WHAT THE BANK OF ENGLAND DOES

Simple Explanation of Its Operations—Why It Seeks Gold

In a notable speech in England the other day Sir Edward Holden, Bart., analyzed in an interesting way the functions of the Bank of England and the indications of its weekly balance sheet. The statement is divided into two parts: (1) The issue department, and (2) the banking department.

Before the Bank Act of 1844, said Sir Edward, every bank could issue bank notes or currency and thus inflate prices. As a consequence gold flowed out from this country, and as the bank notes at that time had no gold held against them, they could not be paid, crises occurred, and a number of private banks failed. To prevent the recurrence of such a state of things Sir Robert Peel, in 1844, brought in his famous Bank Act, under which any bank established after that date was not allowed to issue notes, and this Act practically placed the privilege of issuing notes exclusively in the hands of the Bank of England. Since then the notes issued against securities have increased from £14,000,000 to their present amount of £18,450,000.

Drives Out Gold.

It is affirmed that the issuing of notes against securities drives out gold, and for the following reason: The amount of notes in the issue department, as you see, is now about £54,000,000. Experience has proved that for the purposes of our trade it is necessary to have a Bank of England note-issue of about this amount. Let us assume, that instead of the present system, the law obliged the bank to have gold coin or bullion, pound for pound, for every note issued; we then should have about £54,000,000 in gold in the issue department. If it were then desired to alter that system and issue £18,450,000 of notes against securities, then gold to that amount would be driven out of the issue department, and its place taken by the securities.

The bank at the present time is working under the latter system. The notes issued are covered partly by £18,450,000 worth of securities, consisting of (1) a debt of £11,000,000 due by the Government to the issue department of the Bank of England, and (2) of other securities amounting to £7,435,000. We do not know what kind of securities the latter consist of, but we assume they are written down to market value. The balance of the cover for the notes consists of gold. Thus, you see in this statement the gold held as part cover for the notes amounts to nearly £36,000,000. This is the national reserve of gold, but it is not the only gold, because, as I have already stated, the joint-stock banks hold a large amount.

Silently Gathering Gold.

The total amount of gold in the German State Bank and war chest is now about seventy millions sterling, and is being further increased. It behoves us to take up this question as seriously as Germany has done. It really falls to the duty of three groups to take action. First, the joint-stock banks; secondly, the Chancellor of the Exchequer, and, thirdly, the Bank of England. The joint-stock banks are working silently to the desired end by gradually accumulating gold, and I believe they would satisfy the country that they are doing their duty if they would carry out the suggestion to publish in their balance-sheets once a year the amount of gold which they hold. But they are not unanimous.

The First Lord of the Admiralty, year by year, increases his expenditure on ships. The Minister of War, year by year, increases his expenditure on the army, but no attempt is made by the Chancellor of the Exchequer to provide the gold necessary for operating these two arms of the service in case of emergency. If he would gradually pay off the Government debt of £11,000,000 in the issue department of the bank, then this amount, together with the increasing amount of gold held by the joint stock banks, and the average amount held by the Bank of England, would, in two or three years, aggregate about 100 millions sterling.

Inflow and Outflow of Gold.

For every ounce of bar gold of a certain fineness paid into the issue department of the Bank of England bank notes are issued to the owner of the gold at the rate of £3 17s. 9d. per ounce. The gold in the issue department consists (1) of sovereigns, (2) of foreign coins, and (3) of bar gold. When the bar gold is sent to the Mint for coinage into sovereigns, the Mint will give out for every ounce of gold three sovereigns and seventeen shillings and tenpence halfpenny; thus, leaving interest out of the question, there is a profit of three halfpence per ounce on the transaction.

When bar gold comes from South Africa, it passes through the hands of the assayers and the bullion dealers, and if anyone desires to purchase this gold, he has to pay at least one farthing per ounce more than the Bank of England pays. The Bank of England is understood to have a rule that it will not give more than £3 17s. 9d. per ounce, and as almost the whole of the South African gold has recently been sold to foreigners at £3 17s. 9¼d. per ounce, the Bank of England has received very little, and has consequently been obliged to put up its rate to 5 per cent., and may even have to go to 6 per cent. in order to protect the gold which it has, and in the hope of attracting more from abroad.

Any departure from the rule of not paying more than £3 17s. 9d. per ounce is deprecated, because it is alleged that the discount rate would fall to such an extent as to turn the exchanges against this country, and, consequently, more gold might be taken than had been purchased by giving a higher price. In theory, this might appear true, but in practice, at the present time it is very much open to doubt, and can only be proved to be universally true or otherwise by judiciously (I wish to emphasize the word "judiciously") making the experiment.

Coming now to the banking department of the Bank of England. The notes given out of the issue department in exchange for gold are placed to the credit of their owners in the "other deposits" on one side of the balance-sheet, and, as a contra-entry, they are included in the reserve on the other side of the balance-sheet. It is the rise or fall in the amount of this reserve which causes a rise or fall in the Bank of England rate.

If, therefore, gold is flowing out, the Bank of England raises its rate and the market rate follows it, and by this means we not only check the outflow of gold, but gold is attracted to this country.

Outflow from the Bank.

We have dealt with the case of an inflow of gold into the bank; we will now deal with the case of an outflow from the bank. If a firm desires to export gold, it may take it from the bullion dealers in bars, or by presenting cheques on the joint stock banks and taking payment in Bank of England notes or coin. These notes are presented to the issue department of the Bank of England, when gold, either in the form of sovereigns, foreign coin, or bars, may be taken in exchange. It may also be taken by means of a cheque drawn on the banking department. This cheque would go to the debit of the "other deposits," and notes would be taken out of the reserve, which would thereby be diminished and a rise in the bank rate rendered possible. The notes would then, as before, be presented at the issue department and exchanged for gold.

Gold Exporting Point.

Both bankers and traders here are interested in the exchange when it reaches gold exporting point, because they know that the reserve in the banking department as well as the gold in the issue department will both be reduced, which would result in a rise in the bank rate. As the bank rate governs the rate for overdrafts and loans both in London and the country, borrowers would have to pay a higher rate to lenders, and, in addition, the discount rate rising places a heavier charge on the manufacturer and merchant, thus reducing their profits.

Those who wish to go deeper into this subject will find there is standard gold and fine gold—that is, pure gold.

Standard gold consists of eleven parts of pure gold out of twelve and one part alloy. It is, therefore, said to be eleven-twelfths fine, and when exporters buy gold, it is on the basis of standard gold, the minimum price of which is £3 17s. 9d. per ounce, because the Bank of England is compelled to give that price.

If you invested a sum of money in standard gold which you shipped to New York, the New York Treasury would assay it and buy it as fine gold, giving in exchange 20.6718325 dols. per ounce.

But we all know you would have to pay charges for its conveyance to America. These charges would be for freight, insurance, commissions, cost of packing and interest. You would first debit your gold account with the amount paid for the gold, and, secondly, with the amount paid for the charges. Having received from the Treasury the amount in dollars for the gold, you would buy therewith sterling exchange on London, and you would credit your gold account with the proceeds of that exchange when it arrives in London. The balance of your gold account would, therefore, be the profit or the loss. The lower the rate of exchange you pay for your sterling the larger will be your profit or the smaller will be your loss.

The sterling exchange may be bought either before, during, or after the shipment, the precise time being dependent on the rate of exchange.

INSURANCE COMPANIES

The following insurance companies have been registered to do business in Alberta:—

Employers' Liability, the Prudential of America, Northwestern National of Milwaukee, German American of New York, Metropolitan Life of New York, Mutual Life of Canada, National Life of Canada, Commercial Union.