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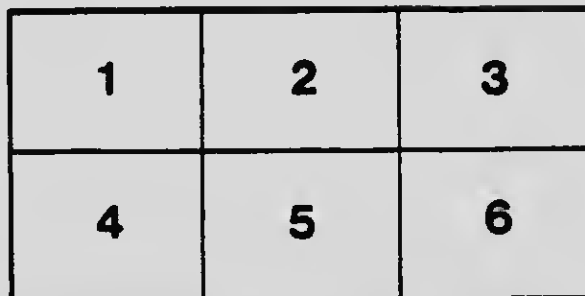
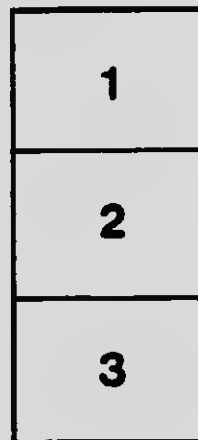
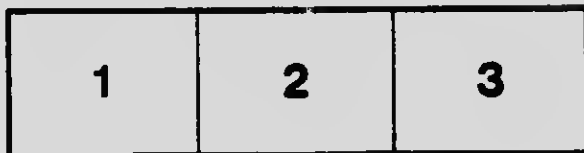
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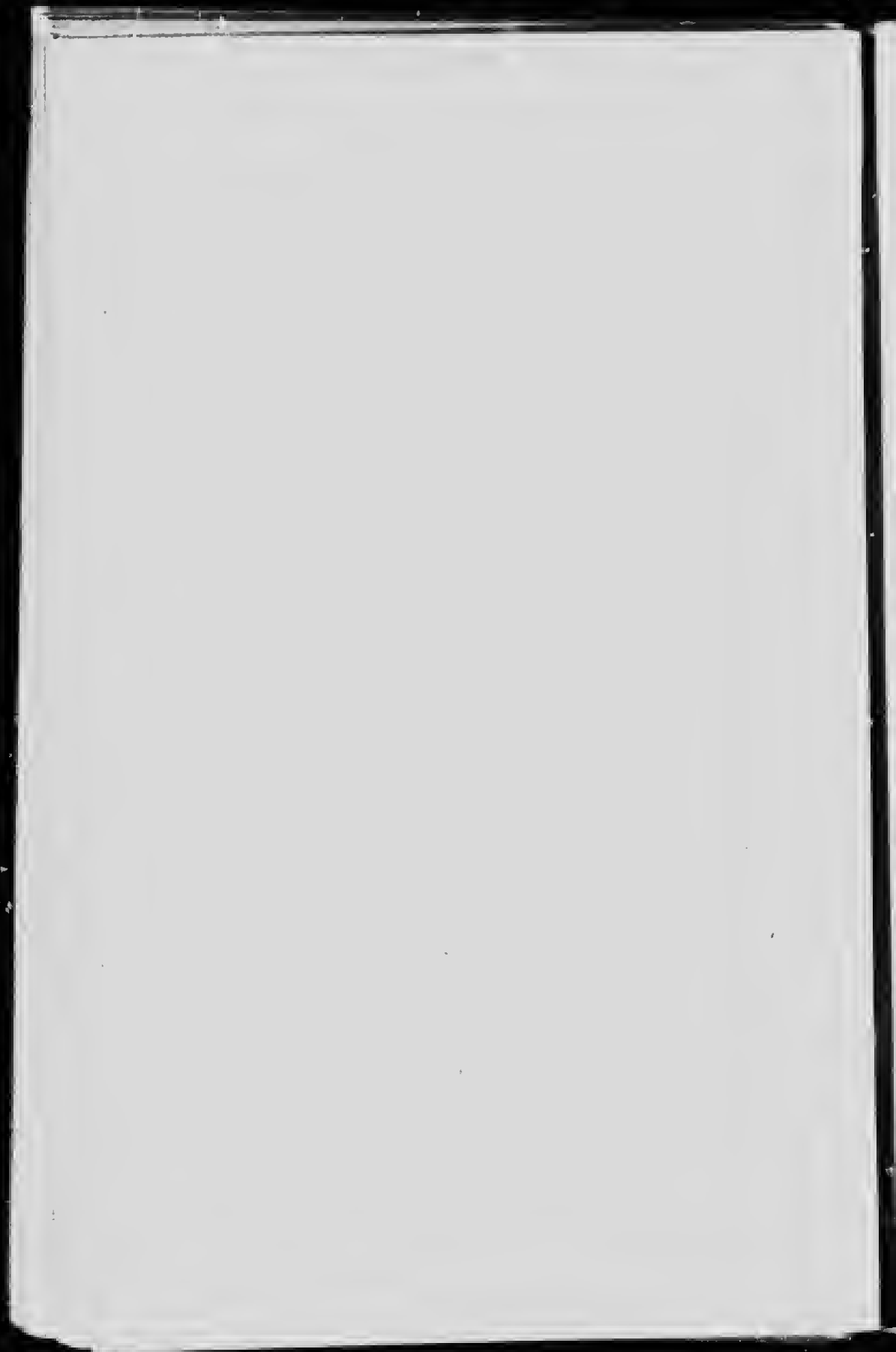
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Queen's University

Course in Banking

LESSONS IX-XII

Money and Banking

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LESSON IX—*Continued.*

Bimetallism in France.

The Bank, while increasing the total of its specie, has given special attention to its quality. The single gold standard has now been adopted in most countries. England was the first to teach the value of gold and to declare that this metal alone was fit to form the basis of a sound monetary system. Germany made use of the 5,000,000,000 franc indemnity to go on a gold basis in 1870; and a law of March 14, 1900 established it in United States. From the standpoint of international relations, therefore, gold is the only metal that can be exported. But France is legally a bimetallic country, although practically it is on a gold basis for the coining of the legal tender five-franc silver piece was definitely suspended in 1878. The Bank has disposed of as much of this silver money as possible, and endeavored to replace it with gold. Hitherto the colonies have provided a market for this silver coin. In many of them, especially in regions remote from the coast, the custom of barter still exists. Only within the last decade or so have the natives in some of the colonies—and especially on the Congo—been willing to receive silver five-franc pieces in lieu of bags of salt or rice for their ivory, rubber and other produce. Yet there is a growing market in such primitive places for the silver of France. In this connection it may be interesting to note that in countries where commercial enterprise is least developed silver is taken in preference to gold; then, as economic knowledge increases, gold gives way to bank notes and bank notes to cheques.

The Bank of France is obliged to accept five franc silver pieces as a legal payment of an obligation; but it is not required to give gold in exchange for silver. While for ordinary sums there is usually no difficulty in obtaining gold from the Bank, a slight premium may be charged on gold wanted for exportation. But this charge has not exceeded one-tenth of 1 per cent., and is often very much less. Gold may be had, in case of real need, on payment of this slight premium. It is by such methods as these that the gold reserves of the Bank have been favored, and yet any real discrimination against silver is practically avoided.

The Discount Rate.

The utility of a low discount rate for the commercial welfare of a nation is well known. It is equally well known that

the rate tends to fall when the cash holdings are increased. This is the case in France; and as a consequence of its strong gold reserves it enjoys a moderate rate of discount. Some great nations—England, Germany and the United States—have had a greater economic expansion than has France. Nevertheless, they pay higher rates for money than do the people of the latter nation. France is a land of cheap money; and any strong impulse toward commercial and economic expansion may in the future produce as great effects as those found in the other countries mentioned. In any event, France shows astonishing strength from a monetary point of view.

The great French economist, Courcelle-Seneuil, has said: "There is something more important for a country than the figure of the discount rate, and that is the uniformity of this rate in space and in time. While it is not possible to reach absolutely fixed and uniform rates of discount and credit conditions, the nearer they are approached the nearer we are to perfection." A discount rate subject to constant change would cause, at each variation, the gravest disturbance in commercial relations. On the other hand, a stable rate allows one to forecast future conditions in business better, and is highly advantageous to serious men of business. Yet it should be remembered that countries lying outside the great international currents are as if in stagnant water, and they are able to preserve longer the same discount rates.

The Bank of France proclaims what is known as the "official" rate of discount. But besides this rate there is another called the outside market rate, which is, perhaps, in greater use than the former. In other countries—as for example, in Germany and England—the officially published rate is in reality a maximum. The joint stock banks may, and often do, discount commercial paper at less than the official rate of the Bank of England; and the latter institution often discounts for private customers at less than the official rate. And the great French banks of deposit—the Credit Lyonnais, the Comptoir National d'Escompte de Paris, and the Société Générale—owing to the fact that they can rediscount their paper at the Bank of France and thus replenish their reserves, are in a position very often to discount prime bills at a rate lower than that of the Bank of France. If it happens that these banks charge a higher rate than the official rate of the Bank of France it is because of the extra risk involved in the loan. In comparing discount rates in England and France, too, one should remember that the exceptionally low rates offered by the joint stock banks of England are made to prosperous firms, and do not affect the average rate. In the open market money is, as a rule, cheaper in France than anywhere else in the world.

Regents, Censors and Stockholders.

The capital of the Bank of France amounts to 182,500,000 francs and is privately owned. As has been said the governor and the two sub-governors are named by a decree of the President upon the proposal of the Minister of Finance. Their terms of service are not for any fixed period.

The general management, in a sense, is in the hands of a council of fifteen regents and three censors. Five regents and three censors must be chosen from among the commercial and industrial classes, and three regents must be taken from the "general paying treasurers." The regents meet usually once a week and decide upon changes in the rate of discount. The shareholders elect the regents and the censors through whom they exercise their right of control over all the management of the bank. It should be noted, however, that only the 200 largest shareholders are allowed to vote for the general council of the Bank—that is, for the regents and censors.

The Rest or Surplus of the Bank of France.

The "rest" or "surplus" of the Bank is known as "reserves." These reserves are of four kinds and comprise:

- (1) Surplus or profit accruing from raising the rate of discount above a certain fixed rate and which, according to the terms of the law, cannot be distributed.
- (2) The surplus coming from different sources and notably from profits accumulated before 1834; from the surplus of departmental banks absorbed in 1848; and from the premium on the new shares issued at the time of the doubling of the capital in 1857; and from various other sources.
- (3) Real estate surplus, representing in the books the value of the central bank building.
- (4) The special surplus constituted in order to insure the relative stability of dividends.

These measures place the Bank in a relatively strong position to meet any emergency that may arise.

Loans upon Collateral.

The Bank usually charges more for loans upon collateral than for discounting bills. The rates are around 3 and 4 per cent. respectively. This rate is made uniform throughout the whole of France. If the bank thought it advisable to apply different rates it could easily become master of the market. But in its position as Bank of France, organized to serve the interests of the public credit in a democratic country, it does not consider itself justified in conducting such a policy.

Securities which may be admitted as collateral are limited by the laws and decrees which govern the Bank and include collateral of easy conversion into cash. These securities are such as are guaranteed by the State, the departments, municipalities or French colonies.

The Bank discounts for everyone who has obtained the opening of a current account, bills of exchange, cheques, and commercial and agricultural paper which has not more than three months to run, and which bears the signature of three persons, tradesmen, agricultural syndicates or others, known to be solvent. It should be said, however, that the Bank is authorized to accept paper bearing only two signatures when the third signature is replaced by a deposit of securities of the kind mentioned above, or by warehouse receipts. In other words, a client having satisfactory collateral may discount commercial paper which has one other name to it in addition to his own.

Payments of Bank to the Government.

The Bank pays to the government all the taxes to which other companies are liable; that is, taxes on real estate, on dividends, a stamp tax on shares, and a tax on the interest on loans granted to companies. Besides these general taxes the Bank pays a stamp tax on its notes, and also a royalty calculated by multiplying the "productive" circulation by one-eighth of the average rate of discount. The productive circulation is not, as might be supposed, the same thing as the notes issued in excess of specie held. The productive circulation is the average amount of the discount and loans; that is to say, the profitable extension of its credit in the ordinary operations of banking. All these payments made by the Bank to the State amount to a large sum—about one-third of the profits distributed.

Conclusion.

The notes of the Bank of France are asset currency; that is to say, no specific property is pledged for their redemption in the shape of securities or gold. The notes are simply based upon the general property of the Bank, although a very large gold reserve is held. There is no legal obligation resting upon the Bank, however, to hold any definite hard money reserve. The limit of note issue has been changed by law on many occasions; being fixed in 1907 at 5,800,000,000 francs; but a glance at the figures given in the statement above will show that this limit has been raised again.

France locks up in its Bank a proportionately larger amount of specie than any other country, but this policy is not

without its compensations. Should the French people reduce by one-half its monetary reserve it would gain the interest on more than \$400,000,000 that is now lying idle. But they would lose the advantage of the reduced rates of discount which the extent and character of the reserves permit them to obtain. They would lose also the feeling of absolute security, of complete financial independence, which they now have. In a word, the system suits France, it has worked well and achieved brilliant results. At first glance, to the Anglo-Saxon, it appears to be a costly mechanism; but final results prove the cost well worth while.

II. *The Imperial Bank of Germany.*

The Imperial Bank of Germany, or, to use its German name, the Reichsbank, is a privately owned institution; the government owns no shares. Yet it occupies much the same position in German finance as the Bank of France and the Bank of England do in the financial organization of their respective countries.

The Reichsbank is organized and managed as follows: There are three boards of management: the Curatorium, the Direktorium and the Central Ausschuss. These may be described in turn.

I. The Curatorium is composed of five members. The chairman is the chancellor of the Empire, the one who holds the highest political office in the State. The Emperor appoints the second member, and it has been his custom to appoint the Prussian Minister of State. The Bundesrath (the German political body that represents the several States) appoints from among their own number three members who complete the board. It is not the law, but it is the custom, that upon the expiration of the term of a member of the Bundesrath who is a member of the Curatorium, or upon his resignation, his connection with the Curatorium also ceases. The board meets once in three months. It is not the custom of the chancellor to preside at this meeting, and the Emperor appoints a representative for him, usually in the person of the Minister of the Interior.

In the Chancellor lies supreme power, although he has exercised it but once in the history of the Bank. On that occasion he demanded that the Bank should not receive Russian securities as collateral for loans. The order was later revoked.

II. The members of the Direktorium (president and directors) are appointed by Emperor for life. It consists of 9 members, 7 of whom are directors, and 2 of whom are the President and Vice-President respectively. The President and the other members of the Direktorium are recommended by the Bundesrath to the Emperor, who makes the appointment. In

the case of directors the advice of the Central Ausschuss is heard.

III. The third body, the Central Ausschuss, is composed of fifteen stockholders, who are elected at the annual meeting, together with fifteen alternates, who serve in the absence of any members of the board. This body meets once a month. From among their number they appoint a sub-committee, known as deputies of the Central Ausschuss, consisting of three members and three alternates. The deputies meet weekly with the president and directors. The Central Ausschuss are made familiar with the transactions carried on by the Bank and give their advice and recommendations to the Direktorium in reference thereto. In practice their advice is carefully considered and taken. In two points they are given actual power: (1) They have the authority to limit the amount of securities which may be purchased by the Bank—not as to the character, but as to the amount. (2) They have the power to veto any proposed transactions with the Empire, or any State of the Empire, if such transactions run counter to the general conditions of business. The point of this is that the Chancellor might request of the Bank loans for the Empire, or for the States of the Empire, for the purpose of carrying into effect certain plans, and the Central Ausschuss has the power of vetoing any such action.

The management is so constituted that the government has actual and final control through the Curatorium. The business of the Bank is transacted by the second body, the Direktorium. In the fixing of the bank rate it is their custom to call a special meeting, if need be, of the Central Ausschuss, who always confer in regard to the advisability of a change in the bank rate. The final word, however, is said by the directors, who usually follow the advice of the Central Ausschuss, but who have at times disregarded it.

Branches of the Bank.

The Reichsbank has many branches and agencies located throughout the Empire. The officers and directors of these branches receive a fixed salary. In addition they share in the profits, although they are not paid in money. The amount is invested for their account in government securities; from these they receive the interest on the capital. Only on retirement do they receive the capital amount. This scheme has been put into operation by royal instruction and is not required by law. These officials, who share in the profits, are personally liable for any loss that may occur if it is proved that they have not followed instructions, not complied with the rules, or have made inexcusable mistakes. In other words, as they have the

responsibility of the head branches and the subordinate branches they are entitled to some consideration in addition to the ordinary salaries.

The Reichsbank and Discounts.

The law prescribes exactly the kinds of bills that may be admitted to discount. They must not exceed three months in time and must be backed up by the names of at least two persons known to be solvent. In many cases the bills are unsecured by collateral. The Bank, for example, will discount a bill drawn by one merchant and accepted by another. In other words, the Reichsbank is not only a bank for banks, where paper may be rediscounted, but for commercial and industrial enterprises of the Empire.

The private banks of Germany finance, in the main, industrial enterprises. For example, if a railroad wished to get money to make improvements it would be financed by a private bank, although it could also borrow at the Reichsbank by depositing satisfactory collateral. Yet the promotion and financing of the majority of the industrial enterprises of Germany are carried on by the great private banks. The Reichsbank discounts by far the greater amount of its bills for bankers; although it also carries on a considerable business with merchants, industrial societies, co-operative societies, farmers and others. People who hand in bills for discount are required to keep a satisfactory balance with the Bank.

The rate that the Reichsbank charges for discount—a rate which applies to all—ranges around 4 per cent. Very often the private rate among the other banks is $2\frac{1}{2}$ per cent. to 3 per cent. The question then arises: Why should anybody pay the Reichsbank 4 per cent. when he can borrow at other banks at a lower rate? The answer is, that not all bills would be accepted at the private rate of discount. Only "prime" bills command the private discount rate; that is, bills which are as a rule for 5,000 marks or more (\$1,000), and which mature in ninety days or less.

As has been said, the Reichsbank has now but one rate of discount for everybody, a policy that has obtained since 1896. There was a time when the Bank carried on a policy similar to that of the Bank of England; that is, it would purchase in the market prime bills at a more favorable rate than its official discount rate. The most important reason for the change made in its policy was that it was thought a great central institution like the Reichsbank ought not to make a distinction in favor of any class. It is now the policy of the Bank to serve all alike. The change was not made because of the complaints of other banks, for its lowest rate was always higher than that of the other financial institutions.

Loans on Collateral.

The collateral on which the Reichsbank is permitted to make loans is as follows:—

1. Gold and silver coin and bullion.
2. Government and municipal issues, and the shares, debentures and bonds of railroads of nearly every kind within the Empire. It does not lend capital on real estate mortgages.
3. Securities of foreign governments, also railroad securities in foreign countries with the guarantee of their respective governments.
4. Bills receivable that are of a character satisfactory for the bank to discount.
5. Bonds of mortgage companies which may be secured by mortgages, real estate, manufacturing plants, etc., the obligation being that of the company, with the bonds as collateral.
6. Merchandise when located within the Empire. Germany does not have the system of warehouse receipts. The merchandise is placed under the lock of a third party, or it is placed in the possession of one of the branches of the Bank.

Interest on Deposits.

The Bank does not pay interest on money deposited with it. It receives large sums of money, however, for deposit from the other banks, who keep balance with it. It is the custom, in fact, for all large financial organizations to keep money on deposit at the Bank. The transfer of funds from point to point in the Empire for banks and for private individuals is an important part of its business. For that, as well as other reasons, the private banks and agricultural associations, etc., keep large deposits with the Reichsbank. It is the custom, too, for banks in Berlin and other important centres to carry balances at the Reichsbank as part of their reserves.

A charge is made for transferring funds for those who have no account at the Bank. It costs 1 mark (25c.) to transfer 10,000 marks; 0.40 mark to transfer 4,000 marks, and so on. Transfers between depositors with satisfactory accounts are made free of charge.

Relation between Reichsbank and Private Banks.

As far as the Bank comes into competition with the great private banks the latter have the advantage. The Reichsbank operates under greater legal restrictions. The rate of discount at a private bank is, as a rule, much less than at the Reichsbank. Moreover, the private banker knows his clients, and he may be willing to accept from them a bill that the Reichsbank would not and could not accept. There is competition,

it is true, but that competition is not intense. It is not felt that the Reichsbank is a competitor of the other banks; it is regarded as a public institution.

Division of Profits.

The law with respect to the division of profits is as follows: Shareholders receive $3\frac{1}{2}$ per cent. in dividends, and one-fourth of the excess profits, while the imperial government receives the other three-fourths. The government, therefore, obtains the lion's share of the earnings of the Bank, the average in recent years being twice as much as has gone to the shareholders.

The Note Issues of the Reichsbank.

The system of note issue of the Reichsbank is somewhat complicated. The notes are divided—as are those of the Bank of England—into two classes: (a) notes backed up by specie which may be issued to any amount; (b) notes limited by law which are based on no special pledge of property—"uncovered" notes as they are called. It should be observed, however, that the "uncovered" issue of the Bank of England—that is to say, the notes not based on gold—are backed up by the pledge of definite securities, while the uncovered issues of the Reichsbank are based on the general assets of the Bank alone. Should the total issue of the Reichsbank exceed the "uncovered" amount permitted and the specie, government notes, etc., held, the excess amount must pay a tax of 5 per cent. until such is retired. A somewhat similar plan is in operation in Canada, when from September 1 until the end of the following February the banks may issue an excess amount of notes equal to 15 per cent. of the paid up capital and reserve, upon which a tax of 5 per cent. is also levied. All of this may, perhaps, be more definitely explained as follows:

Notes issued in excess of the following items are taxed 5 per cent. until they are retired: First, the amount of gold bullion and specie—gold, silver, copper and nickel—held by the Bank; second, the amount of the government notes so held; third, the amount of the uncovered notes authorized by law, 550,000,000 marks (the Kontingent, as it is called); fourth, the amount of notes of other banks held by the Reichsbank.

The amount of the uncovered issue, the Kontingent, is an arbitrary one. When the Bank was established in 1875 it was enacted that no new banks established after that date should have the right of note issue. As the banks having the right of issue at that period have surrendered their rights, the Reichsbank's uncovered note issue has been increased. The "Kontingent" was fixed in 1876 at 250,000,000 marks; but, as

other banks gave up the right to issue and as the population and trade of the Empire have grown, the uncovered issue has been increased also.

In conclusion it may be said that there are no restrictions on the amount of notes that may be issued, so long as the specie holdings of the Bank are increased. The definite limitation placed upon the note issues is as follows: The notes issued must not be greater than three times the amount of gold in coin and gold bullion, silver, copper, and nickel, and government notes held by the Bank; and furthermore, all notes issued in excess of the bullion and money coins described must be covered by short-term commercial bills. There is no restriction as to the percentage of silver that the Bank may hold; but the coinage act provides that the silver coins shall be limited by the growth of population—that is to say, to 20 marks per capita of population.

In Germany the comparatively slight development of the cheque system has left the burden of increased demand to fall almost exclusively on the note currency. The result is that there is a marked fluctuation in the supply, at certain periods, of that medium of exchange. In the United Kingdom, on the contrary, the extreme elasticity of the deposit currency has permitted the heaviest demands to be met without the use of notes. This explains the reason why Germany permits the issue of unprotected notes, subject to a special tax of five per cent. until they are retired. The tax drives them out of circulation when the occasion for their use has passed away.

Financial Statement of the Reichsbank, Nov. 18, 1914.

(\$1.00=419.79 marks).

	Marks.
Total coin and bullion*	1,956,687,000
Of which gold	1,915,970,000
Bills discounted	2,769,714,000
Loans	30,973,000
Securities	257,566,000
Circulation	4,060,009,000
Deposits	1,347,007,000

*Including treasury notes and notes of other banks.

Questions for Review.

I. *On Text.*

1. Why has not deposit currency been as highly developed in France as in England and the United States?

2. In what sense may it be said that the notes of the Bank of France are "asset currency"?
3. Describe the organization of the branch banks of the Bank of France.
4. In what particulars was the Imperial Bank of Germany modeled on the Bank of England?
5. Where is the chief market for securities in the United States? Where is the working capital of the dealers in securities obtained?
6. Describe the conditions under which call loans are made.
7. What is meant by "undigested securities"?
8. What are the functions of the United States Treasury?
9. What is the relation between the banks and the Treasury?

II. *On Lesson.*

10. Why and when was the Bank of France founded?
11. Has the monopoly of note circulation granted to the Bank of France restricted banking in France?
12. What advantages do the French people get because of the large reserves of the Bank of France?
13. What functions does the Bank of France perform for the private joint stock banks as a bank of discount?
14. How did the Bank of France aid the government and the people during the war of 1870?
15. What money is a legal tender in France? Why does the Bank hold so large a part of its reserves in gold?
16. Why is no legal reserve required of the Bank with respect to its demand liabilities, either notes or deposits?
17. What are the relations between the Bank of France and the government?
18. Who appoints the regents and the censors of the Bank? Is the Bank controlled in its policy by the stockholders?
19. Is the Reichsbank a private or public institution? To what extent is it controlled by outside authority?
20. What is the policy of the Reichsbank with regard to its rate of discount?
21. What is the relation of the Reichsbank to the private banks?
22. What functions do the branches of the Reichsbank perform?
23. What collateral may the Reichsbank receive on which to extend loans?

25. Does the Reichsbank grant interest on deposits? Compare the Canadian system and explain difference.

26. Why does the Reichsbank divide its profits with the government? Is there any reason for introducing a similar scheme into Canada?

Questions for Written Answer.

27. Compare the methods of note issue in France and Germany. Which system, in your opinion, should give the best results?

28. Why is there a difference between the "official" and the "private" rates of discount in France and Germany? What are the arguments in behalf of a uniform discount rate?

29. What are the arguments against establishing a central bank in Canada, similar to the Reichsbank or the Bank of France?

30. Bring up any difficulties.

LESSON X.

The Nature and Functions of Money.

Read: *Money and Banking*, Chapters 2-6; Chapter 10.

It is not necessary to consider the question of money and its functions from the historical point of view, as sufficient attention is given in the text book to the evolution of money. Rather an attempt should be made to get clear-cut and definite ideas of the nature and meaning of money and its functions.

Value and Price.

Before proceeding to an examination of money it is advisable to state the primary elements of value and price. If a commodity has qualities which satisfy some need, if it requires effort and sacrifice to obtain it, and if it is transferable, we are ready to give for it other things which we prize, and we say such a thing has value. Value in this sense is not intrinsic in anything, because it can be expressed only in comparison with something else. The exchange value of one thing is stated in the ratio of the number of units of it to the number of units of other things which are exchanged for the given commodity. It should be kept in mind that we can approach the question of exchange value without being drawn into the discussion of what determines value. When we attempt to compare exchange values we do not need to know the cause of value.

If exchange value is the particular phenomenon we are concerned with in the study of money, the definition of what it is is important. If exchange value is purchasing power, how can we express it? The exchange value of A is quantitatively expressed in the amount of certain other goods for which it will exchange. We measure the exchange value of A by finding out the quantity of things it will buy. It may be said, therefore, that value is the ratio of exchange between one good and any another good, quantitatively expressed.

For practical purposes we get fairly accurate ideas of the exchange value of a particular commodity by comparing it with the quantity of a given precious metal, either gold or silver. The quantity of the money material for which an article will exchange is its Price. This, of course, is also a relation. For example, if the price of A is \$5 or £1, that is only a way of saying that A will exchange for the number of grains of pure gold in five Canadian dollars (116.10, or 5 x 23.22 grains Troy), or in an English pound sterling (113.0016 grains

Troy). Now it is obvious that any change in the relation between goods and gold must change the price ratios; hence, in examining the causes that have brought about the price changes we must consider the forces acting upon goods as well as upon gold. Price may be defined as the ratio of exchange between any good whatsoever and one particular good, namely, gold. In one sense, therefore, we cannot correctly speak of the "price" of gold, as in so doing we are merely comparing gold with gold. And yet financial journals quote the price of gold from time to time, and in a certain sense correctly. For example, raw gold in the Yukon has a price placed upon it. To make it available as coin or for commercial purposes it must be refined, assayed and transported to the proper centre. Hence, its price will fluctuate with the cost of transportation, insurance and so forth. Gold may also go to a premium during a time of panic or at the outbreak of war. Thus, immediately before the outbreak of war in August, 1914, France, Russia and Germany were feverishly importing gold, for which they were willing to pay more than its par value in their own money. They used bills of exchange and balances abroad, built up through the sale of commodities, to secure the yellow metal, for gold forms the foundation of the credit of modern nations. Keeping the facts in mind it is seen that one can legitimately speak of the price of gold.

Selection of Standard Money.

Investigation of the evolution of money will show that there has never been one standard money, immutable and universal, for all periods and all places. On the contrary, there have been standards as various as the climate, geographical position, and stage of civilization of different peoples. In arctic regions the people naturally find in skins the satisfaction of their chief need, and therefore skins have remained the unit of value to them. In the Hudson's Bay district to this day articles are valued in skins. Coon, rabbit and squirrel skins are yet freely used by the mountaineers of Kentucky as currency. In the tropics, shells are the form which the medium of exchange assumes. In a word it may be said that when in a certain community one particular kind of commodity is of general use and generally available, it comes to form the standard money in which all values are expressed.

The modern civilized world has sifted from among the different articles that have been used as money in the past the commodity that most nearly approaches the ideal—namely, gold. The United Kingdom, the United States, the British colonies, India, Germany and France are on a gold basis. The latter nation has not definitely and by law rejected the other

metals; but practically France has today the gold standard, as silver is no longer freely coined. Yet both gold and silver are a full legal tender in France. In all the countries mentioned, however, gold is the only precious metal freely coined as a monetary medium. In Canada silver is a legal tender for only \$10, and copper up to 25 cents.

The experience of the people, and not mere legislative acts, have led to the choice of gold as the standard of value. It has gradually displaced silver, because the latter metal is subject to too great fluctuation in its value.

The question of the standard is not a matter of merely academic interest. From time to time there are attempts to change the standard—to substitute for gold either silver or a paper currency that is not as good as gold. It should be remembered that the experience of the race has proved that gold is the best standard to meet a nation's needs; and that it was not selected by simple government action. A sound currency, perhaps above every other consideration, is essential to safeguard not only a country's domestic economic interests but its position in the international world of commerce and finance.

Definition of Money.

Money may be defined as that commodity which functions as a medium of exchange, as a standard of value, and as a standard of deferred payments. Unless a money commodity functions in all three ways it is not a perfect money. Copper and silver coins, for example, act as a medium of exchange, but not as a standard of value; hence they are not complete money.

With the growth of credit the use of money as a medium of exchange is becoming less important. Money is used by the poorer classes and mostly in the retail trade. Probably ninety per cent. of the wholesale and manufacturing business of Canada is carried on by means of cheques drawn against deposits. Thus the functions of the banks in effecting exchanges is becoming increasingly important. That this is the case will be seen from a glance at the following figures which show the huge deposits in Canadian banks against which cheques can be drawn:

Deposits in Canadian Banks, October, 1914.

Deposits payable on demand in Canada	\$348,782,830
Deposits payable after notice	659,806,682
Deposits elsewhere than in Canada	90,868,894
Balances due Dominion Government	21,849,662
Balances due Provincial Government	22,948,156

Meaning of Credit.

At this point it will be necessary to review briefly the nature and meaning of credit.

Bank credit arises through a loan that is made by a bank to a borrower in the shape of notes or as a deposit account. The borrower usually pledges property of some kind as a basis of the loan. He may give his note, but at some time that note must be paid. In the ordinary course of business the obligation is discharged by the sale of goods of one kind or another. Thus, credit may be defined as "the coming of future goods into a present means of payment."

If loans are granted—as they often are—to a borrower who is not engaged in production, but in mere speculation, there is bound to be a reaction at some time, when an emergency compels the banks to enforce payments when they are due. If the loans have been granted for productive purposes no serious harm can result; if not, securities and property of all kinds must be sacrificed to make the debt good. Here we have one of the chief causes of panics and crises. But this problem will be discussed in a later Lesson.

The Money Standard.

The Canadian gold dollar is based on the United States unit—23.22 grains of pure gold, or 25.8 grains nine-tenths fine. Both American and British gold coins are a full legal tender in Canada. It may be noted in passing that the British coins are eleven-twelfths fine. At present only five and ten dollar gold pieces are coined in Canada.

It is not necessary to discuss the exchange function of money further. What has been said already should make this feature of the money mechanism perfectly clear. But there are difficult and intricate practical problems connected with the standard function of gold that will need more extended discussion than has been given.

Gold the Standard of Value.

As has been explained, one of the necessary characteristics of a perfect monetary medium is that it should possess stability of value. This is essential in order that there shall be no wide fluctuation in price, over short periods of time, with consequent demoralization of the markets. When contracts are entered into which entail longer periods of time it is absolutely essential that the monetary standard shall remain stable in order that justice may be done between debtor and creditor. Now, gold has been chosen as most nearly meeting these ideal conditions. It has been chosen out of the experience of the race not because a group of legislators met and said: "Go to

now, let us create a gold standard." The conception that any government or any legislature can pass legislation that will force upon the world of business practices that have not been tested by the fire of experience must be abandoned. On more than one occasion governments have naively attempted to create by law various types of legal tender that were not based upon the experience of the people, but all such attempts have proved futile.

We have at present a gold dollar of constant weight, but of varying purchasing power. The great rise of price during the past decade has made that fact familiar to all. What we need is a dollar of constant purchasing power and of constant weight. That, however, is an ideal requirement, whose conditions can hardly be met.

Difficulties of the Problem.

When it is recalled that price is merely the exchange relation between gold and any other commodity whatsoever, the difficulties involved in securing a stable standard of value are already understood. It is evident that anything that affects either the demand for or the supply of gold, will affect the relation of goods and gold, and hence will affect prices. It is thus perfectly evident that there is no possibility of ever attaining stable prices. At the same time, it is essential that the nations should select a monetary medium that experience has shown to have best met the conditions of an ideal standard.

The Correction of Price Changes.

Historical attempts to correct price changes may be grouped into four classes.

First are the well-known instances of efforts of the authorities in almost every country to fix the price of staple products. But, although every effort has been made to fix prices both in time of peace and in the time of war, these attempts have failed. This policy has therefore been abandoned; although in war crises the authorities yet endeavor to maintain prices at a fixed level by legal promulgations.

The second method to which resort has been had for preventing losses due to price changes has been the selection of some ideal standard, such as a labor unit. But these attempts are important for theoretical and not for practical purposes, as no such standard has ever been put into practical use, indeed, it were possible to do so.

The third class of proposals includes those which would change the money supply of a country by coining two metals such as gold and silver and giving each the quality of legal tender—that is, the power of legally discharging a debt upon payment of the money in question into court. The policy is

known as bimetallism. The experiment has been actually made, and is so important that it will need more extensive treatment.

The fourth method is known as the tabular standard. Here a selected list of commodities are tabulated and the change in their prices from the time that the debt has been contracted until it is due noted. The debt is discharged by the payment of such a sum of money as will purchase the same amount of goods as the sum originally borrowed would have done at the time the debt was contracted. While this method works substantially justice as between debtor and creditor, it has not been possible to put it into practice because of bookkeeping and other difficulties. It may work out ideal justice, but it is not possible to practically apply it.

As has been said, it is impossible to get a perfect money standard, and that will not be liable to fluctuations in value because of forces acting either upon the money metal on the one hand or of commodities in general on the other. But it is nevertheless important to insist upon the soundness of a nation's money, in order that justice may, as far as possible, be subserved as between debtors and creditors. The introduction of "cheap" money not only deals a blow at the economic stability of a nation but injures the most progressive element in the community—the creditor class.

Experiments in Bimetallism.

Bimetallism is important today merely because of the lessons it has taught. Nowhere do we find it adopted in the monetary policy of any nation. But it once played a great role.

Silver and gold were once freely coined by all nations and given full legal tender value. Great Britain ceased to freely coin silver in the early part of the nineteenth century and made gold alone among the metals a full legal tender, silver and copper being legal tender for small amounts only.

Finally, at the close of that century all modern nations practically abandoned the bimetallic standard, and silver ceased to be freely coined. For long centuries silver had been freely coined, and had been the most important monetary metal. It was discarded from this use in the brief course of one generation.

Both before and after the great inflow of specie from the Spanish-American mines, the two metals were used interchangeably. Silver was relatively the more plentiful, and the more commonly used. It was entirely possible to coin each metal independently, and let the two sorts of pieces circulate

together, but not on any common basis. Yet it was highly convenient to link them together in some way, so arranging their denominations that they could be used interchangeably.

Thus the double standard system developed: both metals were manufactured into coins of same, or of similar denominations. The method is illustrated in the system of the United States. The silver dollar contains $371\frac{1}{4}$ grains of pure silver, or $412\frac{1}{2}$ grains of silver 9-10 fine. The gold dollar, if it were coined, would contain 23.22 grains of pure gold, or 25.8 grains of gold 9-10 fine. Their weights are to each other as 16 to 1 (15.988 is the precise figure). Thus, the American silver dollar contains sixteen times as much pure metal as the gold dollar.

The gold standard was definitely adopted by the United States in 1900, although silver ceased to be freely coined several years before. The election of 1896, in which Mr. Bryan played the leading part, centred around the free coinage of silver and gold at the ratio of 16 to 1.

Price in general had been falling up to 1896, due to the constant appreciation in the value of gold. Thus the debtors of the West—the farmers and the others—found that it was becoming increasingly difficult to meet their obligations, as the gold prices of products continued to fall. Mr. Bryan demanded the free coinage of silver, so that debts could be discharged in a metal whose value was continually falling. If gold and silver were both freely coined, and both were a full legal tender, it is perfectly clear that the debtor class would discharge their obligations in the cheaper money. Gold would disappear from circulation, as it would be hoarded or exported. It is clear that foreign merchants would demand payment in gold and not silver. Thus gold would disappear and the silver dollar would become virtually the standard of the United States.

The American nation rejected the proposal. It was quite evident that a metal whose value was so unstable as that of silver could not be selected as the standard of value. There would have been two sets of prices—domestic silver prices and gold export prices. The proposal, if put into effect, would have damaged the international commercial position of the United States. Fortunately it was rejected, and the nation remained on a gold basis.

Token Coins.

The reason why token coins—the cent, five cent and other pieces—have not fallen in value, although they do not contain their legal values in metal, is because their coinage is limited. The demand for these coins for use as change, coupled with the limitation placed upon their coinage, explains why they do not sink in value below their legal denominations.

Questions for Review.

I. *On Text.*

1. What were the disadvantages of barter? Give examples of present-day barter.
2. What is meant by credit? What credit forms are used as media of exchange to-day?
3. To what extent does money make up the wealth of a nation?
4. What are the principal forms of investment? What is meant precisely by "investment"?
5. What is your definition of "value" and "price"?
6. Why is gold not an ideal standard of value?
7. Give examples of primitive forms of money. Why was gold selected by the leading commercial nations as a money standard?
8. What are the functions of a perfect money? To what extent do bank notes perform the functions of money?
9. Platinum is more valuable than gold. Why has it not been adopted as the standard money?
10. What is meant by Gresham's Law? Give examples.
11. What was England's experience with the double standard?
12. What was the significance of the Act of 1900 in the United States?
13. Explain what is meant by "deferred payments." In what way is the debtor class injured by an appreciating standard?
14. Give a brief history of the precious metals.
15. What is meant by "bimetallism"? What are the difficulties inherent in the system?
16. What is meant by the "Latin Union"? When, and why, was silver demonetized in the United States?
17. What was the substance of the United States Acts of 1878 and 1890? What has been the policy of British India with respect to the coinage of silver?

II. *On Lesson.*

18. Can mere legislation determine the kind of money that a nation shall adopt as the standard of value?
19. Is more important to-day as a medium of exchange than hard metal money?
20. What are the functions of credit in the modern business world?
21. Why was bimetallism abandoned by Germany and the United States?

Questions requiring Written Answers.

22. (a) What are the functions of money?
(b) Why is it to the advantage of society that the money standard should remain stable in value?
23. (a) Which is becoming the more important in the field of modern business—money or credit? Why?
(b) In what sense can it be said that "credit is a refined state of barter"?
24. (a) Why did the United Kingdom and the United States abandon bimetalism?
(b) France and Russia have a much larger stock of gold than the United Kingdom, yet the latter has a much greater volume of business. What is the significance of this fact?
25. Bring up any difficulties.

LESSON XI.

Paper Money Issues.

Read: *Money and Banking*, Chapters 11 and 14.

The United Kingdom, alone among the powers involved in the great war, has not suspended specie payments. Nevertheless, it was obliged at the outbreak of the war to issue a legal tender paper currency. If the strongest financial power in the world was obliged to adopt this expedient perhaps some justification can be found in the action of the Canadian parliament in raising the limit of paper money issues in this country. For that reason, among others, we may glance at the financial expedients adopted in the United Kingdom at the beginning of the war, in so far as they concern paper money issues.

The British government advanced to the banks and other financial institutions, at the outbreak of the war, about \$270,000,000 of this legal tender paper money. By the beginning of December, 1914, the amount in circulation had been reduced to about \$170,000,000. This money was issued in denominations of £1 and 10s., and was made redeemable in gold at the Bank of England. It is safe to say that this currency, in greater or less amount, has come to stay, for it represents a great economy in the use of gold. The banks have gradually paid the government for the currency notes advanced to them. Part of the funds secured has been left in the shape of gold at the Bank of England, to redeem such notes as are presented by holders, and part has been invested by the government in its own securities. For the week ending October 22, 1914, the paper currency outstanding was something over £30,000,000; while the Currency Note Redemption Fund was £30,232,528, of which £7,808,983 was represented by a balance at the Bank of England and £13,923,546 by government securities. As has been said, this currency is convertible into gold on demand at the Bank of England; and it is, therefore, the equivalent of so much gold.

For the week ending December 17, 1914, the Bank of England had in circulation notes to the amount of £35,591,000 and gold coin and bullion on hand to the amount of £72,414,000. Now, as is well known, the Bank of England may issue notes up to £18,450,000 on a security basis alone; after which it can issue its notes on a gold basis alone. These figures show the enormously strong position of the Bank as far as its holdings of gold are concerned. They indicate, also, that the Bank of England is quite able, under present conditions, to maintain the government paper currency at par.

It does not follow, however, that the stock of gold of the Bank of England will always be maintained at its present high, and indeed, unprecedented level. A great deal depends on the course of the foreign exchanges. During the latter part of 1914 gold flowed from abroad in large amounts into the vaults of the Bank of England. But conditions are bound to occur under which gold exports will become unavoidable; and they may even be on a scale of sufficient importance to make an appreciable difference in the Bank's stock of the yellow metal. Such a development, however, would afford no ground for distrusting the currency notes. They have not only the Bank's gold at their back, but, what is more important, the wealth and honour of the British nation. Of course a successful invasion would at once send the notes to a discount; but in that event the loss to noteholders would be but a minor part of the economic losses suffered by the nation as a whole.

We find in this paper currency issue in the United Kingdom strong support for the measures adopted by the Canadian government to provide the people with an adequate currency during the war. These measures are strikingly similar to those put into effect in Great Britain. The new paper currency there is based in part on gold and in part on securities. Ultimate redemption will depend upon the power, wealth and honour of the British people. And the same may be said of the Dominion notes that are used both by the people of this country and by the banks. The exact conditions under which they are issued will be described in detail later, it suffices to say at this point that they are based for the most part upon gold and to some extent upon securities of the highest quality. It is true that specie payments have, for the present, been suspended in Canada; but notes are at the present time adequately supported by gold. The ultimate redemption of both the Canadian bank notes and the Dominion notes depends upon the financial power and the honour of the banks and of the people of this country. In some quarters, however, there has been a demand that Canada should finance the war in part, at least, by the issue of government paper currency. It will be necessary, therefore, to consider the limits within which it would be safe for the government to follow such a policy.

Fiat Money.

Inconvertible paper currency has been called "flat" money because it has been called into existence by a mere legislative or administrative act; and depends for its value on the credit of the country. The extent to which the edict of the sovereign power can cause a piece of paper to serve as money, and to maintain its value as money, may be both overstated and understated. Historically, all money has its origin, directly or

indirectly, not in any compulsion or in any deliberate selection, but in the customary selection of some commodity of general serviceability. When, however, such a commodity has once come to be habitually used as money, public authority can very much affect its value, and the mode in which it circulates. If it is made a legal tender for debts it will be forced into circulation. Its value, however, will depend largely upon factors over which the government has no control. A brief historical review of paper money issues will make this fact abundantly clear.

During the French Revolution the authorities issued paper money called "assignats" which was secured by the lands that had been confiscated from the nobility. These assignats fell rapidly in value until they became practically worthless.

During the American revolutionary war the continental congress set the printing presses at work turning out paper money that was supported by nothing else than the promise to pay coin at some future time. These continental notes soon sank in value to zero, and were used by barbers to paper the walls of their shops.

The paper money issued during the declining years of French supremacy in Canada by the Intendant Bigot, brought such suffering to the people of Quebec that for many years they refused to become reconciled to paper issues of any description, even after the English had established a stable Government in Canada. The early note issues of Canadian banks found little circulation among the French farmers and country dealers.

During the war of 1812-14 the Canadian governments of Upper and Lower Canada issued short-time treasury notes which circulated as virtual money. They were payable on demand in bills of exchange on the United Kingdom, and hence fluctuated in value with the rate of exchange. No losses, however, occurred, and they served a very useful purpose during that period of stress and trial.

As has been pointed out, it seems an exceedingly easy expedient to raise money by putting the printing presses of the country in motion, and turning it out by mere government "fiat." But we cannot get something for nothing in this world. Fiat money will inevitably sink in value until it becomes worthless unless some measure is adopted to make it equal to gold. In last analysis, therefore, it must be redeemed in gold, otherwise the country or the government, or both, will suffer economic loss. Taxes and loans are better methods of financing during war than tampering with the money of the nation.

The Greenbacks of the Civil War.

During the American civil war the federal and confederate governments both issued paper currencies. As the confederate paper was never redeemed it proved ultimately valueless.

The federal government issued altogether \$450,000,000 of these notes—called “greenbacks” because of their color. They bore on their face the promise to pay so many “dollars;” but as they were not made payable on demand, and as gold had disappeared entirely from circulation, there was no guarantee that they would ever be paid in gold. As a matter of fact they aided in driving gold out of circulation, as debtors naturally used the cheaper money to discharge their debts and everyone hoarded gold which was at a premium. This admirably illustrates Gresham’s Law which may be stated as follows:—

“When two types of money are in circulation, and both are a legal tender, the cheaper money will drive the more valuable out of circulation.” This has been proved over and over again. The principle is called “Gresham’s Law,” because Sir Thomas Gresham was the first to observe the phenomenon, or at least to put the principle in the form of a clear statement.

The American greenbacks fluctuated in value, according to the success or otherwise of the armies of the North. With a federal victory the chances were better for ultimate redemption of the notes in gold; with a defeat the outlook appeared dubious and the notes fell in value. Naturally, the disturbance of prices which ensued wrought much suffering and hardship. Even after peace was proclaimed the notes did not rise to par, for the United States was not able to redeem them in gold. Finally, however, an act was passed providing for the resumption of specie payments in 1879. The notes gradually gained in value until by January 1, 1879, they attained par. They were at that date redeemable in gold on demand. This makes it perfectly clear that the ability to redeem paper money in gold is the only method by which its par value can be maintained.

Naturally, when the United States once more went on a gold basis, prices fell. The money was more valuable and less of it was given than formerly in exchange for goods. This undoubtedly wrought hardship to the debtor classes, who now had to meet their time obligation in more valuable money—practically with gold. An agitation then arose to issue more paper money, and to prevent the retirement of the greenbacks, in order to maintain prices and prosperity. The Populist party took up the cry for more money. The agitation did not cease until the defeat of Bryan on a free-silver platform in 1896. But

it resulted in forcing upon the government the policy of keeping the unretired greenbacks in circulation. Out of the \$450,000,000 issued during the war \$356,000,000 went unredeemed by the government. This amount of greenbacks still forms part of the monetary media of the United States, although it should not be overlooked that any person holding these notes may have them paid on gold on demand. The government, however, must re-issue the notes.

The greenbacks, it should be noted, were made a full legal tender for all purposes except payment of interest upon the national debt and for discharging customs dues.

It should be borne in mind that we are here considering government paper currency and not obligations of the banks. Now, the Dominion Finance Department reported, November 25, 1914, that the notes outstanding and the gold held were as follows:

NOTES ISSUED.

Provincial	\$	27,785 25
Fractional		791,420 79
\$1		18,658,160 50
\$2		9,628,437 50
\$4		57,871 00
\$5		6,896,297 50
\$50		212,450 00
\$100		2,800 00
\$500		2,165,500 00
\$1,000		4,693,000 00
\$500 Legal Tender Notes for Banks		248,500 00
\$1,000 Legal Tender Notes for Banks		1,855,000 00
\$5,000 Legal Tender Notes for Banks		108,965,000 00
		<hr/>
		\$148,792,222 54

PROVINCIAL NOTES.

\$1	\$	11,304 50
\$2		6,066 00
\$5		4,224 75
\$10		2,180 00
\$20		860 00
\$50		650 00
\$500		2,500 00
		<hr/>
	\$	27,785 25

The provincial notes mentioned in this statement consist of notes issued by the pre-Confederation Provinces, which yet remain in circulation to the extent of some \$27,000.

GOLD IN DOMINION TREASURY.

Gold held October 31, 1914, by the Minister of Finance....	\$ 94,696,017 87
Gold reserve to be held on Savings Banks Deposits—	
10 p.c. on \$58,416,257.24 under The Savings Banks Act..	5,341,625 72
Gold held for redemption of Dominion Notes.....	\$ 89,354,392 15

It should be observed that these statements are given merely as illustrative data. The figures do not show the gold held or the notes issued up to November 25, when the above statement was given out. The actual condition of affairs at the end of November, 1914, will be investigated in the concluding section of this Lesson.

Conditions of Dominion Note Issues.

Before the outbreak of war the conditions under which Dominion notes could be issued were as follows: On the first \$30,000,000 issued the government was obliged to hold a reserve of 25 per cent., 15 per cent. of which might be in securities and the balance in gold. As a matter of fact, the whole 25 per cent. was held in gold. For every dollar issued above \$30,000,000, dollar for dollar had to be kept in gold. The \$30,000,000 limit was increased to \$50,000,000. That is to say, the government secured an additional \$15,000,000 of uncovered paper money. Furthermore, it was provided that additional government notes might be issued to the banks on approved collateral. How much has been issued to the banks it is difficult to determine; but some of them at least have wisely made use of the privilege.

Now the question we have to face is:

Have we in Canada today a fiat money? In a narrow, technical sense—yes; in a real, vital sense—no. While the notes are non-redeemable for the present, they are amply safeguarded by gold and by high-class securities. The printing presses of Canada have not been busy turning out a legal tender paper protected by nothing else than the government's promise to pay gold some time in the future. But it may be objected that the French Revolutionary Government turned out paper money also protected by property. So they did; but that property was land—a non-liquid economic good, and highly mercurial to its value at that. But in the great majority of cases fiat money has meant the mere creation of notes at the command of the sovereign power, unprotected by security of any kind. A very notable case in point is the paper money that was issued by the Continental Congress of the United States during the American War of Independence. This paper money sank in value until it became a byword; so that the people

referred to it with contempt, and a valueless thing was said to be "not worth a continental." And so with the \$450,000,000 of United States notes ("greenbacks") issued during the Civil War, to which reference has been already made. These notes were not secured in any way; they were mere promises to pay legal tender money sometime in the future. As a matter of fact, the United States did not resume specie payments until 1879.

Now, our government notes are amply protected at the present time by the gold held. So far as the government issues them on its own account only \$37,500,000 are uncovered; the remainder are protected by gold. And the notes issued by the government to the banks are amply secured by liquid assets. As long as the government continues to keep an adequate gold reserve and to accept only gilt-edged paper from the banks the policy is thoroughly sound. And it is idle to charge that these notes are not redeemable on demand. The fact is that the government could, if it were to do so, redeem its paper money on demand; but in the face of a great emergency it must safeguard the country's interests by protecting the available gold supply.

Analysis of Note Issues, November 30, 1914.

We may now examine more in detail the Dominion government paper currency as it stood on November 30, 1914.

The circulation of Dominion notes on the date mentioned was	\$160,964,599 29
Of this sum \$50,000,000 requires a 25 per cent. gold reserve	12,500,000 00
The remainder, \$110,964,599.00, requires dollar for dollar in gold	110,964,599 29
The total of \$160,964,599.29 requires in gold	123,464,599 29

But the government return reads:—

"Gold held for redemption of Dominion notes"	89,284,216 76
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Leaving an apparent over-issue of \$ 34,180,382 53

Part of this \$34,000,000 odd has undoubtedly been issued by the government to the banks on approved securities; but the bank returns to the government, of the same date, do not account for a very large sum. Indeed, the banks have availed themselves to but a small extent of the law authorizing loans by the government to them against securities. The knowledge that such advances can be made, if needed, undoubtedly strengthens the position of the banks; but those which have availed themselves of the privilege have been few up to this time (November 30, 1914). The bank returns at this date show, in the statement of liabilities, that the total amount of

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balances due the government by all the banks was \$17,892,000. This, while somewhat larger than usual, cannot be supposed to cover, besides the ordinary collections of Dominion revenue, the large excess in the circulation account. The uncovered issue, which, as will be recalled, may equal 75 per cent. of \$50,000,000, has been exceeded in a way not at present clear. As has been said, part of the uncovered \$34,000,000 has been issued to the banks against securities; but what the remainder has been issued against is at present unknown. The student should carefully watch this point and look for a statement from the Minister of Finance, who will undoubtedly clear up the situation in good time. In the meanwhile it can be said that both the government and the banks have shown that they have met the crisis produced by the war with conspicuous success.

It is easy to criticize, but quite another matter to offer really constructive suggestions. It should be borne in mind that Canada was faced with a quite unprecedented situation at the outbreak of war. The country had been securing capital—mostly from the United Kingdom—at the rate of \$25,000,000 a month; and our interest payments were about \$10,000,000 a month. With supplies of capital suddenly cut off, and interest payments remaining due, we were face to face with a serious situation. Taxes on coffee, sugar, tobacco and liquors were increased; and a credit of \$50,000,000 voted to the government to carry on the war. With the closing of the money markets of the world the government was perhaps justified in increasing the Dominion notes under the conditions described, especially as there yet remains a reserve of 60 per cent. in gold against the total issue of notes (January, 1915). But in the future the government will be well advised to rely upon taxes and loans, rather than upon Dominion notes, to find the funds to finance the war.

Questions for Review.

I. On Text.

1. What were the dual functions of the early Canadian merchant?
2. Describe the nature of Canadian currency in the second quarter of the nineteenth century.
3. Outline the early attempts for the establishment of a paper currency in Canada.

4. Classify government credit currency. Define "flat" money.
5. What are the factors that determine the value of credit money?
6. What are the risks run in the use of credit money?
7. What are the devices adopted to maintain the value of credit money? What are the difficulties in adjusting the supply of such money to the demand?
8. What were the methods adopted in the United States to finance the Civil War?
9. Would it have been better, in the long run, to have borrowed the money to finance the Civil War, rather than to have issued the \$450,000,000 in greenbacks?

II. *On Lesson.*

10. What countries suspended specie payments at the outbreak of war in 1913? Why did the United Kingdom remain on a gold basis?
11. Describe the conditions under which the United Kingdom issues its new legal tender paper currency. In your opinion, will this paper remain as a permanent element in the British currency system?
13. What are the conditions under which paper currency is issued in Canada? Are you in favor of finding the money to finance the war by issuing additional paper currency? Why, or why not?
14. Is it true that if we used paper money instead of gold much social outlay would be saved?
15. As long as sound, gilt-edged securities are behind a government paper currency, is there any danger of that currency depreciating in value? Is there any danger of inflation?

Questions requiring Written Answers.

16. a) Why did the United States government notes (greenbacks) fluctuate in value during the Civil War?
(b) The government was forced to issue them at a rate on the dollar in gold, but stood ready to redeem them on demand in gold, January 1, 1879. Would it have been more advantageous to the government if it had sold bonds to obtain the funds to carry on war, instead of issuing the \$450,000,000 in paper currency?
17. Banks carry, by way of a reserve, only a percentage of their demand obligations in legal tender money. Is it safe

for the government to adopt the same expedient with respect to its notes? What would be the advantages or disadvantages of such a system?

18. During periods of financial stringency the Secretary of the Treasury of the United States has deposited government money with the banks. Contrast with the method adopted at the outbreak of war by the Canadian government, to place the banks in a position to meet any emergency that might arise.

19. Have you any difficulties?

LESSON XII.

Credit, Prices, and the Cost of Living.

Read: *Money and Banking*, Chapters 7, 12, and 13.

One of the most difficult, and one of the least intelligently discussed economic problems, is that of prices. There are various faddists who have their theories of prices, but outside of the works of a few American and English economists the question has never been adequately treated.

Relation of Money to Prices.

The majority of economists have adopted what has been termed the "quantity theory" of prices. This theory stated in the simplest terms is, that the general level of prices is determined by the amount of money in circulation (including cheques) multiplied by the rapidity of exchange and divided by the goods which have been exchanged. So stated the quantity theory appears to be a mere truism—that the money paid for goods divided by the numbers of goods exchanged will give the average price. The theory proves nothing and merely states a fact.

In our judgment there is no relation whatever between the amount of money circulating in a country and the general price level of goods, provided the currency in question is redeemable in gold on demand. The real relationship is between goods and the gold standard, and not money which either directly or indirectly represents gold.

Of course, as has been explained already, if the money of a nation is not redeemable at once on demand in gold, the quantity of currency in circulation has a very decided bearing upon prices. Let us take, by way of illustration, once more the \$450,000,000 of greenbacks issued by the United States in 1861-1865. These notes were not payable on demand in gold. They were issued on three separate occasions—\$150,000,000 in each issue. As their amount increased the possibility of their being ultimately redeemed in gold diminished. Thus greenback prices rose—that is, more of these notes had to be exchanged for goods than would have been the case were they redeemable at once on demand. The greenbacks fell in value until in July, 1864, a dollar in gold sold for \$2.85 in paper. When, as was explained before, gold payments were resumed in 1879 the greenback rose in value to par.

As already defined price is "the ratio of exchange between gold and goods, quantitatively expressed." That is, price

merely denotes the number of gold dollars of 22.23 grains of pure gold that must be given for the goods in question. Any factor that bears upon the demand for, or the supply of gold, must influence prices, just as any change in the demand for, or supply of, goods must affect price.

World's Output of Gold.

From 1493-1910 the world's output of gold was 669,828,000 fine ounces. The periods of greatest production were: 1851-1855, 32,051,000 fine ounces; 1856-1860, 32,431,000 fine ounces; 1861-1865, 29,747,000 ounces; 1866-1870, 31,350,000 ounces; 1896-1900, 62,234,000 ounces.

From 1901 on the output of gold for the world has been phenomenal. During the period 1901-1910 the output in fine ounces was:

1901	12,825,000
1902	14,354,000
1903	15,852,000
1904	16,804,000
1905	18,396,000
1906	19,471,000
1907	19,977,000
1908	21,422,000
1909	21,896,000
1910	21,996,000

The yearly annual output of the yellow metal is now somewhere above \$450,000,000.

Where Gold Comes From.

California and Australia in the early fifties of the nineteenth century brought the world's production of gold up to \$180,000,000 annually. The output in the earlier part of the century was largely derived from Russia. The gradual decay of placer mining in California and Australia reduced the yield for the world to about \$100,000,000 in 1886. In the period from 1856 to 1890 numerous discoveries in South Africa, in Western Australia and in Colorado changed the aspect of the industry.

The cyanide process, which gave better extraction at reduced cost, was introduced about this time. In South Africa, especially, the process has proved of the utmost value. A little later discoveries were made in Alaska, Nevada, the Canadian Yukon, Mexico, Rhodesia, and West Africa.

Thus since 1887 the production of the world's annual supply of gold has been increasing, except for the temporary decline due to the Boer war. Africa now contributes about one-

third of the world's production, and of this the greater part comes from a small district in the Transvaal, called the Rand.

There can be no doubt that the increase in the supply of the yellow metal has cheapened gold, and has resulted in raising prices. But there have been other, almost innumerable, factors operating in the same direction; hence it would be far from true to say that rising prices are due to the world's output of gold alone. An equally important force, making for high prices, is speculation based upon unsound credit.

The world's output of gold for 1914 was about \$450,000,000. While, as has been said in the Lesson, high prices cannot be attributed to the enormous increase in the world's output of the yellow metal alone, there can be hardly any doubt that the increased supply has cheapened gold and raised prices. It may be that after the war the demand for capital will be such that gold will rise in value and hence that prices will show a tendency to fall. In any event, the pressure of the high cost of living has done more than anything else to unsettle labor, and to inaugurate those great "general" strikes that have characterized labor outbreaks in the United Kingdom and on the European continent in recent years.

Credit and Prices.

We have already defined credit and explained in part its uses. It remains to consider the relation of credit to the average level of prices in the community.

There is no doubt that credit throws an enormous amount of purchasing power in the hands of borrowers, and this enhances the demand for goods. An increased demand, other factors remaining constant, means an increase in the level of prices.

But we know from a study of market prices at different periods that credit may be granted in large measure and yet prices remain stable, or even fall. What is the explanation of this?

If we recall the illustration used, of a farmer borrowing at the bank now in anticipation of meeting his obligations in the future by the sale of his products, it will be remembered that by this process he was given purchasing power in the present which enabled him to supply his needs. If we multiply this transaction by a thousand, or ten thousand, it will be perfectly evident that a great purchasing power has been placed in the hands of borrowers. This increased demand would normally raise prices. But prices, under these conditions, do not rise,

for the simple reason that the demand is met with an equal supply of goods.

We must remember that while some are borrowing at the banks, others are meeting their obligations. They do so by selling goods which are now completed and upon which they have previously borrowed. Borrowing and paying are not isolated processes. While thousands are securing credit and purchasing power, other thousands are selling goods to meet their obligations. Thus, demand and supply tend to remain in equilibrium and there are no fluctuations in prices as a result—at least fluctuations that may be traced to the credit process.

But abnormal credit brings different results. When credit is secured, and when that credit is not based on goods that are nearing completion or fruition, purchasing power is increased without any augmentation of the supply. This process will inevitably raise prices and bring about a false atmosphere of prosperity. The day of reckoning comes when banks call in their loans. When such loans have not been based on the production of goods, collateral of all kinds must be sacrificed to secure the necessary funds. If the process is extensive we may have either a sharp monetary crisis or a following period of stagnation and depression.

This makes perfectly clear the causes of the recent inflation in Canada and the resultant depression. We have, as a nation, borrowed beyond our immediate producing power. High prices, fictitious prosperity, booms in real estate and all the accompaniments of high finance have resulted. We shall not better our position until production is greatly increased. Returning prosperity will be foreshadowed in this country by falling prices, and especially in a decline in the cost of living. We have been living under a mirage. The record of the cost of living in Canada has been higher than anywhere else in the world, and this notwithstanding our millions of fertile acres and our great producing power. High prices are good neither for the consumer nor for the workingman; and, in this end, it will be found they bring no lasting returns to the manufacturer, whose cost of production is so enhanced thereby that he is at a disadvantage in meeting foreign competition not only in the home market but abroad.

Index Numbers.

There are two questions that need to be particularly considered when studying the problems involved in prices and their relation to the cost of living—namely, how to ascertain and measure price changes, and second, to discover what are the consequences of such changes.

The measurement of changes in the value of money (gold) would be easy if all prices went up and down together. But this they never do. Some prices go up, while others go down. Occasionally, in periods of crisis or under peculiar conditions, all prices change in the same direction. But even then they do not change to the same extent; some rise or fall in less degree than others. Hence, though the fact of a change in a given direction may be clear the extent of the change may be difficult to measure.

To get at the general trend in prices, and to measure the extent of the change, resort is had to index numbers. An example will best explain how an index number is constructed.

Suppose that on January 1, 1900, the price of iron was \$15 a ton, of wheat \$1 a bushel, of cotton 10 cents a pound, of wool 40 cents a pound. These are called the base prices. Later prices are expressed in relation to these usually by stating them in terms of a percentage. Suppose that a year later, on January 1, 1901, the prices of these four commodities have come to be \$20 for iron, \$1.25 for wheat, 10 cents for cotton, 36 cents for wool. Then the actual prices, and the percentage relation between them, would stand thus:

1900		1901	
	<i>Base Price.</i>	Price	Percentage To base
Iron	\$15.00	\$20.00	132
Wheat	1.00	1.25	125
Cotton10	.10	100
Wool40	.36	90
	400		448
Average (arithmetical av'ge)	100		112

The index number was 400 for 1900, and rose to 448 for 1901. Reduced to the arithmetic mean, the index number for 1900 was 100; that for 1901 became 112. Sometimes index numbers are given in the first form by simple summation; such, for example, is the mode in which the well-known index number of the "London Economist," the greatest financial and commercial paper in the world, is made up. More often the numbers are averaged. The base average, of course, is always 100; the average for any other year is then a percentage of the base average. In the example just given, the index number shows a rise in prices of 12 per cent.; or, rather, as the very word "index" implies, indicates a rise to that extent.

In constructing an index number a great many commodities must be included to indicate the general trend in price levels. Not only so, but all commodities can not be given an equal value in the table. Rice is not as important as wheat, tin

as iron, silk as cotton, etc., in the consumption of America or Europe. Hence, in constructing an index number it is important to give each commodity its relative value from this point of view. This is called "weighting" the index number.

If, therefore, instead of the four commodities mentioned in the table, fifty or a hundred are treated in this way, we can feel some confidence in the results obtained as to the general change in prices. If the summarized result of the prices of a large number of articles shows an advance of ten or twenty per cent. in the index number, it is tolerably certain that most commodities have gone up in price. No doubt it is possible that the result has been due to the fact that half the commodities went up a great deal, and that the other half went down, though moderately. But an examination of actual changes, even a cursory one, almost always shows, where a marked change has occurred in an index number, that the large majority of prices have moved in the one way indicated. The index number serves, therefore, to point to a fact,—that on the whole prices have gone up.

This explains why the statements of many business men in Canada, who have been in business a long time, that prices have not advanced, are unreliable. We have been regaled with accounts of how tea, coffee, sugar, spices, silks, and so forth, have fallen in price during the past fifty years. This is quite true, but prices as a whole have advanced during the past generation. It is quite true, however, that prices in general fell between the years 1870-1896. There was a tremendous decline during that period in the prices of iron, steel, cotton, silk, and innumerable other articles. But since 1900 especially, the advance of prices has been general, and has continued all along the line.

The principal index numbers are those constructed by: the German economist Soetbeer, by the English economist Sauerbeck, by the "London Economist," the United States Labour Department, and also by the Labour Department of Canada. Dun and Bradstreet's index number of prices finds much favor in the United States.

These index numbers show that the cost of living has risen everywhere throughout the world in recent years, and that it is not an economic phenomenon that applies to Canada alone, although, unfortunately, the cost of living is higher in Canada than elsewhere. This is a serious matter, for we cannot hope to attract and retain immigrants unless they are given a chance to "get ahead" in the world. Moreover, high cost of living means high wages; and high wages mean high cost of production. If

we are to increase our exports — and we must to meet the interest on our borrowed capital — our manufacturers and farmers must be placed in a position to compete in neutral markets for a share of the world's trade. Inevitably, high prices and high labor at home must prove a great handicap to them abroad.

✓ *Causes of Rise in Prices.*

It has already been explained that the rise in prices has been due to not one cause only, but to many forces affecting either the production of goods or of gold, on the one hand, or the demand for these commodities on the other. While no doubt, as has been explained elsewhere, the enormous increase in the supply of the yellow metal has affected prices, the factors that have had most influence in advancing prices must be looked for elsewhere.

Chief among these is the increase of uneconomic expenditures. These have been undertaken for wars or in preparation for wars. The cost of the burden of crime, pauperism, insanity, accident, disease, unemployment, and other social wastage must be paid by society, and has meant heavier taxation, increased cost of production and hence increased prices. Meanwhile, also, individual expenditure of an uneconomic character has increased, including outlay for drink, luxury, amusement and wasteful or injurious forms of consumption.

The factors that have contributed to bring about an advance of prices fall into three main groups: influences affecting the supply of commodities and services; changes in the demand of consumers; and a fall in the value of gold. The third point has already been discussed, hence we may proceed to consider the influence of the first two factors.

The main influences that have operated to restrict supply of food products are the drain of population from the land, resulting in decreasing the proportion of persons engaged in agricultural production. One must not conclude that the total production has fallen off—it has, in fact, greatly increased everywhere, but it has not kept pace with the increase of population in urban centres.

The exhaustion, or semi-exhaustion, of natural resources has also restricted the supply, and raised prices. Wasteful methods of production and distribution have also unduly advanced the cost of living. Of particular importance in the field of economic waste are needless multiplication of middlemen, and increased charges in the passing of commodities from the source of supply to the door of the consumer. Perhaps, however, the middlemen have not received justice, on the

whole, from the hands of critics. Certain it is that their services are in most instances economically productive; it is the undue multiplication of middlemen and commission men against which exception is taken.

Excessive expenditures for advertising raise the cost of production. The adulteration and debasement of the quality of foods results in giving the consumer an inferior commodity at a relatively high price, and operates in raising the cost of living. The distribution of food in packages involves, in many cases, short weight and high cost. The influence of the tariff, of mergers and combines, and the consequent demands of labor unions for higher wages to meet the increased cost of living, are all factors in advancing prices. Also, the development of legislation for the control of production and distribution, in the shape of sanitary requirements, pure food laws, and hours of labor for government contracts, are influences of considerable importance with respect to advances in price.

The changes in reference to demand have come about through the growth and concentration of the population in cities and towns, through the general advance in the standard of living, bringing about larger requirements on the part of the individual consumer, and the growing tendency on the part of the upper classes to spend extravagantly. The last influence works in two ways to advance prices: it not only increases demand, but it also reduces supply, through the total destruction or the partial utilization of goods. It has been said that the French family can subsist on what the average Canadian of American family wastes—perhaps an extravagant statement, but still drawing attention to the wasteful methods of household administration on this continent.

The classification of the causes for the increased cost of living may be outlined in tabular form as follows:

I. Increase in uneconomic expenditure.

1. Social wastage.

- a. War and national armaments.
- b. Higher scale of government expenditures.
- c. Cost of crime, pauperism, insanity, accident, disease, unemployment, and so forth.

2. Increase of economic expenditures in consequence of higher prices. The causes of the advance of prices may be classed as:

1. Changes in supply.

- a. Drain of population from the land.
- b. Exhaustion of natural resources.
- c. Wasteful methods of production and distribution.
(1) Transportation.

- (2) Wholesale and retail costs.
- (3) Advertising.
- (4) Adulteration.
- (5) Package foods.
- d. Tariff.
- e. Trusts.
- f. Labor unions.
- g. Legislation.
 - (1) Sanitary laws.
 - (2) Pure food laws.
 - (3) Labor laws.
- 2. Changes in demand.
 - (a) Growth and urban concentration of population.
 - (b) General advance of standard of living.
 - (c) Extravagance in expenditure.
- 3. Changes in value of gold.
 - (a) Increase of gold supply.
 - (b) Extension of unwarranted credit.

Questions for Review.

I. On Text.

1. Differentiate between fiat and credit money. Analyse what constitutes the demand for money. Why is there a special demand for gold?
2. What is meant by "hoarding"? Are bank reserves hoards?
3. What instances can you cite of government hoarding of money? What is the purpose?
4. What are the factors to be considered in the supply of gold? What peculiarities do you notice in the supply of gold?
5. What are the effects of an increased supply of new gold?
6. How much money is needed in a country?
7. How does credit economize the use of gold? In what sense may it be said that gold is at the basis of all credit?
8. Why can it be said that there is an increasing supply of a more efficient money?
9. Does a lessened demand for money cause a rise in prices?
10. What is the relation between credit and speculation?
11. What defects, if any, do you find in the American currency system?

II. On Lesson.

12. To what extent is the supply of gold derived from current production?
13. The value of gold falls. What is the probable effect upon (a) the value of the \$5 gold piece? (b) The price of the

\$5 gold piece? (c) The value of wheat? (d) The price of wheat? (e) The value of the cent piece? (f) The value of the silver coins? (g) The value of an ounce of silver?

14. Construct an index number based on assumed prices for a dozen commodities at two different periods, showing the change in the value of money.

15. Why is "weighting" sometimes used in the construction of index numbers? Is the correction important?

16. In the nineties the gold party in the United States declared that the value of silver had fallen in the preceding twenty-five years; the silver party declared on the other hand that it was not a fall in silver which had taken place, but a rise in gold. How would you proceed to find out the truth in the matter?

17. Enumerate some of the influences which might tend to raise or lower the prices of a large number of commodities independently of any change on the part of the standard.

Questions requiring Written Answers.

18. The introduction of the cyanide process for extraction of gold so decreased the cost of production that refuse heaps of old mines were worked over again. What effects would you expect this to have on the use of gold in the arts? Upon its use as money? What would be the effect upon its value in the arts? Upon its value as money?

19. What is the effect of credit upon prices? Are high prices, in themselves, good or bad for a country?

20. What are the main reasons that have brought about a rise in the cost of living in Canada in recent years? Has the movement, on the whole, been good or bad for this country?

21. Bring up any difficulties.

Erratum.—In Section 518 of "Money and Banking" the reference to the failure of the Farmers' Bank is incorrect. The Commons passed a Bill to reimburse to depositors their losses, but the measure was rejected by the Senate.

