This kind of partial response, with a lag, is the kind of thing that one counts on, and allows for, and is quite tolerable in ordinary circumstances. But there come situations in which it would be desirable, for instance, to exert restraint over bank lending more quickly than would be possible by relying solely on the cash reserve management technique that I described first.

It might be desirable, also, to minimize the effect on market rates of interest which would result if the Bank of Canada were applying a serious cash squeeze and the chartered banks were having to sell securities in large volume in order to avoid changing their loan policy, which probably would be operating in the face of a very strong loan demand under those conditions.

Under the existing legislation, the Bank of Canada could try to deal with a very unusual condition of this kind, by invoking its power to increase the minimum cash reserve ratio from 8 per cent to some higher per cent.

This would force the banks to sell some of their liquid assets, to convert them into cash. In effect, it would impound chartered banks' liquidity, and this would tend to have the more restraining effect, with less increase in interest rates than if we relied on the normal cash management technique. But it would have the incidental effect of reducing chartered banks' earnings quite substantially; they would have to convert an earning asset into something that had no earning attached to it at all, in other words, deposits with us or notes in their tills.

The CHAIRMAN: If the bank had less money as the result of that, or less ability to make loans as the result of such a policy, would not that have the effect of increasing interest rates?

Mr. BEATTIE: Yes, but if this technique were applied, you would not have as much repercussion in the bond market from banks having to sell securities in large volume in order to make loans. This would be a way of short-circuiting the attrition process which normally would be involved in trying to gain the objective through the traditional cash management techniques.

The change that is proposed in this bill is to replace our present power to vary the cash reserve ratio with a power to impose and vary a secondary reserve ratio requirement, that is, a requirement to hold treasury bills and day loans to money market dealers in certain amounts.

This would provide an alternative means of impounding chartered bank liquidity but would enable them to earn some moderate rate of return on the liquidity that was so impounded.

It would have very nearly the same impact on their lending policies but not so harsh an impact on their earnings.

The CHAIRMAN: It would slow up the economy.

Mr. BEATTIE: I will not say it would necessarily slow up the economy. It might taper down the rate of increase. That is nearly always the question, because certainly in relation to the money supply the normal thing to expect is some rate of increase. The only question is, "How large a rate of increase?" And when so-called restrictive policies are being applied, their objective normally is just to reduce the rate of increase to a more sustainable level.

The CHAIRMAN: That may have the effect of transferring more into the street.

Mr. BEATTIE: It may. That is the way the market operates.

Senator MCDONALD: It may have the effect of what?

The CHAIRMAN: It may have the effect of getting more of that business which is looking for money to go to the street, if they cannot get it at the bank.

Senator THORVALDSON: Mr. Chairman, I notice that in some explanatory notes in the bill this is referred to as a new method of dealing with reserves—that is, by establishment of these secondary reserves. I was wondering if you are