IV. EFFECT OF MONETARY POLICIES IN CANADA

(*a*) Monetary Policy and the Price Level

(Submitted by Mr. Towers in reply to several Committee members)

(Volume 3, page 83)

At the last meeting—on March 24th—I was requested by several members of the Committee to prepare a statement on the inter-relations of monetary policy and the Canadian price level. The statement on this subject which I propose to make this morning will in part touch on matters with which I dealt during last week's meeting, and while I have not changed the tenor of my remarks on that occasion, I believe that they may be presented in somewhat clearer relation to the subject as a whole.

Part I—The Price Structure

Before discussing the inter-relations of monetary action and the price level, I would like first to speak briefly on the nature of the price structure itself, because in my opinion it is essential to a clear understanding of this subject that the fundamental inter-dependence of the price structure be kept constantly in mind.

The fact that prices are higher or lower than at some previous date is only significant of a change in economic position to the extent that it represents a change in balance within the price structure. Rapid changes in prices usually do represent a change in balance since costs are slower to adjust. Price movements over long periods, however, are usually accompanied by cost adjustments through renewals of fixed contracts and changes in productive efficiency. The conclusion follows that sharp changes in prices are bad by nature because they are disruptive, but that price movements over a period of years tend to be associated with broad adjustments throughout other phases of the economy, which may considerably lessen their net effect. It is essential when considering the effect of price changes over a considerable length of time to look beyond the mere fact of a change in price and ascertain the impact of the change on the net income of the individual, corporation, community or the country as a whole—which may be very different from the effect indicated by the change in price by itself.

Part II—Monetary Methods

The Committee has shown special interest in the effects which monetary policy may have on the level of prices with respect to the general level and the relationships between certain categories of prices. I now propose to discuss the two monetary methods which might be employed to effect an increase in prices—namely internal monetary expansion and exchange depreciation or a combination of the two.

Expansion of the volume of money in Canada *tends* to produce a rise in the level of prices by increasing the potential demand for goods and services. In general, however, an increase in the volume of money will increase the total amount of buying only if there has been previously an actual shortage of money. There may be important factors offsetting the effect of an increase in the volume of money, as the amount of spending is almost entirely a matter of individuals' decisions which are influenced by many other factors than the volume of money. I have omitted from consideration the type of price rise which follows the excessive issue of money when people through lack of confidence in the currency rush to convert their money holdings into goods—a situation which I am sure everyone will agree is thoroughly undesirable.