countries and least noticeable in the totalitarian states except perhaps amongst themselves where barter is the rule. As far as Canada is concerned this policy was climaxed with the signing of the new treaty with the United States in November 1938 at the same time as the Anglo-American trade treaty was signed at Washington. Economists have foreseen in this policy of trade agreements the beginning of a new era in world trade and the removal of the high protective and prohibitive tariff barriers which have been raised during the post-war period and which reached unprecedented heights in the Hawley-Smoot tariff of the United States in 1930. World trade received a further blow in 1931 when England abandoned free trade, a policy which she had pursued since the middle of the nineteenth century, and embarked on a policy of protection. One might perhaps date the reversal of the trend towards higher tariffs as beginning in 1932 with the signing of the British Empire Trade Agreements at Ottawa in that year. If Canada should deliberately depreciate its currency on the foreign exchange markets the protection which this would give to Canadian products in competition with foreign products for Canadian markets and the subsidization it would give to Canadian products in foreign markets might prejudice other countries against Canada. Instead of opening up markets for Canadian products such a policy might lead to the door being closed more tightly against Canadian goods. Higher tariffs might be raised and trade agreements abrogated, with the resulting loss of trade to Canada far exceeding any potential gains from a

depreciated currency. As was pointed out above Canada has just recently concluded a trade agreement with the United States. It is hoped that this agreement will be of great benefit to Canadian industry and to the general prosperity of the country. It would be very unfortunate indeed if it should be terminated before Canada had had a chance to see if she had in any way benefitted from the agreement.

This fear that a depreciation of the Canadian dollar might result in the abrogation of trade agreements may be quite unfounded, for, at the conclusion of the Anglo-American discussions last November the United States did not hesitate to sign the document even in the face of a declining sterling rate in New York. Nevertheless, this is a possibility which should not be overlooked when deciding upon a national monetary policy, whether that policy be one of strenuous efforts to maintain the Canadian dollar at parity with the United States dollar or with any other currency, whether it be a policy of allowing the Canadian dollar to take its own course of depreciating, of remaining stable, or of appreciating, or whether it be decided that the Canadian dollar should be forced to depreciate. The case of England and the United States cannot be considered as a precedent upon which all similar future cases can be based. England is not Canada and relations between England and the United States are under quite different circumstances than are relations between Canada and the United States or between Canada and any other country. Exchange depreciation may not cause a trade agreement to be terminated, yet it always remains a possibility.

Another effect of exchange depreciation which must not be overlooked is its effect upon capital investments. Canada has always had to depend upon capital from outside sources for the development of her industries. She has been particularly dependent upon Great Britain and the United States. In 1936 British, American and foreign investments in Canada totalled $6,833,700,000.[5]

When a currency falls on the exchanges, foreigners having capital invested in that country are inclined to withdraw it and invest it elsewhere. If this movement is really serious even the country's nationals will invest their capital outside their own country fearing for its safety at home. This is what is known as a flight of capital. A large flight of capital from a country puts a tremendous strain on its financial institutions. It can result in economic collapse. This almost happened to Austria in 1931 when the Creditanstalt, the largest financial institution in that country went bankrupt. "It seemed as though Austria would be plunged into financial chaos. To avoid this, the Bank of England stepped in and provided the whole of the five million pounds required."[6] This loan saved the situation. The Austrian crisis was not caused by an exchange depreciation, but this could have caused a similar situation. However, to-day it is very unlikely that a major flight of capital would be caused by a controlled and moderate exchange depreciation without any other contributing factors. For, since the abandonment of the gold standard by most countries, people have become accustomed

---

(5). Supra, table No. 7, p. 79
(6). Paul Einzig, "World Finance Since 1914," p. 189.

to seeing exchange rates fluctuate widely, and any inclination to withdraw capital invested in other countries would be much smaller at the present time than it would have been previous to 1930 or 1931. Very often it is a flight of capital from a country which causes its monetary unit to depreciate, rather than the depreciation being the cause of the flight of capital. This is what happened to sterling in September 1938. The war scare in Europe caused people to withdraw their balances from the London market and then the pound proceeded to decline quite sharply on the foreign exchange market.

If it should be decided that the Canadian dollar ought to be deliberately depreciated on the foreign exchanges, how could this be accomplished ? Obviously it could be done by Canada importing a large quantity of foreign produced commodities to a total value in excess of the amount of foreign exchange obtainable in Canada for the purpose of making payment for these imports. The result would be that the foreign currencies demanded in Canada would rise in value in terms of Canadian dollars, or in other words, the Canadian dollar would depreciate in terms of these foreign currencies. The depreciation would be accomplished but many of the advantages expected from it would be offset by the great increase in the amount of imports competing with domestically produced goods. Moreover, Canada would have an unfavourable balance of trade instead of the favourable one which was one of the chief objectives of the depreciation of the dollar. This unfavourable balance of trade would in the final settlement of the balance of payments, have to be met by some item other

than real trade, for example, receipts from tourist traffic or foreign loans to Canada.

An equally effective and more desirable way of accomplishing a depreciation would be for the Canadian Treasury to buy British, American, and foreign currencies on the foreign exchange market. To obtain the Canadian bank balances with which to buy the foreign assets it could sell Dominion government obligations to the Bank of Canada in return for the required deposits. Another way of getting the Canadian currency with which to purchase the foreign assets would be for the government to enact legislation so that it could once more issue Dominion notes thus taking part of the note issuing power away from the Bank of Canada. It could then issue the required amount of these Dominion notes to acquire the foreign currencies in an amount sufficient to cause the Canadian dollar to depreciate to the required level. But this would be a very unorthodox means of carrying out the policy of depreciation, and should no more be considered than that government deficits should be met by the issuance of additional paper money. Also, such legislation as would be required to give back to the Treasury the power of issuing notes would automatically remove from the Bank of Canada much of its power of control over the investment and credit markets as well as to nullify its power of control over the exchange value of the Canadian dollar. The existence of the Bank of Canada would become of very little importance to the financial system of the country.

Once the required depreciation has been achieved, efforts to maintain this rate and to prevent <ins>undue</ins> fluctuations could be made by means of an exchange equalization account such as is operated in England. There was such an account established in Canada in 1935 to the extent of some sixty-five million dollars in gold realized from the revaluation of the gold reserves in the vaults of the Bank of Canada. The Canadian Exchange Equalization Account was established by the Exchange-Fund Act which received the Royal Assent on July 5th, 1935. The particular sections of the act which deal with the gold revaluation and the establishment of the Exchange Equalization Account read as follows:-

<ins>Section 3:</ins> "Notwithstanding the provisions of section twenty-nine of the Bank of Canada Act,[7] all gold held as reserve by the Bank of Canada shall be valued by the Bank at the current market price.

<ins>Section 4:</ins> "Any profit resulting from the valuation of the gold in accordance with the provisions of section three of this Act, being the difference between the value of such gold held by the Bank on the date of the coming into force of this Act as computed on the basis established by the Currency Act and its current market price, shall be credited by the Bank to a special account in the name of the Minister: (the Minister of Finance)

---

(7). Section twenty-nine of the Bank of Canada Act, 1934, states that "whenever gold is sold by, transferred to, held as reserve by, or deposited with the Bank pursuant to sub-sections one or three of section twenty-five, section twenty-six, or section twenty-eight of this Act, the value of the said gold shall be computed on the basis established by the Currency Act at the date of the relevant transaction."

Section 5: "The amount of an increase or decrease in the value of gold arising from fluctuations in the market price for gold after the coming into force of section three of this Act shall either be credited or debited, as the case may be, by the Bank to the special account."(8)

Professor Alvin H. Hansen has written that "----- the process of currency re-alignment if deliberately brought about through the purchase of liquid foreign assets, increases the resources of the banking system either directly or in consequence of appropriate supplementary action. If the pegged rate on foreign exchange is maintained by the banks buying foreign exchange, automatically their foreign liquid assets rise in countries where banks count these as part of their liquid cash reserves it is clear that their reserve position is automatically improved. This was the process actually followed in Australia."(9)

---

(8). Statutes of Canada, 25-26 George V, C.60, S.3,4 and 5.
(9). A. H. Hansen, op. cit., p. 16.

CHAPTER VIII

A Fixed Exchange with Sterling.

An editorial in the Monetary Times of December 3, 1938 contains the following statements: "Our export trade is about equally divided between the United States and Great Britain, but our imports from the first greatly outweigh them and it is only from the United Kingdom that we gain our important external cash balances. It is for the protection of those and at the same time the real value of our exports to the British market that the external value of the Canadian dollar should be reduced.

"There is a possibility of our receiving large and much needed armament orders from Great Britain. Should our dollar remain at a premium over sterling, the cost of those armaments will either be made onerous to Westminster authorities or Canadian manufacturers will be required to take payment in sterling which will reduce profits considerably. The former seems an unnecessary burden to place on the buyer and the second would not likely be considered even as a remote possibility by the producers."[1]

This editorial is based on a fact which has been pointed out more than once in the preceding chapters; namely, that Great Britain is Canada's best customer, that her trade with Canada is of such profound importance to Canada's prosperity that it should be carefully guarded and nourished by all the means which Canada has available. The editorial stresses the point that to do this one of Canada's first steps should be to see that the

(1). "Little Johnny Head-in-Air", The Monetary Times, December 3rd, 1938, an editorial, p. 3.

Canadian dollar does not appreciate in terms of sterling.

In the period of sterling depreciation which existed from 1931 to 1933 Canadian trade was seriously reduced by Canada's refusal to devalue her dollar to the level of the British pound. This might possibly occur again. Rather than suffer such a reduction in trade with all its repercussions, it would seem to be more advisable to regulate the value of the dollar so as to keep it in a position of parity with sterling. Such a course would mean that Canada would become one of the countries of the "Sterling Area" much as Australia, Argentina, New Zealand, and other countries have been ever since 1931.

Canada is still a member of the British Commonwealth of Nations, and as long as she remains so, her foreign policy will inevitably be tied up with that of the United Kingdom. This seems to have been realized in the Autumn of 1938 when Canada declined the invitation of the Pan-American Union to attend its convention held at Lima, Peru. Canada at that time had to make a choice between Americanism on the one hand, and adherence to British tradition, institutions and leadership on the other. Canada's geographic position in America, a next-door neighbour of the United States, and her adherence to British rule, often causes her to be in a dilemma as to what course to follow. Because of her close proximity to the United States Canada's economy is greatly influenced by economic conditions there, but because of the nature of her produce, in the main a producer of raw materials and semi-manufactured products, she is dependent upon the British market in which to sell these goods in order to

build up the foreign credits necessary to pay for the goods Canada imports, and to service her external indebtedness. So the dilemma resolves itself into the necessity of deciding which of two policies to follow; (a) the British, (b) the American.

Speaking of the situation from 1931 to 1933 in regard to monetary policy, Mr. Paul Einzig has written as follows; "Canada hesitated for a long time whether to follow deflation in the United States or reflation in Great Britain, and her currency fluctuated somewhere halfway between sterling and the dollar. Her dilemma was not solved until the United States suspended the gold standard and the dollar depreciated to the level of sterling, From that time on Canada duly shared the reflationary influences in the United States."(2)

It has been pointed out in preceding chapters that it was not until Canada set out to follow a policy of reflation that she began to shake off the effects of the depression. There are arguments to show that if the earlier American policy had not been followed and if Canada had reflated sooner that she would have started her climb up the hill to prosperity some months before she did. Other arguments have been presented, namely, with reference to the debt burden payable in currencies other than Canadian dollars, that prevented Canada from embarking on such a reflationary policy. But the question now is, what course should Canada follow in the future ? For many years to come Canada's imports must remain at the comparatively high level they are at to-day, because although many of the goods she imports could be produced at home, still as yet, and for a considerable number of

(2). Paul Einzig, "World Finance Since 1914", p. 284.

years in the future, the cost of producing these goods in Canada will be too great to allow the producers to compete with external producers who sell in the Canadian market. Also, in Canada as in all countries there are some goods which cannot be produced at all and so they must always be imported. Again, as the country continues to be developed, more and more capital investment will have to take place. And just as in the past much of this capital has come from other countries, so in the future it will continue to do so. But here is a place in Canada's economy where there will quite probably be a change in the future, where in fact, there has been considerable change over the past few years.

Previous to the Great War Canada was a great importer of capital but an almost negligible exporter of it. Since the war although capital from other countries invested in Canada has continued to increase, Canadian investment abroad has increased much more rapidly, attaining a figure of $2,083,341,000 (3) as of December 31st, 1934 which at that time was about 30 percent of the $6,887,812,000 of foreign capital invested in Canada.

If Canada is to continue to have imports coming from other countries, she must have a large enough balance of foreign credits to pay for them as well as having the necessary foreign credits to meet the interest and amortization on her loans from foreigners.

The United Kingdom is the place where Canada has always held her large foreign credits for this purpose, and it is therefore to her interests to make trade with England as easy as

---

(3). Source of statistics: The Canada Year Book, 1937 ed.,p.871.

possible. To do this then the Canadian dollar should not be allowed to appreciate in terms of the pound sterling. The two currencies need not be kept in such close harmony that the dollar may never depreciate in terms of sterling, but it should be prevented from ever appreciating relatively to sterling to a position above parity with the latter. What this amounts to is that some mechanism should be set up in Canada with full powers and ample resources to regulate the Canadian dollar on the foreign exchanges. The dollar should then be stabilized with sterling and the mechanism should then be put into operation to keep it at that stabilized level.

These last two paragraphs may have been something in the nature of repetition. of what had been said previously, but they give desired emphasis to these points.

Furthermore, the purpose of a fixed exchange of the dollar with the currency of the United Kingdom would be to help increase production, income and employment in Canada and to aid the export producers by enabling them to sell their product at prices that would give them a profit. Such a policy would also help to remove the competitive advantage which Australia, Argentina and Canada's other competitors in the British market have because of their depreciated currencies.

CHAPTER IX

A Fixed Exchange with the United States Dollar.

Geographically Canada is bounded by the United States for a distance of some three thousand miles and the topography of the adjacent sections of the two countries is very similar. There are five definite sections in Canada, four of which are naturally the complements both economically and geographically of four similar districts in the United States. The Maritime provinces and the Eastern Townships district in Quebec are adjacent to and topographically similar to New England. The industrialized St. Lawrence Valley and Southern Ontario along with New York, Pennsylvania, Ohio, Michigan and the other eastern and middle-western industrial states form a distinct section. The Prairie provinces and the northwestern states of Minnesota, Wisconsin, the Dacotas, etc. have mutual interests in that they are all situated in the grain producing agricultural plains, and the mountain and coastal province of British Columbia is analogous to the corresponding states in the United States, for example, Oregon and Washington. The fifth and only independent district of the five is the great shield, that is, northern Quebec and the Ungava peninsula, northern Ontario, northern Manitoba, and a large part of the Northwest Territories. It is in fact the whole large area surrounding Hudson's Bay and James Bay, extending as far south as the northern shores of Lake Superior and Lake Huron, and the north shore of the St. Lawrence River east of Quebec City.

Because of this correspondence between Canada and the

United States and the similarity of their produce, Canada's economy cannot help but be affected by the general trends in the United States. This always has and probably always will be the case, for the United States is a very large, a well developed, and a very influential neighbour; probably the world's most powerful nation.

But Canada has not been developed in such a way as to complement the United States. Rather it has been developed with just the opposite purpose in mind. Railroads were constructed joining the far western areas to the east rather than in their natural direction, which would have been to have the trunk lines running in a north and south direction connecting with the trans-continental lines in the United States, for until recently the developed portion of Canada has been only a comparatively narrow strip along the southern border. Particularly in the West trade has been forced to move east and west rather than north and south as it would have moved if left to its own natural tendencies. In the East the east-west trade movement has been more natural due to the St. Lawrence River and Great Lakes Waterway systems.

The east-west development was chiefly for military and political reasons rather than economic ones. Military in that by building railways and other means of communication such that movement could take place from one province to another without going through the United States, and political in that these natural communication facilities, a promise in the Confederation agreement, would help to build up a national unity of the

different provinces. The result has been that the economic development of Canada has been upon national lines when the natural tendency would have been for a development more along international lines. But the die is now cast and whatever future development takes place must be upon these same national lines.

It has been stated by some people that economically Canada would be in a better position if she was not so much under the influence of the economy of the United States and policies pursued by that country, and if she did not so closely reflect the conditions of business there. For, when there is a boom in the United States there is likewise a boom in Canada, though to a lesser extent and after a time-lag of about six months. When the United States has a depression then Canada too has a depression. Now if the Canadian dollar should be stabilized with the American dollar, and linked to it so that it would fluctuate with it in the world currency exchange markets, then more than ever would the Canadian economy tend to be influenced by that of the United States. An inflationary movement in American prices would cause a similar though perhaps not a proportional movement in Canadian prices, because, if the exchange value of the two dollars is to be kept constant, then a change in the purchasing power of the one must be reflected in the purchasing power of the other. This follows theoretically, since the value of the currencies is prevented from fluctuating on the exchanges in accordance with changes in their respective purchasing powers as would be their natural tendency according to the Theory of Purchasing Power Parity. The same would be true of a deflationary

price movement. A deflationary movement in prices in the United States would tend to be reflected almost immediately in the general level of prices in Canada. This of course would also be true of English and Canadian prices in the event of a fixed exchange with the pound, but the impact of British price changes is not so direct as is that of the United States because of the longer distance between England and Canada than between the United States and Canada. If prices fell in the United States imports would immediately start to pour into Canada and Canadian prices would react accordingly. In the case of England, if prices fell there it would require a longer time for the effects to be felt in Canada, and if the price decline was only temporary, all its effects on Canada might be dissipated before they were really felt. Also with this slower impact there would be more opportunity for readjustment.

- - - - - - - - - - - -

Over a long period the old east-west plan in the development of Canada could be abandoned and replaced by the more natural one, the north-south development. If it was decided that this policy should be followed and that to do so to the best advantage a currency alignment was necessary, then the linking of the Canadian dollar to the American dollar at a fixed rate of exchange would probably be inevitable, since the rest of the Canadian economy was being linked up more strongly than ever with the American economy. But, if this policy of aligning the two economies was to be followed, I believe that for a period of at least some twenty-five years such a policy would cause intense hardship in Canada with a generally lower standard of living. However, if

this long period of dislocation could be withstood and the policy adhered to diligently, the final result would undoubtedly be a desirable one; one of widespread benefits to the whole of Canada.

This argument is precisely the same as the argument for complete free trade for Canada. Many tariffs were raised in Canada under the infant industry argument for protection. Many of these infant industries, sheltered behind a protective wall, have refused to grow up. If then the tariff was to be abolished, some of these infant industries would find themselves unable to operate at a profit and the industry would be abandoned with the resulting dislocations. The dislocations, including unemployment and loss of capital investment, caused by the closing down of a number of these industries would be tremendous due to the large physical size of the industries. The infants have grown up physically but not mentally as it were. They have the physical size of adults but they are still unable to shoulder the responsibility of competing unprotected in an open market.

However, over a long period, the closing down and abandonment of these uneconomic industries would prosper the whole country. During the period of readjustment large volumes of unemployed and poverty stricken people would have to be cared for. But, after the readjustment had finally been accomplished with the labour and whatever capital had been salvaged from the abandoned industries being employed in other fields of enterprise, in industries where Canada has a natural competitive advantage at home and abroad, then, with all the nations efforts being put into those industries to which she is best suited the full bene-

fits of the abolition of a high protective tariff would be realized.

Thus we see that just as the immediate benefits of protection would have to be foregone if a policy of free trade was to be followed, so the immediate gains from the continuance of the east-west development would have to be given up if it was decided to follow a policy of economic adjustment to, and currency alignment with, the United States.

Supposing that it was decided to embark upon such a long term policy, it is hardly likely that the political party which began it would carry it through to completion, for such a move with its resulting dislocations would be political suicide for that party. Also it is hardly likely that any country would voluntarily suffer the hardships that would be encountered under such a policy as that of changing to north and south development in Canada. Such a change could only be accomplished in a totalitarian state, it could not be done in a democratic one. We have seen this in Russia, where having undertaken a complete change in their whole economic system, they found that it could only be accomplished by the methods of an arbitrary government.

Even if such a policy of complete alignment with the economy of the United States was commenced and carried on for a period of from five to ten years, by that time a new generation would be growing up who had not endorsed the program at its inception, and seeing people in other countries more prosperous, and having the impatience of youth, they would preach the abandonment of the long term policy and would seek a policy which

would lead to some sort of prosperity over the short term period.

The purpose of this rather long exposition with regard to the Canadian economic developmental policy has been something of a digression from our main problem of monetary policy, but it has been necessary in order to prove the earlier statement that Canada must continue her growth along the lines set down in the early years of confederation.

- - - - - - - - - - - -

Since the war the United States has become the most important foreign investor in Canada, displacing the United Kingdom from this position which she held until the outbreak of the war. A certain percentage of this investment, as was pointed out in chapter six, is in the form of loans and mortgages (portfolio investments) upon which a fixed rate of return has to be paid in terms of American currency. A fixed exchange with the United States dollar would facilitate the payment of this return, and would also encourage further investment by Americans in Canada since they would, under such circumstances, have more confidence in the Canadian dollar than they would have if the Canadian dollar was continually fluctuating relative to the United States dollar.

It has been shown previously that it is unlikely that the fixed return on portfolio investments would become more burdensome to the country as a whole if the Canadian dollar depreciated relative to the American dollar, for the increase in business activity as a result of the depreciation would tend to overcome any increase in the interest burden. It is even possible that an appreciating Canadian dollar, where the appreciation was caused

by monetary policy and not by increased productive efficiency, would make this burden heavier in its final effects. Although the actual interest payments in terms of Canadian dollars would be decreased, the deflationary effects of the appreciation on internal prices, and the resulting slow down in business and industrial activity throughout the whole country might quite possibly more than offset any gains made through savings in the amount of interest paid on American portfolio investments in Canada, in terms of Canadian dollars.

With regard to direct investments in Canada by Americans, the general trend for these to increase will tend to continue so long as Americans can see a possibility of making a fair rate of profit on their investments no matter what the rate of exchange between American and Canadian dollars happens to be.

There is always the question of the uncertainties and difficulties caused to traders by a fluctuating exchange, and hence the advisability of maintaining a fixed exchange with the United States, a country with which we have so much trade. It is our leading source of imports and an export market second only to that of the United Kingdom. However, Mr. Paul Einzig has written that the economic history of the past decade has shown that these fears of the uncertainties of trade and the extent to which fluctuating exchanges handicap foreign trade are usually exaggerated.[1] In the light of this opinion it would seem that any hesitancy about allowing the Canadian dollar to fluctuate is quite unfounded.

---

(1). Paul Einzig, "World Finance Since 1914", p. 202.

In reply to this statement the argument may be presented that during the period 1931 - 1933 when exchange fluctuations were the greatest, world trade decreased tremendously. During this period the value of world trade decreased by approximately 65 percent, and the quantum by about 26 percent.(2) However, with regard to the value of international trade much of the loss was due to the large fall in prices from 1929 to 1933. The American index of wholesale prices (1926 - 100) fell from 96 in August 1929 to 60 in February 1933, while the Canadian wholesale price index (1926 - 100) fell from 98.4 in August 1929 to 63.6 in February 1933.(3) Thus approximately 35 percent of the loss in value of international trade may be attributed to the fall in prices. This fall in prices as well as directly removing from the value of the trade caused a loss in confidence in trade itself and a hesitancy on the part of buyers to buy, fearing further price declines. Along with this there was the rising spirit of nationalism with its protectionist and self-sufficiency policies which led to a great decline in world trade. Countries such as Germany, Italy, France, and even the United Kingdom to some extent, which had previously been large importers of raw materials and food stuffs such as Canada, Australia, South American countries, etc., could supply, began to develop their own productive capacities in these lines of production to the maximum of output, and also reduced consumption of such goods as they could not pro-

---

(2). League of Nations, "Monthly Bulletin of Statistics",Vol.15, 1934, p. 243. - The indexes are for 30 countries representing about 80% of the world. World trade remained at these levels until about the end of 1935 (Ref.,cf.Monthly Bulletin of Statistics.Vol.16; 1935, p. 548.

(3). Supra; Chart No. 4. p.53.

duce at all or could not produce in quantities sufficient to fill the demand. This reduced consumption is particularly true of Germany and Italy. To all these factors and many more may be attributed the great decline in world trade, and any part which the uncertainty caused by fluctuating exchanges may have played must have been very small. But now, after almost ten years of fluctuating currency values on the foreign exchange market, traders are becoming used to such an occurrence and do not fear such fluctuations as they used to do. They have learned to safeguard themselves by dealing in exchange futures just as they have been dealing in produce futures for years back. So if it should appear to Canada that she should follow a policy of controlling the exchange valuation of the dollar at whatever value she might choose, she should not refrain from doing so because of the fear that such a policy would put a restraining influence upon the development of international trade. Rather it would seem that the benefits to be derived from such a policy would outweigh the handicaps.

The main argument for keeping the Canadian dollar in line with the United States monetary unit has been because of the preponderance of American owned Canadian bond issues, and the large proportion of these which are payable in New York funds. As was pointed out above, it was mainly because of this fact that Canada did not join the "Sterling Area" in 1931, but tried to keep the Canadian dollar as close as possible to parity with the American dollar.

The position to-day is somewhat changed from what it was

in the 1931-1933 period. A large number of the loans payable in New York funds have been refunded since then and the refunding loans that have been issued to get the necessary capital to pay these bond holders have been made payable, to a large extent, in Canadian dollars only. Thus the need for keeping the Canadian dollar at or near parity with the United States dollar has been considerably diminished, and if the Canadian dollar should depreciate in terms of the United States currency some time in the future, the cost to Canada of servicing the debt will not be increased nearly as much as would have been the case in the 1931-1933 period. In fact it might be that the increased cost of servicing such bonds as are still payable in New York funds would not be as much as the real saving that would be made in paying the service on that part of the debt which is payable in Canadian currency due to the reduced purchasing power that the Canadian dollar would have. When a currency depreciates on the foreign exchanges, it is usually because the purchasing power of the monetary unit has decreased, and so, as long as the interest rates of bonds, or the capital value of them at par does not change, the real amounts paid as interest and amortization are less. That is, the bond holders receive less real purchasing power than they had received previous to the depreciation of the monetary unit.

CHAPTER X.

Purchasing Power Control

The Dollar used as a Means of Regulating the Canadian Price Level.

In Chapter nine it was pointed out how a fixed exchange between the Canadian dollar and the currency of another country such as the United States or the United Kingdom would cause the general level of prices in Canada to reflect the price levels in the country to whose currency the Canadian dollar is pegged. A link up between the Canadian dollar and the British pound would be for the purpose of helping the export producer. A link up between the Canadian dollar and the American dollar would be for the purpose of facilitating American investment in Canada, and the payment of interest and amortization charges by Canada and Canadians to people in the United States who have made loans to governments and corporations in Canada repayable in terms of New York funds. A third policy is that of regulating the general level of prices in Canada by means of controlling the value of the dollar, and it is with that aspect of the problem that this chapter will deal.

For a number of years now the general complaint of business men has been a lack of business, or if there was business to be had, there was a lack of profits. The reason for the lack of profits is often stated to be because prices are too low. What is meant is that prices relative to the costs of production are too low to allow for the realization of a profit. How could this situation be rectified ? There are two possible courses of

attack; (1) to lower costs which include wages, interest payments, taxes, rents and so forth, (2) to raise prices while keeping costs at the same level.

The second of the two alternatives is easier to accomplish than the first, for in regard to wages in particular, and it is the largest item on the cost sheet, there will be resistance to reductions. Also, a producer cannot reduce the rate of interest he has to pay on loans which he has raised, nor can he reduce his rent, for both are fixed for a period of years by contract, and as regards taxes, control is absolutely beyond his reach. Again with regard to wages, labour will strenuously resist any reductions in their money wages, while a general reduction in real wages, accomplished by means of raising the general level of prices, will be received without much comment. Furthermore, if a producer decides to reduce wages it is difficult for him to know **when** to do so, where to do so, and by how much. Mr. J. M. Keynes has written, "Whilst workers will usually resist a reduction of money wages, it is not their practice to withdraw their labour whenever there is a rise in the price of wage goods."(1)

One asks "What of the 2,500 odd strikes in the United States during 1936 and 1937, a period of rising prices ?" For the most part these strikes were for the purpose of forcing the manufacturers to recognize the unions as the bargaining agencies for the labour body. There were some cases of demands for higher wages, but these were mostly by-products, as it were, of the main issue; that is, that the entrepreneurs grant the unions

(1). J. M. Keynes, "General Theory of Employment, Interest and Money" p. 9.

recognition. On the other hand the General Strike in England in 1926 was called for the purpose of resisting money-wages reductions in the coal mining industry. In Lancashire, for example, the wage of the coal getter, the highest paid miner was, in 1926, 9s/6½d per day. The mine owners wanted to reduce this wage to 8s/1½d. The surface labourer's wage was 7s/6½d per day. The owners demanded that it should be reduced to 5s/2½d.(2)

The spending policy which has been carried on in the United States during the last few years by the Roosevelt New Deal Administration has been for the purpose of restoring prices to their 1926 level which has been taken as the norm. It has been called a reflationary rather than an inflationary policy because its purpose is to bring the price level back to normal, not to raise it, whether intentionally or unintentionally, above the normal level by the creation of new money either by means of new credits or by directly issuing additional fiat paper money. The purpose of desiring to raise the price level has been to restore profits by increasing the differential of prices and costs, and ultimately by increasing the profitability of business to increase the volume of employment and reciprocally to reduce the number of those unemployed.

The American experiment has not been entirely successful, for the government's pump priming has not caught hold the way it was hoped that it would. The government of the United States

---

(2). "The British Worker"; An official strike news bulletin published by the General Council of the Trades Union Congress, No. 8, Wednesday, May 12, 1926.

did not wish to raise the price level entirely by its own efforts, but by spending large sums the way it has been doing it hoped to instil sufficient confidence in the American public that individuals and corporations would increase their expenditures, especially on much needed <u>new</u> capital investment. The resulting increase in the velocity of circulation of money because of these private expenditures would tend to cause prices to rise with the effect of stimulating further confidence and further expenditures. The process was to be cumulative. However, the public has not been made as confident as the government had hoped, due partly to the anxiety that increasing public debt has caused among the American people. The government expenditures have to a large extent been financed through the loan method, and the public has been hesitant about taking up the spending torch which was lighted in such a fundmentally unsound manner. Thus it appears that the Americans experiment at trying to control the purchasing power of their monetary unit has not been entirely successful, nor has it had all the beneficial effects that were predicted and expected by those who have carried on the experiment. The pump priming policy has been an attempt at controlling the purchasing power of the American dollar, the plan being to raise prices which means a lowering of the purchasing power of the dollar. Prices have been raised, but the effects which were expected to follow from the rise in the general level of prices have not been entirely realized.

As was shown in chapter five, a depreciating currency tends to cause internal prices to rise, while an appreciating currency tends to produce a price decline. If then prices are to be

controlled by action of the monetary authorities, what they must do is to deliberately appreciate or depreciate the monetary unit on the foreign exchange markets. If prices are seen to be rising too high the monetary authorities should take such action as will cause the unit to appreciate, thus increasing its purchasing power and inversely causing prices to fall. On the other hand, if prices tend to be falling below the norm which has been chosen the appropriate action to be taken would be to depreciate the currency and check the fall. The countries of the "Sterling Area" depreciated their currencies (or allowed them to depreciate) in 1931 and so checked the precipitous fall in internal prices which was occurring at that time.

"The old gold standard, in its internal as well as its external functioning at times operated to produce violent dislocation in the internal cost price structure and at the same time to produce quite untenable cost price relationships on the international plane. While it fulfilled a certain formal canon of monetary integrity, it in fact operated not infrequently, and particularly in periods of stress, to produce gross injustices and serious economic disturbances."[3] This might also be true of a currency which, though not based on gold, is linked to another currency. Because, where formerly rigidities were caused by the efforts taken to preserve the value of the currency in relation to gold, under the new arrangement, similar rigidities might be caused by the measures taken to preserve its value in relation to the currency to which it is linked.

---

(3). A. H. Hansen, op. cit., p. 4.

Mr. Arthur Montgomery has written as follows with regard to Sweden; "It is pretty generally recognized that the country's monetary policy played a very important part in combating the depression. The transition to a paper standard in September 1931 was, it is true, no more a voluntary step in Sweden than it was in England, but it made it possible to restrict the fall in prices."(4) No economic revival was automatically entailed by the abandonment of the gold standard by Sweden and the depreciation of the Krona in terms of gold. On the contrary, the economic situation in Sweden a year after the adoption of the paper standard and a managed currency, that is, at the end of 1932, was still somewhat insecure and unsettled. However, when once the Krona had depreciated (it fell by about 33 percent in terms of gold) it was easier for Sweden to develop an independent economic policy.(5)

If one country's currency is linked to that of another, for example, the Canadian dollar linked to sterling, it means that the Canadian dollar is then practically on a sterling standard. Sterling would not have to be held as reserve for all the Canadian dollars in circulation, as gold would, if Canada were on the gold standard, but all the regulative powers of the currency controlling body, would have to be exerted in order to keep the dollar at a position of parity with sterling. It would mean that just as when Canada was on the gold standard, the monetary controlling body would have to interest itself more with the external value of the dollar than with the internal business stability, industrial stability and general price level of the country. It was found, as has been mentioned above, that the

(4). Arthur Montgomery, "How Sweden Overcame the Depression",p.5.
(5). ibid., p. 6.

gold standard caused certain rigidities in the business organization of the nation, and also that a "Sterling Standard" might easily cause many of these same rigidities. On the other hand, it would seem to be more advisable to keep the Canadian dollar unattached to any such standard, but to leave it free to be managed in the best interests of the country. At some times it might be the best line of policy to keep it at parity with sterling. At other times due to changed circumstances it might prove necessary to allow it to rise above or to fall below this level on the foreign exchanges in order to regulate the general level of prices. The monetary unit is only a means to an end; it is not an end in itself. Its purpose is to regulate and facilitate exchange of goods and commodities within the country. If this can be accomplished better under certain circumstances of business if the dollar's value on the foreign exchanges is lowered, then by all means it should be lowered. If the opposite is the case and a higher exchange value appears to be the right course, then raise its value. The idea of keeping a monetary unit at some fixed value on the foreign exchange market no matter what happens to the internal economy, is ill-advised. France tried it with disastrous results from 1932 until September 1936 when she abandoned her deflationary policy and the gold standard. Switzerland, the Netherlands, Poland, Danzig, and other Central European countries tried it during the same period, and they also had to give up the cause of the gold standard. But the whole policy was backward. It was a policy of destruction to the internal economy of the nation in order to sustain the external value of the monetary unit. It was a case of "the tail wagging

the dog". It was a case of adhering to orthodoxy in monetary policy when to have acted in a less orthodox manner would have been more in the interests of the nation itself, and as later results have proven, in the interests of the world as a whole.

It is quite possible that a flexible monetary policy may be the only method by which a reasonable balance of economic advantage may be secured by the various groups and regions within a country and by means of which serious international maladjustments may be avoided.(6)

Probably the most enthusiastic of the upholders of a monetary policy based upon a stable level of prices, is Professor Irving Fisher of Yale University. Many of the theories applied in American New Deal monetary policy are traceable to him, though they were instituted more through the efforts of Professors Warren and Pearson, two of his followers, than through any efforts of his own.

Professor Fisher's theory is based upon price level index numbers. An index of the general level of prices, he says, should be compiled weekly and as it shows a rise or fall in the price level, the gold content of the monetary unit should be changed, thus allowing more or less money to be issued according to the direction in which the authorities wish prices to move. The index is to be compiled from as many representative articles as possible, weighted according to their importance.

---

(6). A. H. Hansen, op. cit., p. 4.

Professor Fisher has written, "What we need is that the money circulation (meaning its total effectiveness which involves both volume and speed) shall be steadfastly proportional to the fairly steadfast needs of business, that is, we want to see the line for money moving parallel with the line for production" (on a chart). "The ratio between the two would then be constant, that is, the average price (the price for a cross-section of the goods) would be the same as before."(7) He points out that what is known as a depression is, for the most part, the group of tragic consequences which grow out of a fallen price level. Business gets sandwiched between the falling price level on one side and the almost stationary expenses and debts on the other, so that the entrepreneur is compelled to narrow his undertakings and must discharge some of his men and his remaining employees have to accept wage-cuts. Or perhaps he may go into bankruptcy, in which case all his men find themselves out of work.(8)

Sweden has used index numbers for steering purposes as to monetary policy. She began to do so at the end of September 1931, after devaluing her currency. From then on, for the period of sixty-five weeks that Professor Fisher had reports on Swedish conditions, he found that Sweden maintained a retail price level which did not fall more than 55/100ths of one percent, nor rise more than 52/100ths, and its biggest cumulative departure from the established norm was 1-76/100ths.(9)

---

(7). Irving Fisher, "Inflation ?" pp.43-44.
(8). ibid., p. 77.
(9). ibid., pp. 94-95.

This was no accident. Sweden controlled her price level in pursuit of an explicit avowal by the banking committee of the Rikstag, with the concurrence of the Swedish Minister of Finance, who declared for "preserving the internal purchasing power of the Krona"; and in January 1932 announced with pride how Sweden had proved that prices can be stabilized within narrow limits. In the monthly review of the Midland Bank in England, this demonstration is commended as a great achievement.(10)

A very brief summary of Professor Fisher's trade cycle theory has been given here because he has been, as pointed out above, one of the most ardent supporters of a stable price level brought about by varying the amount of money in circulation.

As for the desirability of such a policy in Canada; it would be to the great advantage of the country's whole economy if prices were to be regulated through monetary policy. It is not meant to suggest, however, that prices should be kept stable at all times. In face of rising world prices, for Canada, a country needing imports and depending upon exports to pay for them, to keep her price level considerably below world prices would be an unnecessary loss. Such a course would undoubtedly increase Canada's competitive advantage in world markets, but her loss in barter terms of trade would be tremendous. On the other hand, for Canada to keep her internal prices from falling at a time when world prices were falling might be a great help towards stabilizing the Canadian economy. Also, looking at the question

(10). "Monthly Review of the Midland Bank", October, 1932, pp.1-5 incl.

from a short-term point of view, for Canada to resist an upward movement in prices at the present time would be to obstruct the reflationary process. A reflationary process because world prices are still considerably below the 1926 level which has been chosen almost universally as the norm. However, if at some future date prices should reach that level, it might be more advisable then for Canada to look towards a policy which would keep prices from either rising or falling.

The point to be made here is neither that prices should be kept stable as Fisher's school desires, nor that they should fall gradually (Hayek) or rise gradually (Keynes) after there has been reflation to the norm and some kind of condition of equilibrium achieved. The point to be noted is that price levels can be controlled to a considerable extent by monetary policy, and should be so controlled.

CHAPTER XI

Conclusion

In 1932 Mr. Graham F. Towers, now Governor of the Bank of Canada, but at that time Assistant General-Manager of the Royal Bank of Canada, wrote as follows, "While it has been generally recognized that the premium on gold has increased the profits or substantially mitigated the losses of those Canadians engaged in manufacturing for export, it is a grave mistake to think that the benefits which accrue from such a premium are confined to the export industry. The outstanding benefit to Canadians from the premium on gold is found in the price structure. Since Canadian prices have not fallen as severely as those in the United States, business losses have been correspondingly less heavy and earnings have a more normal relation to debts. It is true that there is a premium to the mining industry, to the farmer and to the fisherman who send their goods abroad, but it is no less true that almost all other forms of business activity have been maintained in a more healthy state than in the United States and in the other countries which are attempting to remain on the gold standard.

"The better volume of internal business, made possible by the lesser decline in Canadian prices, is really a net gain to the country as a whole. While there are disadvantages to those who have foreign obligations to meet, these losses are offset by the gains of the farmer, and others who must sell their products in foreign markets. There is no offsetting factor

against the advantages which have accrued to internal business."[1]

In the light of these statements it would seem that the arguments presented in 1931, 1932 and 1933, that is, that Canada because of her large volume of foreign indebtedness payable in foreign currencies, could not afford to allow the dollar to depreciate any more than had already occurred, were false. In justifying the existing discount on Canadian funds in New York during late 1931 and early 1932 Mr. Towers believed that the advantages had outweighed the offsetting factors.

The policy followed during the 1931-1934 period may have been wrong, on the other hand it may have been right. It is difficult to come to any conclusion one way or the other. However, circumstances are seldom identical at two different periods, and changed circumstances call for changed policies.

The amount of Canadian debt payable in foreign currencies is now considerably less than was the case in the period of the early thirties. Also, although the general level of prices is considerably higher now than it was during 1932 and 1933, it is still considerably below the 1926 level which has been chosen as the norm. In fact after rising to some extent during 1936 and 1937, at the end of 1938 wholesale commodity prices in Canada had fallen again to a level of approximately 74,[2] (1926 - 100). This put the level of wholesale prices almost back to their 1934 - 1936 level. With prices still approximately 25 percent

---

(1). G.F.Towers, "Foreign Exchange - Its effect on the Pulp and Paper Industry"; Pulp and Paper of Canada, Vol.33, No.3, May 1932,p.111.
(2). Source: The Annalist, Wednesday, January 25, 1939, p. 135.

below the normal, it would seem to be advisable to force the dollar to depreciate and thus cause the internal price level to rise. An 8 to 10 percent depreciation would bring the Canadian dollar down to approximate parity with the pound sterling which, as was pointed out above, has depreciated during the past year from somewhere slightly above $5.00 to $4.70 (approximately) in Montreal. However, linking the Canadian dollar to sterling permanently should not be the policy, for that would mean, as pointed out above, that Canada would be on a sterling standard, and in order to maintain her currency on that standard, all kinds of rigidities might have to be borne. Instead, Canada should be free to manage her currency as seems most desirable at any particular time.

At the Imperial Economic Conference held at Ottawa during July and August 1932, it was resolved by the participating countries to follow the monetary policy of the United Kingdom as much as possible. It would appear, however, that since then Canada, in so far as she has followed the monetary policy of any country, has followed the United States more than Great Britain, with the policy of cheap money which she has pursued being in line with both.

Under prevailing conditions a depreciation of the Canadian dollar by about 10 percent appears to be the appropriate measure to take. As was mentioned previously, the pound sterling has fallen from above $5.00 to about $4.70 in Montreal. The depreciation of the pound has been due to the greatly increased

armament expenditures under the speeded up rearmament program of the United Kingdom. That it has not fallen more is due to the action of the monetary authorities in England. The British Exchange Equalization Account, originally established for the purpose of preventing undue fluctuations of the pound, such as speculation and the influx or efflux of "hot money" might cause, is quite probably being used to hold the pound temporarily at an artifically high level. Eventually the pound must fall more and especially so if the armament expenditures continue at the present rate. When the pound does depreciate further however, its course may have to be watched in terms of some currency other than the United States dollar, for, that currency may depreciate too in the near future if the huge public works expenditures continue. Any future depreciation of the British pound will make it more difficult than at present for Canadian exporters to compete in the British market. If such a situation is to be avoided then the present Canadian monetary policy should be to keep the dollar as near as possible to parity with sterling. Such a course of depreciation would also tend to cause Canadian domestic prices to rise; a desirable effect at the present time. Again, this policy should also be acceptable to the Canadian manufacturers who desire tariff protection. For, depreciation of a country's currency tends to cause a reduction of imports into that country, while at the same time it tends to cause a general increase in its exports.

However, while a depreciation of the Canadian dollar would be a good short term policy, it must not be forgotten that it is only a short term policy. Also, the depreciation if carried

out must be done gradually and quietly. Any fanfare might cause Canadians and foreigners to lose confidence in the currency and a flight from it might occur causing a much larger depreciation than was originally intended and causing financial crises and other repercussions in Canada.

That the dollar cannot be held permanently at an artificially low level is just as true as the statement that the pound sterling cannot be held at an artifically high one for any great length of time. In fact, the period during which the Canadian dollar could be held at an abnormally low level would, in all probability, be of shorter duration than the period during which the pound could be held at an overvalued position on the exchanges. The maintenance of a currency at an unreal level requires both expert management and large resources. Those at the disposal of Canada are somewhat less than those which are available to the United Kingdom. If the dollar is forced to depreciate on the foreign exchange markets, the resulting decrease in imports and increase in exports will soon cause it to begin to rise again towards its previous level.

While the present policy should be to keep the dollar at approximately the same level as the British pound, it is not meant to infer that it should be permanently linked to the pound. As long as managed currencies are the rule throughout the world Canada should keep herself in such a position as to be able to manage her own currency according to the necessities of prevailing circumstances. To-day a lower exchange value of the dollar seems to be the requirement. Perhaps some months, or a year or

two hence, if conditions have changed, a higher exchange value may be needed; for example, if internal prices reach the 1926 level and tend to go considerably beyond it. The Canadian dollar should be kept free to be managed as Canadian internal conditions require and irrespective of what the monetary policies of other countries may be in managing their currencies; that is, irrespective of what other countries do in so far as their actions do not adversely affect the Canadian economy.

At the present time there is a tendency for large amounts of capital to be flowing into Canada due to the political tension in Europe. This buying of dollars by frightened Europeans will be apt to cause the dollar to appreciate. The upward movement of the dollar on the exchanges should, and is being equalized. If the country, then, is willing to equalize the effects of an inflow of "hot money" it is only a short step farther to cause a slight depreciation. For the country to hail the equalization of an appreciation and yet to condemn a slight (10%) depreciation seems almost to be "splitting hairs".

While previous mention has been made briefly as to the effects that a deliberately depreciated Canadian dollar might have on that country's credit, a few additional words on that phase of the question might be appropriate at this time. It has been pointed out that when the Australian pound was depreciated in 1930, the rate of interest that the Australian Government had to pay on new loans rose considerably (by 1 to 1½%). Australia depreciated her currency by about 25 percent, and allowing for a proportionate increase in the rate of

interest that would be demanded on loans to the Canadian government if the Canadian dollar was deliberately depreciated, a 10 percent depreciation as advocated above should cause the interest rate to rise only by about 40 percent as much; that is, from 4/10 of 1 percent to 6/10 of 1 percent. Also it may be worthwhile to note that when the Canadian dollar depreciated by about 10 percent on the average during 1932, Canada's credit did not suffer; interest rates did not rise on new Canadian bond issues at that time. Also, available capital is very plentiful to-day and this tends to keep the interest rates low. Of course, it may be noted that in 1932 the dollar had depreciated of its own accord as a result of general economic conditions. It was not forced to do so by action of the monetary authorities. To this, however, one might add that under the present world conditions of political tension Canada is one of the safest places for investment due to her geographic position and her comparatively stable and conservatively minded government, both the major parties[3] being fundamentally "right wingers". The only left wing party of any strength at all is the C.C.F.[4] and it is not the extreme left, but merely slightly left of the centre. Further, the C.C.F. is as yet a long way from gaining any kind of a majority in the House of Commons. So, the safety which Canada offers for investment should tend to keep the rate of interest demanded by lenders at a comparatively low level.

Though a controlled currency depreciation at the present

---

(3). The Liberal and Conservative Parties.
(4). Co-operative Commonwealth Federation.

time would be an action beneficial to the Canadian economy on the whole, such a policy must be handled with great care so that it does not run into a hyperinflation. A continuous currency depreciation, as is well known generally after what happened to the German paper mark in 1923, is no haven of refuge, nor is it a sure-fire benefit producer for any country's economy.

Finally, if the world ever goes back to some sort of international standard and a stabilization of currencies on the foreign exchange markets, then Canada too would undoubtedly stabilize her dollar. It is only under conditions of no international monetary standard that the present discussion is of value. However, it is not meant to convey the opinion that the world will some day return to some international standard such as gold or silver; perhaps it will, perhaps it will not. To make any definite predictions of such future world policy would be unwise at the present time; further developments must be awaited before one will be able to perceive clearly the general trend of world monetary policy.

BIBLIOGRAPHY

Books

Coe, V. F. "Monetary Theory and Politics" - Essays in Political Economy in honour of E.J.Urwick, edited by H.A.Innis. Toronto, Toronto University Press, 1938. pp. 85-98.

Copland, D.B. "Australia in the World Crisis 1929-1933 New York, The Macmillan Company, 1934.

Edie, L. D. "Dollars", New Haven, Conn., Yale University Press, 1934.

Einzig, Paul. "Monetary Reform in Theory and Practice", London; Kegan Paul, Trench, Trubner and Co., Ltd., 1936.

Einzig, Paul. "World Finance Since 1914", London, Kegan Paul, Trench, Trubner & Co.,Ltd.,1935.

Einzig, Paul. "World Finance 1935-1937", New York, The Macmillan Company, 1937.

Fisher, Irving. "Inflation ?", New York, Adelphi Co., 1933.

von Haberler, G. "The Theory of International Trade"; translated from the German by Alfred Stonier and Frederic Benham. London, W. Hodge and Company, Ltd., 1936.

Harris, S. E. "Exchange Depreciation 1931-1935", Cambridge, Mass., Harvard University Press, 1936.

Harris, Major Eric, "The New Deal in Canada", Toronto, the Ryerson Press, 1934.

von Hayek, F. A. "Prices and Production", London, G. Routledge and Sons, 1935.

Keynes, J.M. "The General Theory of Employment,Interest and Money", London, Macmillan & Company, Limited, 1936.

Keynes, J.M. "A Treatise on Money". New York,Harcourt, Brace & Company, 1930.

Laureys, Henry. "Foreign Trade of Canada", Toronto, The Macmillan Company of Canada, Ltd., 1930. Translated from the French by H.A. Innis and A.H. Smith.

MacGregor, D.L. "Statistics of Public Debt in Canada", Toronto University Studies, Volume VII, Toronto, Toronto University Press, 1934.

MacKay, R.A. and Rogers, E.B. "Canada Looks Abroad", Toronto, The Oxford University Press, 1938. Printed by the Ryerson Press. A publication under the auspices of the Canadian Institute of International Affairs.

Meade, J.E. "An Introduction to Economic Analysis and Policy". Oxford, at the Clarendon Press, 1936.

Montgomery, Arthur. "How Sweden Overcame the Depression 1930-1933", Stockholm, A. Bounier, 1938. (New Sweden Tercentenary Publications).

PEP (Political and Economic Planning) "Report on International Trade", Published by PEP, 16 Queen Anne's Gate, London, S.W.1., May, 1937.

R.I.I.A. (Royal Institute of International Affairs) "The Future of Monetary Policy", Oxford University Press, London: Humphrey Milford, 1935.

R.I.I.A. "Monetary Policy and the Depression", Oxford University Press, London: Humphrey Milford, 1933.

Warren, G.F. and Pearson, F. A. "Gold and Prices", New York, John Wiley and Sons, Inc., 1935.

Periodical Literature

Bryce, R. B. "A Note on Banking Policy and the Exchanges", The Review of Economic Studies, June 1937, pp. 240-243 and on p. 214.

Cassidy, Ralph, Jr., and Upgren, A. R. "International Trade and Devaluation of the Dollar", Quarterly Journal of Economics, May, 1936, pp. 415-435.

Choh-Ming Li, "The Effect of Depreciated Exchange upon Merchandise Movements", Quarterly Journal of Economics, May 1935, pp. 495-502.

Curtis, C.A. "Canada and the Gold Standard", Queens' Quarterly, Winter 1931, Vol. 38, No. 1, pp. 104-120.

Curtis, C.A. "The Canadian Monetary Situation", Journal of Political Economy, June 1932, pp. 314-337.

Gilbert, D.W. "Foreign Trade and Exchange Stabilization", American Economic Review, June 1936, pp. 272-279.

Hackett, W.T.G. "The Australian Recovery Plan (A Canadian Viewpoint)", The Canadian Chartered Accountant, January 1936, pp.18-38.

Harris, S.E. "British and American Exchange Policies - The American Experience", Quarterly Journal of Economics, August 1934, pp. 686-726.

Harris, S.E. "British and American Exchange Policies - The British Experience", Quarterley Journal of Economics, May 1934, pp. 471-510.

James, F.C. "The Cost of the New Deal", The Annals of the American Academy of Political and Social Science, Volume 176, November 1934, pp. 138-144.

Macdonald, C.S. "A Recovery Program for Canada", an address reported in the Financial Post, Toronto, January 28, 1939, p. 14.

MacGibbon, D.A. "Inflation and Inflationism", Canadian Journal of Economics and Political Science, August 1935, pp. 325-336.

Noble, S. R. "The Monetary Experience of Canada during the Depression", The Canadian Banker, April 1938, pp. 269-278.

Robinson, Joan. "Banking Policy and the Exchanges", The Review of Economic Studies, June 1936, pp.226-229.

Slichter, S.H. "Profits and Prosperity", Atlantic Monthly, November 1938, pp. 635-642.

Silverstein, N. L. "Effects of American Devaluation on Prices and Export Trade", American Economic Review, June 1937, pp.279-293.

Towers, G.F. "Foreign Exchange - Its Effect on the Pulp and Paper Industry", Pulp and Paper of Canada, Volume 33, No. 3, May 1932, pp. 111-112.

White, H.G.Jr. "Foreign Exchange Rates and Internal Prices under Inconvertible Paper Currencies", American Economic Review, June 1935, pp. 259-272.

Anonymous, "Little Johnny Head-in-Air", The Monetary Times, Volume 101, No. 23, Toronto, December 3, 1938, p. 3.

Anonymous, "Exchange and Political Unity", The Monetary Times, Volume 101, No. 23, Toronto, December 3, 1938, pp. 5, 6 and 25.

Government Publications

The Government of Alberta; "The Case of Alberta", a submission by the Government of Alberta to the Royal Commission on Dominion - Provincial Relations.

The Government of British Columbia; "British Columbia in the Canadian Confederation", a submission to the Royal Commission on Dominion - Provincial Relations.

The Government of the Dominion of Canada;
Canada Gazette
Canada Year Book
Debates of the House of Commons
Report of the Royal Commission on Banking and Currency in Canada, Ottawa, the King's Printer, 1933.
Statutes of Canada
Trade of Canada

The Government of Great Britain; "Report of the Committee on National Debt and Taxation", Command Paper #2800, 1927. Lord Colwyn, Chairman of the Committee.

The Government of Manitoba; "Manitoba's Case", a submission to the Royal Commission on Dominion - Provincial Relations.

The Government of Ontario; "Statement by the Government of Ontario to the Royal Commission on Dominion - Provincial Relations, April, 1938".

The Government of Saskatchewan; "A Submission by the Government of Saskatchewan to the Royal Commission on Dominion - Provincial Relations".

Miscellaneous

"The Annalist".

"The British Worker", an official strike-news bulletin published by the General Council of the Trades Union Congress; No. 8, Wednesday, May 12, 1926.

Bank of Canada, "Statistical Summary".

"The Economist".

Hansen, A. H. "A Submission upon behalf of the Manitoba Government before the Royal Commission on Dominion - Provincial Relations at Ottawa, November, 1938".

League of Nations, "Monthly Bulletin of Statistics".

Midland Bank, "Monthly Review", London, October - November, 1932.

United States Federal Reserve Bulletin.