BOOK REVIEWS

Cross of Gold: Money and the Canadian Business Cycle, 1867–1913
Georg Rich
Ottawa, Canada: Carleton University Press, 1988, 307 pp.

Someone who picks up Georg Rich's book expecting to find an anecdote-filled polemic against the gold standard (or perhaps organized religion!) will be sadly disappointed. Instead they will find a painstaking and rigorous inquiry into the functioning of the pre–World War I (1867–1913) gold standard in Canada.

There are four principle findings. First, the stock of money moved procylically in Canada during the gold standard period. In Rich's view this exacerbated the business cycle generated by nonmonetary forces. So at least on this criterion the gold standard gets bad marks. This finding is based primarily on a comparison of peaks and troughs in the levels of the money stock with the peaks and troughs in the business cycle. Previous researchers, Keith Hay (1967) and George Macesich (1970), using the techniques developed by Milton Friedman and Anna Schwartz for the United States, emphasized the finding that peaks in the rate of change of the money supply led the cycle.

Second, the procyclical behavior of the money stock was due to the procyclical movement of bank reserve ratios. Rich is generally critical of the banks for taking an accommodative stance, although he does allow that the willingness of the Canadian banks to accommodate an increased demand for money may have had a positive effect during periods of financial stringency.

Third, the monetary base moved countercyclically, much as the classical theory of the gold standard predicts. The balance of payments was the key. During expansions rising imports led to a balance-of-trade deficit and an outflow of gold. The problem was simply that movements in the base did not fully offset the effect of the fall in reserve ratios, so the behavior of the money supply did not mirror that of the base. The government of Canada did issue notes, and part of the issue was not covered by gold. But discretionary monetary policy played a small role in determining fluctuations in the monetary base, particularly after 1885.

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Fourth, interest rate movements in Canada were damped in comparison with the United States, again due to the willingness of banks to make additional loans during expansions. The author believes that interest rates are the major channel through which money influences the economy. Thus, banks actually added to the severity of the business cycle by keeping interest rates on an even keel.

The difference in the behavior of interest rates between the United States and Canada uncovered by Rich deserves further study. The conclusion is based on a variety of interest series including interesting comparisons of call loan rates, and of the average return on loans earned by Canadian and foreign branches of the Bank of Nova Scotia. It is possible that differences in the way the interest series were constructed are the explanation, but Rich has done yeomen work in digging out alternative interest rate series. Is the explanation, then, to be found in the structure of the Canadian banking system, in the organization of financial markets, or as I would conjecture, in the cyclical variability of real income itself since real GNP was less variable in Canada than in the United States. Of course, if the latter explanation turns out to be the right one, the difference in the variability of interest rates would not be a key link in the explanation of the difference in the amplitude of the business cycle in the two economies.

Together Rich's findings alter, somewhat, the picture developed by Jacob Viner (1924) who saw the experience of Canada as confirming, for the most part, the traditional theory of the gold standard. Indeed, among the older writers Rich's emphasis on the role of bank reserve ratios is most reminiscent of the views of R. G. Hawtrey (1933).

How important are these findings as a criticism of the gold standard? They are consistent with recent studies of the United States and other countries that stress the short-run instability of prices and real output during the gold standard era, and in that sense add to the case against the gold standard. But supporters of the gold standard can still point to the traditional strengths of the system. First, it should be noted that even under alternative monetary standards there might well have been procyclical movements in bank reserve ratios. It is by no means certain that a central bank operating through a gold standard or through fiat money would have done a better job of managing the monetary base. The chief claims for the gold standard, moreover, are longer run. Long-run price stability, for example, was maintained in Canada. The price level fell by only 3 percent per year in Canada from 1870–71 to 1895–96, and rose by only 2.1 percent per year from 1896–97 to 1912–13, an experience similar to other countries on the gold standard. The gold standard, while it permitted modest inflations, proved to be a bulwark against the kind of runaway inflation that can occur under a pure fiat standard.

There is also an interesting chapter on the Crisis of 1907 in Canada, linking it to events in New York. Surprisingly, previous writers have

looked at the Canadian case as an internally generated phenomenon. Rich's explanation appears far more convincing. As he sees it, the key actors were Canadian exporters. Unable to discount bills in New York during the panic, they ran down their own deposit accounts, transferring the pressure to the Canadian banking system.

In the course of his study Rich developed several new series on interest rates, the balance of payments, and the money supply that will be of interest to monetary historians. Undoubtedly, these series will prove to be among the most important contributions of the volume.

Finally, a minor complaint: There is no index, and there are no page numbers in the lists of tables and charts. These omissions make it hard to find information without a prolonged search of the text.

This book, I believe, will have a long academic life. Canadian economic historians will naturally find the book of interest. And students of the monetary history of other countries, the United States in particular, will find the additional perspective provided by this able study of Canadian money and banking during the gold standard era extremely useful.

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Money: Lectures on the Basis of General Equilibrium Theory and the Economics of Institutions
Rudolf Richter
Translated from the German by Wolfgang F. Stolper
Berlin: Springer-Verlag, 1989, 399 pp.

Systematic treatises are not so common in economics now as they were before mid-century. In the "secondary currency community" of academic economics (to apply a term of Rudolf Richter's by way of analogy), the journal article is the unchallenged unit of account; whereas, in the "primary currency community," it is the dollar; and textbooks, not monographs, are the stock in trade. Richter's lectures bow to fashion by posing as a quasi-textbook. In reality, they have been fashioned into the rare treatise on money. They are an extended effort to marry the theory of general equilibrium with the new institutionalist economics, which