Back on the Gold Standard—Temporarily (1926-31)

Canada, $5 and $10 patterns, 1928
Following the resumption of the gold standard in 1926, consideration was briefly given to striking $5 and $10 gold pieces similar to those issued prior to World War I. Copper patterns were prepared, but no further action was taken.

With Canada's return to the gold standard, currency supplied by the chartered banks lost its legal tender status, although the government could restore this status under the Finance Act in the event of an emergency. Consequently, legal tender in Canada once again consisted of British gold sovereigns and other current British gold coins, U.S. gold eagles ($10), double eagles, and half eagles, Canadian gold coins (denominations of $5 and $10), and Dominion notes. Limited legal tender status was also accorded silver, nickel, and bronze coins minted in Canada.[59]

Canada's return to the gold standard proved to be short-lived. It has been argued that monetary operations under the Finance Act were inconsistent with maintaining a gold standard. Dominion notes issued to banks under the authority of the act upon the pledge of securities were not backed by gold.[60] They were, however, legally redeemable in gold on demand. In 1933, James Creighton, a prominent University of British Columbia economics professor, wrote,

> Apparently the sponsors of the 1923 Act did not realize that when Canada went back on the gold standard, as she did in 1926, the effects of the operations of the Act would be vitally different from what they were during the paper money period (Creighton 1933, 116).

Some modern-day economists also point to excessive monetary expansion during the late 1920s as causing the eventual demise of the gold standard (Courchene 1969, 384). The percentage of gold reserves to Dominion notes outstanding

59. Silver coins were legal tender in amounts not exceeding $10; nickel coins in amounts not exceeding $5; and bronze coins in amounts not exceeding 25 cents (Macmillan Report 1933, 37).
60. Limits were set annually for advances to chartered banks under the Finance Act. Because they were typically set very high, such limits did not pose an effective restraint on the borrowing activities of banks.

fell from 54 per cent on 30 June 1926 to 28 per cent three years later (Macmillan Report 1933, 38). Other economists have emphasized the unwillingness of the Canadian authorities to accept the discipline of the gold standard, especially during a period of significant international financial stress (Shearer and Clark 1984, 300). A fall in commodity prices, resulting in a deterioration in Canada's trade balance, was also a factor. The currencies of other heavily indebted, commodity-producing countries, such as Australia and Argentina, also came under significant downward pressure during the 1929–31 period (Knox 1940, 8).

The Canadian dollar experienced three bouts of weakness between 1928 and 1931. But instead of automatically allowing the export of gold when the dollar weakened beyond the gold-export point, as it would have done under a "pure" gold standard, the government increasingly relied on a number of "gold devices" to stop its export (Shearer and Clark 1984, 29–30). For example, instead of making gold available in Montréal or Toronto as required by law, it was available only in Ottawa, thereby increasing the cost and inconvenience of exporting gold. Similarly, instead of supplying U.S. gold coins, the authorities provided British sovereigns or bullion, which had to be assayed before the U.S. authorities would accept it. Alternatively, only small-denomination coins were provided. Moral suasion was also used on bullion shippers.

An increase in the Advance Rate would have been the expected monetary response to the outflow of gold. While the "ordinary rate" was increased from 3.75 per cent to 5 per cent on 9 June 1928, a special 3.75 per cent rate remained in effect. To facilitate the sale of a special issue of 4 per cent treasury notes, the government had apparently made a commitment to the banks to discount these notes at this special rate (Shearer and Clark 1984, 295). When the pressure on the Canadian dollar temporarily eased in the autumn of 1928 because of seasonal factors, the ordinary Advance Rate was reduced to 4.5 per cent. It stayed at this level until late October 1931, despite the Canadian dollar falling below the gold-export point during late 1929 and early 1930 and again through the summer of 1931.

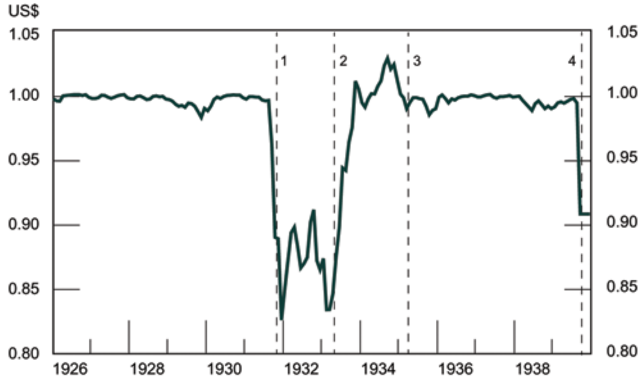
Banque Canadienne Nationale, $50, 1925
Based in Montréal, the Banque Canadienne Nationale issued a series of notes in 1925 that featured familiar Canadian statuary. The design of the $50 note included a portrait of the bank's President, J.A. Vaillancourt, the bank's General Manager, Beaudry Leman, and an image of the statue of Maisonneuve in Place d'Armes square in old Montréal.

In effect, if not in form, Canada went off the gold standard in 1929. However, the export of gold was not officially banned until 31 October 1931 by an Order-in-Council. The banks and the government also used moral suasion, through appeals to patriotism, to convince Canadians not to convert Dominion notes into gold (Bryce 1986). But with the politically traumatic, although economically sound, decision by the United Kingdom to abandon the gold standard on 21 September 1931, the fiction of a gold standard was finally abandoned.

With the pound sterling falling precipitously from its old fixed rate of US$4.8666 to as low as US$3.40 in the days immediately following the British decision to float the currency, the Canadian dollar came under sharp downward pressure (Chart 3) amid a general loss of confidence in the global financial system. World money markets essentially ceased to function, with borrowers, such as Canada, unable to borrow even short-term money in New York. Investor concern about Canada focused on the wavering nature of Canada's commitment to the gold standard, its high level of debt, and its low gold reserves (Creighton 1933, 122). In this environment, the Canadian dollar fell to a low of roughly US$0.80 in the autumn of 1931 before recovering.

The *coup de grâce* to Canada's adherence to the gold standard was finally delivered on 10 April 1933 when an Order-in-Council officially suspended the redemption of Dominion notes for gold. As was the case in other countries that left the gold standard during the 1930s, this move was expected to be temporary, with a return to the gold standard widely anticipated once the economic climate improved (Bordo and Kydland 1992).

Chart 3
Canadian Dollar in Terms of the U.S. Dollar
Monthly averages (1926–39)



1. October 1931: Gold exports banned
2. April 1933: Redemption of Dominion notes into gold suspended
3. March 1935: Bank of Canada begins operations.
4. September 1939: War is declared, the Canadian dollar is fixed, and exchange controls are imposed.

Source: U.S. Board of Governors of the Federal Reserve System (1943)