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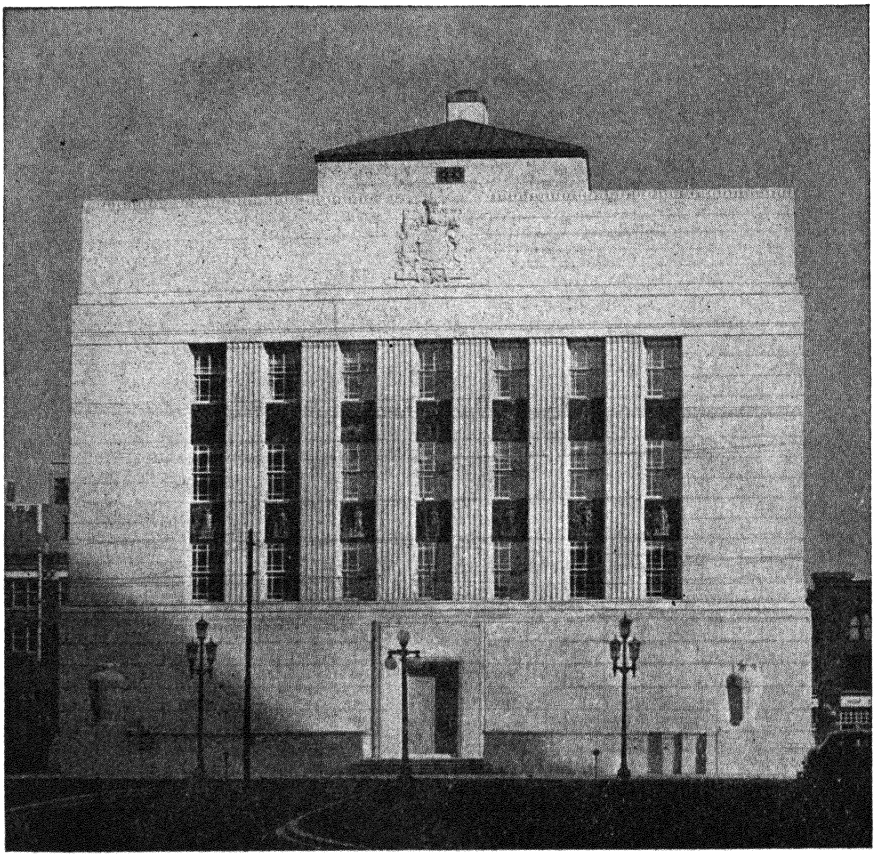

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BANK OF CANADA IN OTTAWA

THE BANK OF CANADA

The Development and Present Position of Central Banking in Canada

By

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With Foreword by

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1939

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BY

MILTON LONSDALE STOKES

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TO MY WIFE

FOREWORD

by

F. CYRIL JAMES, B.COM. (LONDON); PH.D.
Director of the School of Commerce, McGill University, Montreal

ALTHOUGH the creation of central banks, designed to execute policies of monetary management, has often been regarded as a sovereign panacea for all the economic ailments that have afflicted the world during the troublous years since 1920, Canada was the last of the larger nations to set up such an institution. Nor was that decision taken without deep thought and widespread discussion, as Dr. Stokes has clearly demonstrated in the following pages, so that the story of the central banking developments in Canada holds for all economists and students of political science an interest akin to that which the creation of the Federal Reserve System in the United States aroused a quarter of a century ago.

If we look backward, and attempt to catch the spirit of historical development, it is apparent that the modern conception of central banking had its birth during the years of controversy between the Banking School and the Currency School which lasted from the English Bullion Report of 1810 to the Bank Charter Act of 1844. For almost three centuries prior to that time commercial banks, in all countries, had operated competitively and independently on the basis of the liquidity theory and, although that theory was not invariably applied in practice, it did serve (in conjunction with the need for metallic reserves of coin) as an effective limitation on the lending policies of the banking system. Because of her pioneering development in the fields of industry and commerce, England was the first to recognize the inadequacy of the old tradition. In view of the growing use of checking accounts for the receipt and payment of income, it was no longer possible to suggest that the funds at the disposal of the commercial banks represented nothing but the idle working-capital funds of the community. In view of the

growing volume of savings accounts and time deposits, it was no longer possible to suggest that commercial banks should rigidly confine their operations to the short-term money market. The liquidity theory could no longer serve as the sole guide to commercial banking policy.

By the end of the nineteenth century this fact had become apparent in the case of each of the great powers. Institutions like the Banque de France and the Reichsbank had been developed on the model of the Bank of England and, in 1913, the Federal Reserve Act was passed by the Congress of the United States for the purpose of creating a central banking mechanism that should be even better than its predecessors. Unfortunately, however, the abandonment of the international gold standard during the World War (and the failure to re-establish it effectively after that war was over) destroyed the foundation on which the central banking ideals of the nineteenth century had been erected. Central banks were more necessary than ever before, and dozens of these institutions were created during the post-war years, but the task of adapting central banking policies to the novel economic conditions of the period was fully as difficult as that of creating new institutions.

Canada has played a significant part in the solution of both these problems, and Dr. Stokes has provided an important account of her contribution. Expert investigation and public discussion have led to a reformulation of the concept of central banking structure and monetary policy, so that the Bank of Canada may be regarded, not only as an adaptation of basic principles to the economic and political conditions of the Dominion, but as an attempt to restate those principles in the light of conditions as they exist in the modern world.

F. CYRIL JAMES

Philadelphia,
April 14, 1939.

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PREFACE

IN THE post-war era, and more particularly since the depression and the breakdown of the gold standard, increasingly greater attention has been given to the influence of the monetary system on the general economy. Recent years have brought new responsibilities to banking systems and bankers generally. It has become more generally accepted today that bankers, in addition to safeguarding the interests of their depositors and shareholders, must share responsibility for the management of the monetary system.

It had become increasingly clear to many in Canada that the banking system as it existed was not adequate to assume the increased responsibilities imposed by the more recent developments in the field of monetary finance. As a result, for a number of years, particularly after 1923, Parliament was faced with demands for a central bank. A Royal Commission was appointed in 1933 to investigate the establishment of such an institution. The report of the Commission emphasized the fact that there existed in Canada no single authority accepting responsibility for the management of the monetary system. There was no institution primarily responsible for the maintenance of the external stability of the country's currency and there was no authority to which the government of the day could turn for informed and impartial advice on financial policy. The Commission found no institution charged with the regulation of credit and currency in the best interests of the economic life of the country. There was no agency through which Canada could co-operate in monetary matters with foreign countries. To carry out these functions the Royal Commission recommended the establishment of a central bank.

Acting on the recommendations contained in the report of the Royal Commission, Parliament passed "An Act to Incorporate the Bank of Canada" on June 28, 1934 (24-25 George V, c. 43). Royal Assent was given on July 3, 1934. The new bank authorized by Parliament began business the following year on March 11th, 1935.

With the establishment of the Bank of Canada, Canada has become one of the last of the important countries of the world

to create a central banking organization. In setting up a central bank the Dominion has definitely aligned herself with the banking experience and practices of the Motherland and with the nations of Continental Europe. The establishment of the Bank of Canada completes the chain of intra-Empire central banks which have been established in the self-governing commonwealths of the Empire and in India.

Canada's long delay in establishing a central bank has been due, in part, to her highly centralized banking system (there are ten banks in Canada) and the Treasury Board, set up under the Finance Act, which performed some of the functions ordinarily associated with a central bank. The Treasury Board was a sort of half-way house on the way to a central bank.

The purpose of this book is to describe the historical development, the structure and operations of the Bank of Canada and its role in the Canadian economy.

I am particularly indebted to Mr. Graham Towers, Governor of the Bank of Canada, and Dr. W. C. Clarke, Deputy Minister of Finance, Dominion of Canada. Much valuable information, aid, and suggestions were received from these officials. In a very real sense Dr. Clarke may be regarded as the "father" of the Bank. I take this opportunity of acknowledging the valuable services extended by Mr. S. R. Noble, Assistant General Manager of the Royal Bank of Canada, and Mr. W. G. More, Assistant General Manager of the Imperial Bank of Canada, in furnishing information relative to the parts played by the late Mr. E. L. Pease and the late Mr. D. R. Wilkie, respectively, former presidents of the Canadian Bankers' Association, in the development of central banking in Canada. Valuable suggestions were received from Dr. F. Cyril James and Professor J. P. Day of McGill University and from Mr. J. P. Bell, former general manager of the Bank of Hamilton. The volume owes much to Dr. William J. Carson of the University of Pennsylvania who read the manuscript and made many helpful criticisms and suggestions and to Miss Gladys Fencil and Dr. George G. Struble of Lebanon Valley College for their aid in the preparation and the editing of the manuscript.

MILTON L. STOKES

Annville, Pennsylvania,
April, 1939.

THE BANK OF CANADA

CHAPTER I

THE PRE-WAR CANADIAN MONETARY SYSTEM

THE monetary structure of Canada, as it existed prior to 1914, was based on the gold standard. Adopted by the United Provinces of Canada (now the Provinces of Ontario and Quebec) in 1853, it was continued as the standard of the Dominion of Canada without a break until shortly after the commencement of the War in 1914, when it was abandoned.

In Canada, as in most countries, the gold standard of the pre-war period was operated in accordance with what is sometimes called "the rules of the game". A free flow of gold into and out of the monetary stock was permitted. Dominion of Canada notes were payable in gold on demand and the gold so obtained was exportable at will. The note issue could only be increased by a corresponding increase in gold in reserve. An import of gold was followed by an expansion of credit, and conversely, an export of gold by a contraction of credit.

Gold circulated only to a negligible extent; practically the entire stock was in the custody of the banks and the Finance Department. The portion which belonged to the former was held either in their vaults in Canada or in their branches and depositories abroad. They also held some gold in the central gold reserves. The major portion of the gold held by the Finance Department was held as a gold coin reserve against savings bank deposits and Dominion Notes.[1] Gold was coined free or for private accounts, and the depositor was permitted to demand payment in Canadian coins or in British sovereigns.

DOMINION NOTE ISSUE

Dominion or government notes secured by gold constituted a very important part of the Canadian monetary system.

Following confederation in 1867 the new federal government assumed the various provincial issues and amalgamated and

[1] Under the Dominion Notes Act of 1914, it was provided that the reserve against Dominion notes might be in the form of either coin or bullion.

enlarged them into one called the Dominion Note Issue which was managed by the Minister of Finance pursuant to the Dominion Notes Act of 1868. They were made legal tender in all amounts and were freely redeemable in gold.

The Dominion Note Issue was based on the Bank of England principle of a limited uncovered issue and a dollar-for-dollar gold reserve for the covered issue. Statutory changes were made from time to time regarding the reserve requirements. The situation in 1913 was that the Minister of Finance was required by law to hold a reserve of 25 per cent. in gold or guaranteed debentures for the first $30,000,000 issued.[2] This reserve was, in reality, wholly specie. Over this limit all notes issued required a 100 per cent. gold reserve. Dominion notes were thus virtually gold certificates. The duties of the Minister of Finance were automatic—the exchange of gold for notes and notes for gold.

Two functions were performed by the Dominion note issue—the supplying of the hand-to-hand currency of the country and supplying legal cash currency for the banking system. The hand-to-hand currency, circulating among the public for the purpose of carrying on the small cash transactions of the country, was rarely presented for redemption. The remainder of the issue, consisting of large denominations, was used mainly for transactions between the banks. This part of the issue never got into the hands of the public.

THE CANADIAN BANKING SYSTEM

The Canadian banking system supplied the third part of the monetary structure. Under the British North America Act which created the Dominion of Canada, power to make laws with regard to currency and coinage, banking, incorporation of banks, and the issue of paper money, comes under the exclusive authority of the Parliament of Canada. Commercial banking in the Dominion is

[2] In the war session of August, 1914, Parliament raised the partially covered issue to $50,000,000. Subsequently an issue of $16,000,000 was made against a deposit of railway securities guaranteed by the Dominion Government, as well as an uncovered issue of $10,000,000 for governmental purposes. In 1917 an emergency issue of $50,000,000 Dominion notes was made to finance war purchases in Canada by the British Government. The notes were secured by Imperial Treasury bills. In due course, this indebtedness was liquidated by payments from the British Treasury and all of this issue was redeemed by 1927. By the statute passed on March 30, 1933, the Governor-in-Council was empowered to suspend the redemption in gold of Dominion notes, and an Order-in-Council to this effect was made on April 10, 1933.

in the hands of a comparatively few independent banks of large capital, each of which operates a large number of branches throughout Canada, in England, the United States and other foreign countries. Banks operate under Dominion charters which are granted for ten-year periods subject to renewal. The major powers of Canadian banks are set forth in the Bank Act which is subject to decennial revision, the period of revision corresponding to the expiry of the charters of the banks.

In 1901 the Canadian banking system embraced thirty-four banks.[3] Since that date the number of banks has steadily diminished, in part through failures and liquidations, but largely through mergers, banking like industry having been subject to an era of amalgamations. In 1913 there were twenty-five chartered banks but by 1931 this number had been reduced to ten.[4]

Every chartered bank was permitted, under the Bank Act, to issue its own notes in denominations of $5 and multiples thereof, to the limit of its paid-up capital. On this issue the Dominion Government imposed a tax of one per cent. During the crop-moving season (September 1st to February 28th) the banks might issue additional notes up to 15 per cent. of their unimpaired paid-up capital and rest or reserve fund. Interest at 5 per cent. per annum was charged by the Government upon the notes so issued. In the 1913 revision of the Bank Act another increase in the bank note issue was provided for by the creation of the central gold reserves. Banks were allowed to issue notes in excess of the amount previously allowed to any amount, provided there was deposited with a board of trustees at Montreal, gold or Dominion notes to cover the increase in issue. In other words, banks could still issue notes up to the full amount of their paid-up capital, and an additional amount in the crop-moving season equal to 15 per cent. of a bank's combined capital and reserve fund. It was only for notes issued in excess of these amounts that legal tender money must be deposited with a board of trustees. No tax was levied on the gold reserve notes. The Canadian Bankers' Association was authorized to make rules and regulations for the operation of the fund, but the actual administration was delegated to a board of four trustees, three of whom were appointed by the Association and one by the Minister of Finance.

[3] *The Canada Year Book, 1936*, p. 914.
[4] Ibid., p. 915.

Bank notes were legal tender neither between the bank and its customers nor between banks themselves.

In substance, Canada based her bank note issue on the banking principle that the notes of a bank are to be limited to the capital of the bank, with a penalty for excessive use, the latter being permitted by law under certain stipulated conditions.

Security of Bank Notes

Banks were not required by the Bank Act to pledge any specific asset for the security of their notes, as in the case of the national banks of the United States. The Act did not provide for a specific minimum cash reserve. Banks were required, however, to maintain 40 per cent. of their cash reserves in Dominion notes. Each bank was required to redeem its notes at its head office, and in such commercial centres as were designated by the Treasury Board. The Bank Act provided that in the case of the insolvency of any bank the payment of its notes in circulation should be the first charge upon the assets of the bank. The notes were further secured, in case of insolvency, by the bank circulation redemption fund, to which all banks contributed on the basis of 5 per cent. of their average circulation not covered by gold or Dominion notes deposited in the central gold reserves established in 1913. The sum thus secured was available for the redemption of the notes of failed banks.

Coins and Coinage[5]

In 1871, the Uniform Currency Act authorized a decimal currency for the Dominion of Canada and made the British sovereign legal tender for $4.86-2/3 and the eagle of the United States legal tender for $10. It also provided for a Canadian five-dollar gold piece, although none were struck until 1912. The Currency Act of 1910 provided for the following coins: gold in denominations of $2.50, $5, $10 and $20, based on a $10-piece weighing 258 grams 9/10ths fine; silver in one dollar, fifty, twenty-five, ten and five cents based on a dollar of 360 grains 8/10ths fine; a nickel of 70 grains pure nickel; and a penny containing 50 grains of mixed metal. The legal tender limits of the bronze, nickel, and silver coins were twenty-five cents, five and ten dollars, respec-

[5] Much of the data on Coins and Coinage and the Royal Canadian Mint was obtained from *The Canada Year Book, 1936*, pp. 892-895.

tively. Only five- and ten-dollar gold pieces were coined among the gold coins authorized. The silver dollar was never coined until 1935, when by Royal Proclamation of April 12, the design of the new Jubilee Silver Dollar was set out.

THE ROYAL CANADIAN MINT

The Ottawa Mint, established as a branch of the Royal Mint under the (Imperial) Coinage Act, 1870, and opened on January 2, 1908, was by 21-22 George V, c. 48, constituted a branch of the Department of Finance, and by the proclamation of November 14, 1931, has since December 1, 1931, operated as the Royal Canadian Mint. At first the British North American provinces, and later, the Dominion of Canada, obtained their coins from the Royal Mint in London or from The Mint, Birmingham, Ltd. In its earlier years the operations of the Mint, in Canada, were confined to the production of gold, silver, and bronze coins for domestic circulation, of British sovereigns, and of small coins, struck under contract for Newfoundland and Jamaica. The first gold coins struck were sovereigns identical with those of Great Britain except for a small "c" identifying them as having been coined in Canada. The first Canadian $10 and $5 gold pieces were struck in 1912, but the amount of Canadian gold coins minted was very limited, since gold coins were never in great demand by Canadians, paper money being much more popular.

Previous to 1914 small quantities of gold bullion were refined. During the War the Mint came to the assistance of the British Government by establishing a refinery in which nearly twenty million ounces of South African gold were treated on the account of the Bank of England. The subsequent development of the gold mining industry in Canada has resulted in gold refining becoming one of the principal activities of the Mint. No gold coins have been struck since 1919. Most of the fine gold produced from the rough shipments from the mines has been delivered to the Department of Finance in the form of gold bars worth between $10,000 and $11,000 each, the rest being sold in a convenient form to manufacturers. The fine silver is extracted from the rough gold, and when not required for coinage, is sold on the New York market or disposed of to local manufacturing firms.

The growth of Canada's gold mining industry has, in recent years, been particularly rapid, and, since the initiation in 1931

of the policy of prohibiting the export of gold except under licence, practically the entire production of the country has been deposited with the Mint to be refined and later exported through the Department of Finance. In practice all the gold is purchased by the Government through the Mint and is exported by the Department to the world's markets.

The Canadian Bankers' Association

Second only to the branch bank system as a distinctive feature of the Canadian Banking System is the Canadian Bankers' Association. Following the revision of the Bank Act in 1891, some of the leading bankers felt that it would be to their mutual interest to organize an association similar to those existing in England and in the United States. As a result the Canadian Bankers' Association was organized in 1892 as a voluntary organization for the common benefit and protection of the banks. Its members were the chartered banks and its associate members, bank officers, and bank clerks. In meetings of the Association members were represented by their chief executives for the time being. Between meetings the interests of the organization were watched and its affairs managed by an executive council whose liberty of action, subject to the approval of the Association at the annual meetings, was as wide as could be desired.

In the session of 1900 in a special Act the Dominion Parliament gave this voluntary association the status of a public corporation, the declared object of which was "to promote generally the interests and efficiency of bank officers and the education and training of those contemplating employment in banks, and for such purposes, among other means, to arrange for lectures, discussions, competitive papers and examinations in Commercial Law and Banking, and to acquire, publish, and carry on the *Journal of the Canadian Bankers' Association.*"[6] Power was accorded the Association to establish subsections, to establish a clearing house for banks in any place in the Dominion, and to make rules and regulations for the conduct of clearing houses.

The formation of the Association marked the beginning of a common effort toward encouraging and enforcing the general observance of high standards of banking, the maintenance of adequate reserves, the prevention of frauds in the issues, and the

[6] 63-64 Victoria, c. 93.

administration of insolvent banks' estates in the best interest of both their creditors and stockholders.

By section 124 of the Bank Act there have been delegated powers and administrative duties to the Canadian Bankers' Association unknown to any similar association in the world.[7] Unlike the American Bankers' Association, it has official standing. Parliament has given authority to the Canadian Bankers' Association to establish clearing houses and to provide for the efficient transfer of funds. It can make rules and regulations for the administration of the clearing houses subject to the approval of the Treasury Board and the stipulation that membership shall be voluntary and that each member shall have one vote on all matters. A large number of clearing houses have been established, all of which operate under general rules and regulations proposed by the Association. In 1913 the Association brought about the insertion of a provision in the Bank Act providing for the establishment of a central gold reserve wherein the banks were permitted to deposit gold or Dominion notes against which they could issue their own notes in an equal amount. The management of this reserve was placed under the Canadian Bankers' Association. In 1927 through the efforts of the Association, a central clearing fund was established at Montreal to facilitate the settlement of balances between clearing houses located in Montreal, Toronto, Winnipeg, and Vancouver. The Royal Trust Company was selected as trustee for this fund in which each bank was required to keep a supply of Dominion notes sufficient to meet its adverse balances from time to time. The Association was authorized to examine these funds at least yearly.[8]

The main powers of the Canadian Bankers' Association may be summarized as follows:

1. To establish subsections of the Association;
2. To appoint a curator for a bank which suspends payment and to supervise its affairs until the resumption of its business or until a liquidator is appointed;
3. To establish clearing houses whose by-laws must be approved by the Treasury Board;

[7] Bank Act, 1934.

[8] The operation of the central gold reserves and the central clearing fund was discontinued when the Bank of Canada began to function in 1935 and became the clearing agent of the chartered banks.

4. To supervise the printing, delivery, and destruction of bank notes and to inspect the circulation accounts of the individual banks;
5. To supervise the custody and management of the central gold reserves;
6. To impose penalties for the breach or non-observance of any by-law, rule, or regulation.

The Association naturally interests itself in any proposed legislation respecting banking and related matters. Its activity in this connection, uniformly conducted on a high plane, includes the publication of pamphlets, the giving of testimony before Committees, the editing of news and the publication of *The Canadian Banker*. One of the chief functions of the Association now includes the education of bank officers. Courses in banking and allied subjects are conducted for the Association by the University of Toronto, Queen's University, and Shaw Schools.

Credit Control

In the pre-war period the only monetary objective thought of in Canada was the maintenance of the exchanges. There was little attempt to formulate a conscious policy of credit control on the part of the chartered banks although each bank had more or less mechanical rules to guide it in preventing undue expansion of credit. Canadian bankers had what might be called a balance sheet concept of credit control—a more or less mechanistic concept of the proportion of cash they should maintain to liabilities. Bankers generally were of the opinion that cash holdings should at least equal 10 per cent. of their liabilities. This served to check credit expansion as effectively as would legal reserves. Some banks kept an eye on the financial statements of other chartered banks to ascertain if their own was out of line. In addition, to some extent before 1914, the chartered banks followed the credit policies of the Bank of England and the larger New York banks in the United States.

What credit control there was in pre-war days was almost exclusively in terms of bank reserves; when bank reserves were high credit was expanded, and when reserves became low credit was contracted. The Canadian banking system was a completely decentralized one, and the ultimate amount of bank credit was limited almost solely by the physical reserves possessed by the

banks. There was no agency in Canada whereby the banks could immediately increase their reserves. An elastic element in bank reserves was provided by call loans in London and New York. When the demand for credit was slack in Canada the banks placed their surplus resources in call loans in these cities, and when the demand for credit in Canada increased, such call loans were reduced and the proceeds used in Canada. Once, however, the banks had reduced call loans to a minimum, the elasticity of their reserves disappeared, and their ability to extend credit was curtailed. In time of need the banks could borrow in London and New York, but this was more of an emergency resort. Thus it will be seen that the reserves physically possessed by the chartered banks controlled their ability to extend credit.

The Dominion note issue functioned in an automatic way. The Department of Finance exchanged Dominion notes for gold, and gold for notes. The growth of the Dominion note issue was dependent on the acquisition of additional gold stocks.

The pre-war position of the system was well summarized by the Royal Commission in 1933, as follows:[9]

> "As there were then no rediscounting facilities or anything of a similar character in Canada, there was no way by which the banking system could, within Canada, quickly increase its cash reserves. It was thus forced to rely upon its assets quickly realizable outside of Canada.
>
> "Each bank extended or limited credit in the light of its position in terms of cash within the country and claims on cash without. The fundamental consideration of a bank was always to keep its position sufficiently liquid to meet all the cash demands upon it. On the Canadian banking structure as a whole, the main demands for cash, apart from domestic seasonal needs, were for meeting external requirements. The ability to meet this demand implied the ability to maintain the gold standard.
>
> "The functioning of the gold standard meant that an efflux of gold would result in credit being restricted, with all the economic stresses which such a policy involves. An influx of gold brought about the opposite result. The functioning of the gold standard meant the maintenance of stable foreign exchanges and so kept the movements of the domestic and world-price structures in harmony.
>
> "In the years from 1900-1913 the great expansion in Canada was financed by a heavy importation of capital. The usual

[9] *Report of the Royal Commission on Banking and Currency in Canada, 1933*, pp. 57, 58.

economic stresses and strains involved in an adherence to the gold standard were therefore easily borne.

"When Canada sold securities in London, the proceeds of the loan were usually deposited in a branch of a Canadian bank. Some of the proceeds of the loan were used to buy goods which were sent to Canada, but a large part of the proceeds was wanted for expenditure in Canada. Accordingly, the borrower sold his London balance for a deposit in Canada; the bank increased its assets abroad and its deposit liabilities in Canada. In this way, the Canadian banks, in return for deposits in Canada, were constantly coming into foreign balances. As the domestic deposit did not need a reserve equal to the whole foreign balance, the bank was able to use the excess of the foreign balance as it desired. It could be lent or invested in London or in New York or taken to Canada in the form of gold. In either case the bank had an additional reserve asset which permitted the further extension of credit if it so desired. This procedure permitted a continuous expansion of credit to go on in Canada. Balances obtained through a sudden increase in the returns from the export trade, either through added volume or an advance in prices, might also result in the expansion of credit. The great importance to the Canadian banking system of balances obtained in these ways is thus clear."

Adherents of the banking principle rather than the currency principle, Canadian bankers disclaimed any control or degree of management over the volume of credit. They were reluctant to admit that while the pre-war gold standard was as automatic as it was possible for any currency to be, a certain minimum management was indispensable. They placed an exaggerated and unwarranted emphasis on the automatic action of the gold standard in regulating the volume of currency. The stability of the currency and the foreign exchanges, or the adjustment of internal or external prices was not, they contended, a banking function at all. These were matters which might be left to the play of supply and demand without any interference on the part of the banks.

As Sir Charles Addis has stated,[10] "The truth, of course, was otherwise. The banks had no choice in the matter. Like Monsieur Jourdain, who had been talking prose all his life without knowing it, the banks in fact had been managing the currency all along. It was not a question of choice. They could not help themselves. Consciously or unconsciously, whether they liked it or not, it was

[10] Sir Charles Addis, K.C.M.G., *The Journal of the Canadian Bankers' Association*, Vol. XVII, p. 43.

the banks, who, by their daily operations, were responsible for regulating the volume of credit by which the stability of the price level and of the foreign exchanges was largely determined . . . It is a tribute to the efficiency of the banks that the course of Canada's agricultural and industrial development was not in any way hampered or checked by the lack of adequate banking credit right up to the outbreak of the War."

CHAPTER II

THE FINANCE ACT

THE closing of the stock exchanges and the crises which developed in Europe and the United States during the latter part of July, 1914, induced in Canada a feeling of uneasiness and apprehension. An atmosphere of incipient panic prevailed generally. Heavy withdrawals of gold took place in the larger cities, and it appeared not at all improbable that this might develop into runs on the banks. The banks became apprehensive of their ability to meet the financial situation, which by Monday, August 3, became so critical that the leading members of the Canadian Bankers' Association, headed by its President, Mr. D. R. Wilkie, arrived in Ottawa to confer with the Minister of Finance, Sir Thomas White, regarding remedial measures. It was recognized that the cash reserves of the banks were insufficient to meet the drain and that their other reserves in the form of call loans in New York and London were not available. To meet conditions an Order-in-Council was passed on August 3, providing, *inter alia*, for advances to the chartered banks and to the savings banks (to which the Quebec Savings Banks Act applies) in the form of Dominion notes issued against deposits made by the banks with the Minister of Finance of such securities as might be approved by the Minister.[1] The Department of Finance was empowered thereby to advance Dominion notes to the banks upon the pledge of satisfactory collateral. At a special session of Parliament held later in the month the Finance Act was passed and assented to August 22, 1914.

THE FINANCE ACT, 1914

The Finance Act confirmed the issue of notes made under the provisions of the Order-in-Council, and provided for authorization by proclamation of similar advances in case of war, invasion, riot or insurrection, real or apprehended, and in case of real or

[1] *Canada Gazette*, Vol. 48, p. 466.

apprehended financial crises. The Governor-in-Council was empowered by the Act, in such circumstances of emergency, by proclamation (1) to authorize the chartered banks to make payments in their own notes instead of in gold or Dominion notes and to use the facility of issuing excess notes throughout the year and not merely during the crop-moving season; (2) to suspend the redemption in gold of Dominion notes and (3) to establish a general moratorium. In effect it meant the abandonment of the gold standard.

In pursuance of the Act, a proclamation was issued on September 3, 1914; and thenceforth throughout the War and the early post-war period extensive use was made of the Act.

The Finance Act, devised under conditions of great emergency, had two main objects: first, to ward off a threatened panic; and second, to finance the War on an unprecedented scale. Both of these purposes were admirably discharged.

An Act passed in 1919 provided for the continuance in force of the proclamation made on September 3, 1914, "until two years after the conclusion of peace on termination of the present war."

THE FINANCE ACT, 1923

In 1923 the Liberal Government, upon the termination of the Act of 1914, introduced through Mr. Fielding, their Minister of Finance, the Finance Act of 1923. In introducing the bill Mr. Fielding pointed out that the original act had been adopted as a war measure, and although the War was over, experience had shown the Act was still required. He stated that he was inclined to think that something of the kind would have to become a permanent part of the Canadian financial system. Both parties favoured the measure, an amended edition of the 1914 Act. As a result, the bill was enacted with little discussion on the floor of the House, the debate covering only three or four pages of *Hansard*. Apparently, as a result of the extensive use which had been and was being made of the Act, it was decided to make the Finance Act mechanism a permanent part of the financial system.

Under the Finance Act, the Minister of Finance was empowered to make advances of Dominion notes to the chartered banks and to the savings banks (to which the Quebec Savings Banks Act applies) upon the pledge of:[2]

[2] Statutes of Canada, 13 and 14, George V, Chapter 48.

(a) Treasury bills, bonds, debentures, or stocks of the Dominion of Canada, Great Britain, any province of Canada, and of any British possession.

(b) Public securities of the Government of the United States.

(c) Canadian municipal securities.

(d) Promissory notes and bills of exchange secured by documentary title to wheat, oats, rye, barley, corn, buckwheat, flax, or other commodity.

(e) Promissory notes and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes and which have been used or are to be used for such purposes.

The Finance Act[3] provided that such securities were to be deposited by the borrowing bank with the Minister of Finance or with the Assistant Receiver-General. The duration of advances was limited to one year.

Treasury Board

The administration of the Act was placed in the hands of the Treasury Board. This Board was, in effect, a Committee of the Cabinet, consisting of the Minister of Finance who acted as Chairman and five other Ministers nominated from time to time by the Governor-in-Council with the Deputy Minister of Finance as Secretary.[4] The Board was authorized to fix the rates of interest and to make regulations with regard to advances, the terms and conditions affecting the deposit of securities, and all other provisions necessary to give effect to the provisions of the Act.

Procedure Under the Act

The procedure under the Finance Act was exceedingly simple, and, from the standpoint of the banks, admirably convenient. In accordance with the Act each bank applied to the Treasury once or twice a year, usually once a year, for a credit, against which the bank undertook to pledge securities of the character specified by the Act. The Treasury Board authorized the extent to which borrowings under the Act might be made by the bank and deter-

[3] The Acts of 1914 and 1923 were consolidated in Chapter 70 of the Revised Statutes of Canada, 1927.

[4] In 1933 the Treasury Board consisted of the Minister of Finance, the Minister of Justice, the Minister of Trade and Commerce, the Minister of Railways and Canals, the Minister of National Revenue, the Minister of Marine and Fisheries, and the Deputy Minister of Finance. The first and last were members *ex officio*.

mined the values to be placed upon the securities deposited for the purpose of securing that credit. These securities were lodged with the Receiver-General of Canada. The bank thereby was enabled to obtain Dominion notes whenever it required a temporary enlargement of its cash resources.

These were required, normally, in Montreal, which was the domicile of the central clearing fund. If, on the other hand, they should be required in Toronto or elsewhere, they could be made available immediately upon telegraphic instructions from the Receiver-General in Ottawa, at the office of the Assistant Receiver-General in the province concerned.

If additional Dominion notes of small denominations should be needed elsewhere in Canada it was possible under the system for the bank, either in Montreal or Toronto (where most of the Dominion notes of large denominations were stored in vaults), to deposit with either of the Assistant Receivers-General stationed in these cities legal tender notes of $50,000 and upwards, receiving in exchange, from the Assistant Receiver-General in the province containing the branch which required the additional cash resources, a corresponding amount of Dominion notes of small denominations.

All advances under the Finance Act became due on May 1 of each year. It became the practice for the banks to submit to the Treasury Board just prior to that date their application for the authorization of advances to cover anticipated requirements during the whole of the ensuing year, including the renewal of outstanding amounts. The Treasury Board authorized advances to the several banks of such amounts as the Treasury Board deemed advisable. This was a sort of standing credit or maximum authorization. The practice did not, however, preclude a bank from making, during the course of the year, other applications which changing conditions might require, nor did it prevent the Treasury Board from lowering the standing credit or maximum authorizations allowed to such bank if such reduction should be deemed advisable.

The formal application contained a schedule giving a description of the securities to be deposited, the bank's valuation of such securities and the valuation placed upon them by the Treasury Board as the basis for the advance. The Treasury Board set up margins by which the different classes of securities must exceed

the amount of the advance. The valuation of the banks was checked by departmental officials against current market quotations and such other information as was at their disposal. The Minister of Finance might require also the trustees of the central gold reserves to make a valuation of, and recommendation as to the amount which, in the judgment of the trustees, might properly be advanced against the securities.

A War Measure Converted Into a Permanent Peace-Time Measure

The Finance Act had started out as a war measure to meet the emergency of war finance. In 1923 it was converted into part of the permanent financial structure. As a war measure the Act seems to have been well conceived and to have operated exceedingly well. Generally speaking, the Finance Act served a most useful purpose to the Dominion as a whole. The prosecution of a war places immense financial burdens on the Governments involved. The part played by the Finance Act during the war period has been well stated by the Royal Commission on Banking and Currency in Canada:[5]

> "The problem facing the Canadian Government at the outbreak of the War was that of directing part of the productive capacities of the country to the supply and manufacture of materials necessary for the prosecution of the War. If this was to be done it was necessary that the community's consumption of goods be reduced in order that other goods for military purposes might be produced. Credit inflation was one method open to the Government to divert to its own purposes a larger proportion of the total production.
>
> "The Canadian Government did not attempt to use the Dominion note issue to any extent as an agency of inflation. The Government borrowed from the banks, through the sale of treasury bills, and then repaid the banks from the proceeds of bonds sold the public. Under the provisions of the Finance Act the banks were able to borrow Dominion notes—cash reserves—which provided a base on which to support the added credit made necessary by the financial operations of the Government. In this way, the Finance Act may be said to have been the efficient agency which made effective the policy of inflation which Canada, in common with all belligerent countries, followed."

[5] *Report of the Royal Commission on Banking and Currency in Canada, 1933*, p. 58.

THE TREASURY BOARD NOT A CENTRAL BANK

The significant difference between the pre-war and the post-war financial structure of Canada is found in the Finance Act, a thoroughly revolutionary measure which completely altered the operation of the Canadian monetary system. Few, if any, at the time of its enactment in 1923, really understood the implications of the Act or foresaw its economic consequences. The Act had worked well as a war measure during the regime of a paper standard, but war measures are seldom suitable to peace times. This was true of the Finance Act, particularly following the return to the gold standard in 1926. As to the operation of the Act of 1923, there have been a variety of opinions. In general the bankers were favourable to the Act. Its severest critics were the economists.

Some regarded the Act as a sort of half-way house to a central bank. About the only likeness the Treasury Board bore to a central bank was in discount operations. Even here the resemblance was somewhat illusory. Most of the functions of central banking were entirely lacking. Former Prime Minister R. B. Bennett once stated, "there is about as much resemblance between the operations of the Finance Act and the central bank as a between a lot of steel plates lying in a yard and a finished ship." [6]

The Committee which constituted the Treasury Board was a variable committee of the Cabinet. It had little resemblance to a central bank. The Department of Finance, which was given the task of administering the Act, is a Civil Service department of the Dominion Government and, with the exception of the Inspector-General, who was appointed in 1925, has a staff who lay no claim to being experts in banking or economic matters. The Treasury Board, functioning within the Department of Finance, was composed of political heads of departments, men little qualified by training for the work of the Board. The Department of Finance was not designed to deal with monetary problems. It was not equipped in personnel nor had it the knowledge or the technique required for supervising or controlling the monetary system. According to the evidence of a former Deputy Minister of Finance in 1924, there was no expert or adviser to the Treasury Board outside of himself.[7]

[6] R. B. Bennett, *Debates, House of Commons, Dominion of Canada, 1934*, p. 4223.

[7] J. G. Saunders, Deputy Minister of Finance: *Revised Proceedings, Select Standing Committee on Banking and Commerce, 1924*, p. 349.

While the Board was a political body, Sir Thomas White, wartime Minister of Finance for Canada, and one of the members of the Royal Commission on Banking and Currency in 1933, pointed out[8] that the authorization of advances under the Act was an almost purely routine matter of administration carried out by the Treasury Board, aided by the recommendation of the Minister of Finance and the advice of his chief officials. Sir Thomas stated he had no hesitation in asserting that the administration of the Finance Act under all governments had been wholly free from political influence.

Treasury Board Made No Attempt to Control Credit

One of the cardinal tasks of a central bank is that of regulating the volume of credit, an important factor in influencing the level of economic activity and, therefore, of prices. The Finance Department made no attempt to control the volume of credit and thus influence the tempo of business activity and the price level. Under the operation of the Act, the Treasury Board did nothing more than authorize the amount of credit and fix the value of the securities pledged for the purpose of securing the credit. There was no supervision on the part of the Treasury Board of the expansion or contraction of credit and questions allied to the credit problem. When the Finance Act was enacted there was, apparently, no thought or intention of giving the Treasury Board control over credit. It had no power to deal with gold bullion or foreign exchange. It had no power to conduct open market operations. Moreover the Treasury Board failed to provide all the discounting facilities made available by modern central banks. Advances to the banks were based on securities. A former Minister of Finance stated that the Treasury Board never had an opportunity to consider, and since the War never had considered, the question of rediscounting commercial paper. The only securities they ever dealt with were bonds and securities of that character, federal and provincial, upon which advances were made.[9] The facilities the Board did provide, however, were carried out in a simple and inexpensive manner with a minimum of red tape and delay.

Little or no attempt was made by the Treasury Board to con-

[8] *Report of the Royal Commission on Banking and Currency, 1933*, pp. 87, 88.

[9] R. B. Bennett, *Debates, House of Commons, 1934*, p. 4273.

trol or manage credit by raising or lowering the discount rate. The Deputy Minister of Finance testified before the Select Standing Committee on Banking and Commerce in 1924, that between 1914 and 1924, except for a temporary period in the early part of the War, to aid the banks in making a large loan to the Imperial Treasury for supplies in Canada, the rate had remained at five per cent., and that with that single exception there had been no variation. In answer to a question the Deputy Minister stated he did not think that raising and lowering of the interest rate was an effective instrument to cause deflation or to assist inflation. He was of the opinion that the interest rate had no relation to the matter at all.[10]

In view of the opinion expressed by the then Deputy Minister of Finance, an interesting development took place after 1924. The Treasury Board reduced the rate of interest on November 1, 1924, to 4½%. There it remained until November 1, 1927, when the rate was reduced to 4%. Within one month the rate was again reduced, on December 1, to 3¾%. The lowering of the rate took place at the very time when speculation on the stock exchanges was becoming so active as to call for a warning by banking officials in their speeches at their annual meetings.

The majority report of the Royal Commission on Banking and Currency in Canada stated that in the light of contemporary conditions, an examination of the rates charged from time to time on Finance Act advances suggests that these rates were not used as an instrument of credit expansion and contraction, but were mainly varied to meet the exigencies of the Dominion Government's finances.[11] Sir Thomas White, in a minority report, took exception to the above statement. He stated that with respect to this suggestion, it need only be pointed out that the rates charged on the advances referred to were practically in keeping with the rediscount rates of the Bank of England and with those of the New York Federal Reserve Bank during the period in question.[12] Sir Thomas then set forth the following tables showing the comparative rates from 1926 to 1930:[13]

[10] *Revised Proceedings, Select Standing Committee on Banking and Currency, 1924*, p. 349.
[11] Paragraph 195, p. 59.
[12] *Report of the Royal Commission on Banking and Currency in Canada, 1933*, p. 86.
[13] Ibid.

	Canada	Bank of England	New York Federal Reserve Bank
1926	4½%	5%	4%, 3½%, 4%
1927	4¼%, 4%, 3¾%	4½%	3½%
1928	3¾%, 5%, 4½%	4½%	4%, 4½%, and 5%
1929	4½%	5½%, 6½%, 6% 5½% and 5%	6%, 5% and 4½%
1930	4½%	4½%	4%

An examination of the above rates shows that the rate in Canada remained 4½% during the latter part of 1928 and all of 1929 while the rates of both the Bank of England and the New York Federal Reserve Bank advanced sharply during the latter part of the boom period and then fell after the stock market crash. The Canadian rate remained the same during the latter part of 1928, 1929, and 1930. The very data submitted by Sir Thomas appears to support the position of the majority report of the Commission and refute his own.

Sir Thomas admitted that it is possible that rates on advances under the Finance Act were not used as an instrument of credit expansion and contraction.[14] He was of the opinion, however, that changes in the rate would have little effect, in any event. He contended that it is only in larger international centres, such as London, Paris, and New York, that a rise or fall in rediscount rates exert an important effect upon credit expansion or contraction. In his view, an examination of the borrowings of Canadian banks under the Finance Act shows that the aggregate of such borrowings to the total volume of Canadian bank credits including security holdings (1 to 3%), was so slight that the rate charged upon such advances could have had no appreciable effect unless, of course, it had been raised so much higher than the London and New York rates as to cause a violent contraction of credit and a rise in the interest rates charged to the entire agricultural, commercial, and financial community.[15] The real check upon undue expansion of the currency issued under the Finance Act was due, in the opinion of Sir Thomas, to the caution exhibited by the banks themselves. "They have always been sparing in their resort to its privileges and pay off their advances as quickly as possible. There is a two-fold reason for this policy: firstly, because they do not desire to continue to pay interest any longer than is necessary, and secondly, they do not care to incur

[14] *Report of the Royal Commission on Banking and Currency in Canada, 1933*, p. 87.

[15] Ibid.

or to show in their returns heavy indebtedness in respect to advances under the Act."[16]

It may be a matter of opinion whether Sir Thomas properly appraised the effectiveness of the discount rate in Canada. Seemingly, he underestimated its value as an instrument of credit control in Canadian finance. In any event, no attempt was made to regulate the advances to the banks. If the rate was as ineffective as Sir Thomas suggests, why did the Treasury Board vary the rate at all? Between 1926 and the latter part of 1928 several changes were made in the rate. If the changes in the rate could not be made effective why then were these changes made? Seemingly, the rate was varied mainly to meet the exigencies of the Dominion Government's finances. At the very time when New York and London were raising their rates in an attempt to control the speculation then in progress, Canada was pursuing an easy money policy. It is rather significant that the advances under the Finance Act increased rapidly during the latter part of 1928 and were maintained at a high level during 1929, reaching a peak in November of that year, within striking distance of the all-time peak in November, 1920. From 1924 to 1927 the borrowings by the chartered banks never exceeded $38,000,000 for any one month. Beginning with May, 1928, advances for every single month of that year, and 1929, were considerably above that figure, the advances finally reaching a peak of $111,400,000 in November, 1929. From 1924 to 1927 the advances for November varied from $7,000,000 to $17,000,000. Yet in 1928 the amount was $66,550,000 and in 1929 it was at the peak shown above.[17]

The above facts would seem to support the critics of the Finance Act when they asserted that the rate charged the banks for advances thereunder had not been in line with current conditions. Apparently the Finance Department had no intention of using the interest rate as a means of credit control. When asked for more notes by the banks and on receipt of the statutory securities the Department lent irrespective of the general credit conditions of the country.

[16] *Report of the Royal Commission on Banking and Currency in Canada, 1933*, p. 87.

[17] The data showing the advances under the Finance Act by months from August, 1914, to July, 1933, were obtained from the *Proceedings of the Royal Commission on Banking and Currency, Canada, 1933*, pp. 3172, 3173 (Table C).

In pre-war days the control of bank credit rested with the banks themselves. Under the Finance Act the banks shared the responsibility with the Department of Finance. The notes were only issued by the Treasury Board on the demand of the banks. The initiative rested with the banks and not with the Government. The result of this division of functions was to create an ambiguity which rendered it difficult to fix the responsibility for the management of the currency. The Treasury declined to assume responsibility for controlling the issue with a view to maintaining the value of the monetary unit. The banks, who by applying for notes in the first instance, were responsible for the addition to the currency, disclaimed any obligation on their part to manage an inconvertible note issue.

THE FINANCE ACT FOSTERED SPECULATION

The very freedom of their access to abundant and cheap government currency relieved the banks of anxiety with regard to the liquidity of their cash position, and exposed the more competitive among them to the temptation of utilizing government advances, so easily obtained, for other and more profitable purposes than the strictly national services for which they were intended. There was nothing in the Act to prevent a bank from employing at high rates on the New York stock exchange the funds obtained from the Government at 4%. It is not suggested that the banks utilized this opportunity. Mr. J. P. Bell, former General Manager of the Bank of Hamilton, has stated that this criticism is more theoretical than real, for the banks exercised self-restraint. Self-interest and the way they watched each other urged them to limit their Finance Act borrowings to temporary periods, and the amounts involved were never relatively large.[18] The temptation, however, did exist.

THE FINANCE ACT AND THE GOLD STANDARD

Another fault with the Finance Act which rendered it a dangerous piece of legislation was the failure to require any reserve to be held against the notes issued to the banks. Under its provisions the advances to the banks were not subject to any limitation imposed by a gold reserve. Under the pre-war system gold

[18] *Banking in Canada, Past and Present*,—a pamphlet containing an address given before the Winnipeg Bankers' Lecture Club, April 13, 1937.

exports reduced the reserves of the chartered banks and placed them under pressure to reduce outstanding credit appropriately. This reduction in credit in turn brought about readjustment of prices and of the international balance of payments so that gold exports were checked. Under the Finance Act gold exports reduced temporarily the banks' reserves, but such losses could be immediately recouped by securing advances of Dominion notes under the provisions of the Act. Banks were under no pressure to reduce credits outstanding. Being assured of their own solvency, banks no longer brought about a control of credit in conformity with the monetary policy of the country. The pre-war system was a quasi-automatic system of credit control. On the enactment of the Finance Act Canada passed to a system in which control must be deliberate rather than largely automatic. No institution, however, was set up for the exercise of deliberate control. It was not contemplated in the Act that the Department of Finance should assume central banking functions as no provision was made for the maintenance of any reserve against the notes advanced to the banks under the Act. As noted before, the Department was not given effective instruments of control.

The defects of the Finance Act became particularly noticeable after July, 1926, the date on which Canada returned to the gold standard. Between 1924-1927 the amount of borrowings of the banks was relatively small, rarely exceeding $20,000,000 and at one time falling as low as $3,000,000. With the improvements in business activity the banks used the facilities afforded by the Finance Act more freely. From 1927-1929 their borrowings under the Act increased steadily. A foreign exchange situation calling for the export of gold was met by the banks presenting to the Finance Department Dominion notes for redemption, obtaining gold from the Government's reserve and exporting the gold. They then replenished their own reserves by obtaining more Dominion notes under the provisions of the Finance Act. A general assumption associated with the gold standard is that as a country loses gold, the reserves of the banking system become smaller and credit must be restricted. This is just precisely what did not take place. Under the Finance Act mechanism the loss of gold did not reduce bank reserves and restrict credit. Although gold was exported, bank reserves in the form of Dominion notes were not reduced on account of the rediscounting operations

under the Finance Act. Thus the normal influence of gold exports was never exerted on the credit structure. The only check on credit expansion, apparently, was the ability of the banks to place further loans to their satisfaction.

Decline of Gold Reserves of Dominion Government

As a result of the operations of the Finance Act the gold reserves of the Government declined rapidly. The total volume of Dominion notes, however, did not show any substantial reduction due to the fact that, as Dominion notes were redeemed in gold, others were issued under the Act, thus keeping the total fairly constant.

The gold reserves were further reduced by the action of the Finance Minister in 1928. During that year certain obligations of the Dominion became due in New York. Without endeavouring to obtain the sale of a sufficient amount of Dominion securities to take up the obligations falling due, Mr. Robb, Minister of Finance, undertook by authority of the Governor-in-Council, to export $40,000,000 of the country's gold reserves to pay off the maturing obligations. To replenish the deficiency in Canada's reserves, he issued a corresponding amount of Dominion notes, diluting still further the country's gold reserves.

During 1928 and 1929 the Department of Finance made advances to the banks without having a sufficient stock of gold to support the added credit brought into existence. The continued expansion during the period was in no way justified by the underlying monetary conditions of the country. The constant withdrawal of gold by the banks from the Dominion gold reserves precipitated a crisis at the end of 1928 and the beginning of 1929.

Canada Abandons the Gold Standard

While there has been much discussion as to when Canada abandoned the gold standard, there seems no doubt that *de facto* Canada abandoned the gold standard at the close of 1928, although the abandonment of the gold standard *de jure* did not take place until 1931. Professor Curtis of Queen's University stated that it may be concluded that during 1929 the country was definitely off the gold standard and that during the last half of 1930, and in 1931, until the legal abandonment of the gold stan-

dard occurred, the country did not adhere consistently to the standard.[19]

From July 1, 1926, when Canada returned to the gold standard, her foreign exchanges were maintained within the gold points for nearly two and one-half years. From the end of 1928, however, gold was not freely available for export, and the Canadian dollar was at almost a continuous discount of from 1 to 2¼%. An unofficial embargo was imposed by the Department of Finance on the export of gold. Professor Plumptre of the University of Toronto has summarized the situation as follows:

"Except for a period of a few months in 1930, when circumstances had in the immediate past been exceptionally favourable to the Canadian balance of payments, there has been no period since the beginning of 1929 when gold was obtained freely and without penalty at the Department of Finance in exchange for Dominion notes. Nevertheless, in spite of the evidence of strain, the Canadian dollar did not fluctuate very far beyond the "gold points", only once exceeding 2 per cent. from par, and the man in the street was certainly unaware of untoward events, until Great Britain abandoned the gold standard in September, 1931.[20]

The economic and financial crisis which engulfed the world late in 1929 did not force Canada to abandon the gold standard. She had already abandoned it almost a year before the peak of prosperity was reached. The operations of the Finance Act forced Canada extra legally, but effectively, to abandon gold. There would appear to be little doubt that Canada's early abandonment of the gold standard is directly traceable to the operation of the Finance Act.

Independent Institution Needed

Under the Finance Act Canada had a monetary system in which no one accepted the responsibility for credit control. Under the Act responsibility for credit control had been transferred from the banks to a Civil division of the Government which seemed in no way aware of its responsibilities. There was much justification for the Finance Act as a piece of legislation hastily adopted to meet the unknown exigencies of war. As a part of the

[19] "Canadian Monetary Situation", *Journal of Political Economy*, Vol. XL, p. 322.

[20] *The Canadian Economy and Its Problems* (ed. H. A. Innis and A. F. W. Plumptre), 1934, p. 160.

permanent monetary structure of a country which professed to adhere to an international standard, it had demonstrated not only its inadequacy but its dangerous implications.

It had become clearly evident by 1929, if not before, that for external reasons the Finance Act should be either modified or abandoned. As an emergency measure the Act had been justified, but it was clearly inexpedient in normal times that the Government, which was itself the chief borrower, should also be the original source of credit and the direct instrument for controlling the volume of currency, and therefore, to a large extent, the final arbiter and distributor of purchasing power. An independent institution was needed, moreover. There was no existing authority to which the Government could apply for practical guidance in formulating its financial policy. There was no agency which could represent it abroad and expound in international conferences the authentic monetary policy of Canada. It was quite apparent that the time had come for the establishment in Canada of a real central banking institution.

CHAPTER III

GROWTH AND DEVELOPMENT OF THE CENTRAL BANKING IDEA IN CANADA 1913-1923

ORIGINS are always difficult to trace. This is no less true of the Bank of Canada. Before the War there was little or no discussion in Canada concerning the need of a central bank. Certain western members of Parliament did feel very strongly that some new character should be given to the banking system of the country. Some were in favour of the nationalization of the banks—that is, the complete control by the Government of the note-issuing and credit-granting functions of the banks.

PRE-WAR PARLIAMENTARY DISCUSSIONS

One of the earliest references in the House of Commons regarding a central bank was the suggestion made by the late W. F. MacLean on the second reading of the Bank Act revision proceedings in 1913.[1] He suggested that Canada should have a great national or State Bank, the shares of which would be largely owned by the public, but regulated in the public interest. He referred to the Imperial Bank of Germany as an example of a State bank which issued practically the sole national currency. He thought that in Canada the State could utilize its credit and suggested that two or three of the largest Canadian banks be consolidated into the Bank of Canada with a capital of at least $250,000,000, such a bank to be called the Bank of Canada and to be the sole bank of issue. It would lend its notes to other banks on proper security at a fair rate of interest. The new bank would be a banker's bank, also the bank of the Dominion Government, of the provinces, and the great corporations. National notes should be secured by a gold reserve of at least 25%. He did not propose that the notes issued by the Bank of Canada should be fiat money—they should have substantial security behind them.

[1] *Debates, House of Commons, Dominion of Canada, 1913*, p. 1886.

Honourable R. L. Borden, Prime Minister, was not inclined to believe there was any necessity for a central bank.[2]

A curious objection to a central bank was voiced at the time by one of the members, Mr. J. A. Currie.[3] He stated that the great European central banks had been intended to give profits of banking to the State and to lend money to the State. Canada did not need to borrow money for the State from her people, so did not need to establish a national bank. He objected further on the ground that there was a danger of currency inflation by the State.

The Honourable W. T. White, Minister of Finance, opposed the establishment of a central bank in Canada on the ground that, as far as he could see, there was no job for such an institution.[4] Moreover, he felt that there was no public demand for a great national bank administered by the Government, the function of which would be to gather up the savings of the people and use those savings in the construction of public works. He expressed the view that public opinion in Canada favoured borrowing abroad, particularly from Great Britain, the funds required for public works, thus making the savings of the Canadian people available for the rapidly expanding commercial needs of the country.[5]

These early discussions in Parliament on central banking reveal the fact that many of the speakers were of the view that the most important, if not the only function of a central bank, was for the purpose of lending money to the Government. It is true that Mr. MacLean did have a wider conception of the functions of a central bank. There appears to have been little or no thought of the bank exercising credit control.

Bankers Among Early Advocates of Central Bank

Possibly the earliest expressed view of a Canadian banker in favour of a central bank was that of Mr. D. R. Wilkie, a former President of the Imperial Bank of Canada, and a former President of the Canadian Bankers' Association. He stated on May 27, 1914, before the enactment of the Finance Act:

> "The time will come in Canada, and come early, when we will find it advisable, yes, necessary, with our growth and

[2] *Debates, House of Commons, Dominion of Canada, 1913*, p. 2300.
[3] Ibid., p. 2329.
[4] Ibid., p. 2493.
[5] Ibid.

development, to establish a bank of rediscount under the patronage of the Dominion Government and with somewhat similar powers to those granted to the Reserve Banks of the United States."[6]

At the beginning of the War the Finance Act introduced into the Canadian Banking System some of the functions of a central bank and paved the way for a discussion of a fully organized institution.

Central Bank Proposed by E. L. Pease

The late Mr. E. L. Pease, former President of the Royal Bank of Canada, one-time President of the Canadian Bankers' Association, and one of Canada's most gifted and farseeing bankers, had long been a proponent of a central bank for Canada. At the annual meeting of the shareholders of the Royal Bank of Canada in January, 1918, he stated:[7]

> "In my opinion the question of providing supplementary banking facilities in this country is very important and should receive the consideration of the Government and the banks. If we had a bank of rediscount patterned somewhat after the Federal Reserve Banks in the United States, it would render legitimately available millions of assets in the form of high grade commercial paper, now lying dormant in the portfolios of the banks, and thereby increase our financial resources. I think the Government should appoint a committee of experts to investigate the question."

In 1918 Mr. Pease proposed to the Canadian Bankers' Association that a bank of rediscount be created. The results of Mr. Pease's proposal probably can be stated best in Mr. Pease's own words. In his Presidential address to the Canadian Bankers' Association on November 14, 1918, Mr. Pease said:[8]

> "At the meeting of the Executive Council on the 30th of May last, a resolution was passed for the appointment of a Committee, subject to the approval of the Finance Minister, to consider and report upon the proposal. It was understood that the Confidential Committee would undertake these duties if approval were given.
>
> "The Finance Minister gave his approval. I learned, however, that one member of the Committee was unfavourable to

[6] *Report of the Annual Meeting of the Shareholders of the Imperial Bank of Canada, 1914*, p. 24.

[7] *Report of the Annual Meeting of the Shareholders of the Royal Bank of Canada, 1918.*

[8] *Report of the Canadian Bankers' Association*, November, 1918, pp. 11-14.

the discussion of the matter until after the war, and concluded that it would not be desirable to record a divided opinion. The Committee was, therefore, not convened, and the question is referred back to the Council. You will be asked to decide today whether it shall be further considered or dropped."

Referring to the opinion he had expressed earlier in the year, Mr. Pease stated:

"I understood there has been criticism on the part of some members of the Council in regard to my action in mentioning this suggestion first to the shareholders of the Royal Bank of Canada at its annual meeting in January last, instead of to the Council. While, of course, I made the suggestion in my individual capacity, I adopted that course with a view of eliciting preliminary public discussion and criticism. You are aware that leading bankers in the United States were strongly opposed to the Federal Reserve scheme, and that the Government was obliged to proceed without their support, though it was not long before the banks began to extol the system. Public criticism in Canada following my suggestion was favourable so far as it went. I have not been advised that any General Manager is opposed to the scheme in principle, but the opinion was held by one or more of you gentlemen that the subject should not be discussed until after the War."

It was pointed out by Mr. Pease that the matter of supplementary banking facilities had been widely discussed in England during the War, and that huge amalgamations had been effected, and controlling and other interests acquired in banks operating in distant countries. British banks had opened branches in leading business centres of France and Spain.

In the opinion of Mr. Pease serious problems would soon confront Canada following the close of the War. There would be a deflation of commodity values, dislocation in industry, and withdrawal and shrinkage in deposits. Canada would be expected to grant extensive credits to her allies for reconstruction in devastated Europe and at the same time at home she would have to provide credits for reconstruction of railway systems, shipbuilding, and extension of her foreign trade in general. Mr. Pease proposed a central bank to meet what he regarded as a definite need.

Mr. Pease stated that it was in order to minimize uncertainty with regard to the difficulties which would presently confront Canada, and to provide increased financial facilities, that he advocated the creation of a bank of rediscount. Without this he did

not believe the country could properly cope with the approaching situation.

While recognizing that the privilege of borrowing under the Finance Act of 1914 had proved most effective and advantageous during the War, Mr. Pease pointed out that it was a war measure and not applicable, therefore, to normal conditions. It should not be perpetuated, because it was not a good principle for the Government to engage permanently in the banking business. Furthermore, the tendency of the banks was to borrow from the Government only with reluctance—they were criticized if they did so. He contended, further, that production and export trade would not receive the attention and facilities they should if the banks were dependent upon borrowing from the Government. Moreover, this method of financing tended to have inflationary results.

Mr. Pease referred to the fact that some bankers entertained the opinion that there is little difference between borrowing from the Government and borrowing from a central bank; that if the former resulted in inflation the same result would follow the creation of credit by a central bank. That opinion Mr. Pease regarded as erroneous.

Structure of Proposed Central Bank

The details of Mr. Pease's proposals as to the character and functions of a central bank included direct control by the Government, rediscounting by the chartered banks, the establishment of a bill market, and many of the other features which have now been incorporated in the structure and practice of the existing Bank of Canada. It was taken for granted that the central bank would discount only high grade commercial paper which would liquidate itself at maturity.

In submitting his proposals, Mr. Pease said:[9]

> "With your permission I shall outline briefly the scheme of a central bank such as I have in mind. I am aware it is very imperfect in its conception, but it may serve as a skeleton to build upon.
>
> "Capitalization. $20,000,000, one-half to be contributed by the Government and one-half by the chartered banks on a pro-rata basis to capital.

[9] Ibid.

"Control. Under the direct control of the Government, who will appoint Directors on the nomination of the Canadian Bankers' Association.

"Dividends. Dividends to be limited to 6%, after payment of which one-half of the net earnings to be paid to a surplus fund until it amounts to 50% of the paid-up capital, and one-half to the Dominion Government as a franchise tax, thereafter the whole surplus to the Government.

"Note Circulation. To be the obligation of the Dominion Government, secured as hereinafter mentioned. The central bank to be the exclusive issuing medium of the Government.

"Circulation Reserves. A gold reserve of 40% to be maintained against the notes in circulation, and the remaining 60% to be secured by high grade commercial paper.

"Receivers-General Offices. To be discontinued. Branches of the central bank to be substituted.

"Gold Holdings. The Government to deposit its entire gold holdings with the central bank, provision being made for the substitution of central bank notes for present Dominion notes.

"Reserve Balances. The chartered banks to maintain reserve balances with the central bank equal to —[10] of their Canadian deposits.

"Clearing House. The central bank to exercise the functions of a Clearing House.

"Bank Note Circulation. The free note circulation of the chartered banks to be restricted to the amount of their paid-up capital.

"Excess Circulation. The excess circulation of the chartered banks now covered by deposits of gold and legal tender in the Central Gold Reserve to be exchanged on transfer of their deposits for central bank notes."

Bankers Opposed Proposed Central Bank

Opposition to this idea on the part of the officers of the other Canadian banks, particularly the Bank of Montreal, and of the Government of the day, was so great that no tangible progress in this direction was possible.

Sir Frederick Williams-Taylor, General Manager of the Bank of Montreal, suggested that the Finance Act had satisfactorily performed the functions of a bank of rediscount during the War and that the extension of its provisions to peace conditions might well be considered before any radical departure from the existing system of finance was undertaken. The Canadian Banking System, Sir Frederick urged, had in times of peace met all emer-

[10] No percentage was suggested.

gencies when the banking system of the United States had completely failed. With the assistance of the Government it had proved adequate during the War. Furthermore, it was not clear that the adoption of the principles which had been found necessary to add to the American system was required or that they would prove effective in operation in Canada. The Bank of Montreal was not favourable to the proposal.

Mr. Bell, General Manager of the Bank of Hamilton, commented favourably on the plan outlined by the President, Mr. Pease. In his view there was a need for such an institution in Canada. He called attention to the statement made by the eminent English banker, Sir Edward Holden, to the effect that the Federal Reserve Banking system in the United States was, in Sir Edward's opinion, the best banking system in existence at that time. Mr. Pease's proposals, Mr. Bell added, followed the main features of the Federal Reserve plan.

Sir John Aird, General Manager of the Canadian Bank of Commerce, pointed out that while he had not been in favour during the period of the War of entering upon the discussion of proposals of this kind, he had always stated that as soon as the War was over he thought the time was ripe for a full discussion of the questions raised by the President in his address.[11]

The following resolution, moved by Sir John Aird, was thereupon adopted:

> "Resolved, that the subject matter of the President's address, namely, the establishment of a rediscount bank in Canada, be referred to the Confidential Committee for consideration and report to the members of the Association, and that the Committee be authorized to add to their numbers one or more of the Honorary Presidents, to employ if deemed advisable experts on economics to assist the Committee in formulating its conclusions."

This was a quiet way of shelving the issue.

While Mr. Pease was an enthusiastic advocate of the general idea, he did not care to place himself publicly on record until banking opinion had developed to a point where it would not be received with bitter hostility by the other banks. Over a period

[11] The views expressed by Sir Frederick Williams-Taylor, Mr. Bell and Sir John Aird were taken from the *Report of the Canadian Bankers' Association*, November 1, 1918.

of years, both before and after this address, he conducted extensive correspondence on the subject, obtaining views from the United States of such men as Mr. Barton A. Hepburn and Mr. Frederick I. Kent, as well as writing to many people in Great Britain and all parts of Canada.

It seems clear that the idea of a central bank for Canada originated with Mr. Pease. Actually, he was long in advance of his time, but throughout his lifetime active opposition to the idea continued. His views made a greater impression upon banking opinion and traditions in Canada than might be indicated by quotations from any of his public addresses.

Dr. Clarke an Early Advocate of a Central Bank

About the same time, Dr. W. C. Clarke, Professor of Economics, Queen's University, Kingston, was espousing similar views. Dr. Clarke furnished a good deal of the inspiration for the western Members of Parliament who a few years later began advocating a central bank for credit control. Many of these western representatives consulted Dr. Clarke relative to this matter. Dr. Clarke's influence and work toward the establishment of a central bank was at this point indirect rather than direct. He furnished the ideas. However, many of the views expounded by these parliamentarians, particularly the radical views, are not to be ascribed to Dr. Clarke. While he remained in the background, behind the scenes, as it were, he exerted a very considerable influence in favour of a central bank for Canada.

Coalition Government Opposed to Central Bank

Shortly after the end of the War a central bank was discussed by members of the Coalition Government. It was rejected on the ground that at that particular stage, when finance and politics were disordered, it would be inconvenient and dangerous to have a new authority introduced into the situation without any particular experience or prestige. It was thought that such an institution would hamper the Government in its activities in regard to the finance of the country. As a result the proposal was dropped.[12]

Every year from 1921, when the first Labour member and the first group of Progressives sat in the House of Commons, they brought before Parliament again and again the question of a

[12] *Round Table*, Vol. XXIV, 1933-1934, p. 621.

central bank of issue and rediscount and, as the days went on, proceeded to develop the policy until it became one of complete nationalization. With one exception, the chartered banks, the managers and presidents in Canada opposed the creation of a central bank.

Post-War Agricultural Conditions Created a Demand for a Reorganized Banking System

Economic conditions existing in Canada in 1923 made it certain that when the Bank Act came up for its decennial revision in that year, attempts would be made to alter in radical fashion the banking system. The farmers were passing through a severe readjustment initiated by the fall in the general level of prices three years previously and intensified by the relatively low prices prevailing for farm products as compared with commodities they were forced to purchase. The farmers found a wide gap existed also between the cost of production on the farm and the prices received for their products. During the War farmers had increased production greatly. They had invested heavily in expansion programmes and many had gone heavily into debt as a result. The collapse in prices was laid in part, as usual, at the door of the banks. Many agriculturists were of the belief that the restriction of credit which developed had hammered prices down. Credit had been so widely extended that banks were forced to scrutinize carefully every loan. Farmers found it increasingly difficult to finance necessary requirements. Many were of the opinion that their economic ills and chills could be cured by an expansion of credit, that some engine of credit expansion should be set up in the banking system. What many groups advocating credit expansion in Canada failed to see, or refused to see, was that the collapse in wheat and other agricultural prices was largely the result of world-wide conditions over which the Canadian banking system had little or no control.

As a result of depressed economic and financial conditions, one of the more radical groups, the United Farmers of Alberta, passed a resolution to the effect that the banking system of Canada was a mystery to them, and they wanted to have the issue of money and financial operations at large taken over by the Government or by the people. In some way or other they thought that by so doing the mystery could be taken out of banking.

The farmers, discontented and rebellious, were represented by a fairly strong agrarian party (Progressive party), which occupied a most strategic position in that it held the balance as between the older political parties, the Liberals and the Conservatives. Some of the members were firmly convinced that the banking system was responsible for the economic maladjustments in which the farmers and other classes were enmeshed. They had the feeling that Canada was in the grip of a banking monopoly.

Some were of the opinion that Canada needed a Federal Reserve System, a Bank of Canada, or an institution similar to the Commonwealth Bank of Australia. If some such institution were set up they believed that additional credit would become available and that more equitable distribution would be brought about, that interest rates would become lower and more uniform. They held that rediscount facilities were needed to take care of the seasonal and cyclical credit needs of the chartered banks.

Decennial Revision of Bank Act, 1923

When the Bank Act came up for revision in 1923, representatives of the farmers of the West and two provincial legislatures asked that revision be held over for a year, or at least that the bank charters be granted for one year only until there had been a thorough investigation as to the needs of the banking system.

The attitude of the Canadian Bankers' Association toward the revision was wholly negative. The representatives of the banks took issue with the criticisms already noted. They stated that the Canadian banking system was well adapted to meet the requirements of production and consumption as well as those of the mercantile community. They maintained that the circulating medium, consisting of bank notes and Dominion notes, issued under conditions prescribed by legislation, was entirely adequate to meet business and agricultural conditions, and that it constituted a currency second to none in existence in its essential soundness and its flexibility in meeting changing economic conditions.

The policy of the Liberal Government, as outlined by the Minister of Finance, Honourable W. S. Fielding, was that of steering a safe middle course between the Scylla of "do-nothingness" and the Charybdis of "radicalism". The Government ac-

cepted a resolution moved by Mr. Irvine, one of the representatives of the United Farmers of Alberta, for an investigation into the basis, function and control of financial credit.

Banking and Currency Committee Investigate Credit in 1923

The order of reference stated, "that, in the opinion of this House, the question of appointing a representative Parliamentary Committee to investigate the basis, the function and control of financial credit, and the relation of credit to the industrial problems, be referred to the Select Standing Committee on Banking and Commerce." The Committee reported back that, "it appears to the Committee that the said resolution does not quite represent the intention of the House in making reference to them, but that such intention was that your Committee should investigate the basis, the function, and the control of financial credit, and the relation of credit to the industrial problems." The Committee asked that if their impression was well founded that they should do their investigating themselves, then the House should amend the reference accordingly. This the House did, and in addition authorized the Committee to recommend any amendments to the Bank Act deemed advisable.

The work of the Banking Committee of the House represents the first investigation hitherto made by the Parliament of Canada into the basis, function, and control of financial credit and the relation of credit to industrial problems. The Committee, which was given leave to sit while the House was in session, began its examination of witnesses on April 11th and concluded its work on May 28th, 1923. The testimony taken and the Committee's proceedings fill nearly eleven hundred pages. Two witnesses were brought from abroad, Professor Irving Fisher from the United States and Major Hugh Douglas from England. One Canadian economist, Professor Swanson, testified before the Committee. A number of the leading officers of the Canadian Bankers' Association and of the chartered banks presented evidence and were subjected to considerable questioning by members of the Committee. Few representatives of business and commercial interests appeared, but Agriculture was well represented, particularly by Western farmers. The Committee heard various proposals for the betterment of the monetary system, among which were: the

establishment of a Federal Reserve Bank, a central bank, the establishment of provincial banks, the institution of a social credit scheme for Canada, stabilizing the purchasing power of the dollar, a scheme for issuing Dominion notes in substitution for Dominion of Canada bonds, and a Farm Loan Fund. A summary of the leading groups of ideas submitted to the Committee will be presented.

Agricultural representatives appearing before the Committee complained that the existing banking system did not meet the needs of agriculture because it did not lend itself readily to extension of long credits to farmers. Farm representatives stated that it was the practice of some banks to lend funds for a period altogether too short for the purpose of the loan and then of compounding the interest on maturity. As the chartered banks are commercial banks they wished to keep their funds liquid whereas farmers required loans for periods running from six months to a number of years. Moreover, the Bank Act forbade the chartered banks making loans on real estate. Often this was the only form of security the borrower could present to a bank as security for a loan. Complaint was made also that higher interest rates prevailed in the West than in the East. Western farmers thus felt that they were being discriminated against by bankers.

Bankers Opposed the Institution of a Federal Reserve Bank in Canada

The Committee considered, in a limited way, a proposal submitted by Mr. Ladner, one of the members of the Committee, to establish in Canada a Federal Reserve Bank. When Sir Frederick Williams-Taylor, General Manager of the Bank of Montreal and President of the Canadian Bankers' Association, appeared before the Committee, he was questioned by Mr. Ladner concerning the expediency of establishing such an institution. Specifically, Mr. Ladner asked him if he thought it would be to the advantage of the Canadian people, generally, and to the industrial, commercial, and manufacturing community of Canada, in particular, if there was established some form of a Federal Reserve Bank, taking the machinery then operating in the Finance Department as the first step and creating a corporate body with seventeen chartered banks as members of the corporate body. Mr. Ladner stated the

capital was a matter of arrangement but suggested $15,000,000 in gold.[13]

In answer to this question, Sir Frederick Williams-Taylor replied that, in his opinion, there was no necessity for a Federal Reserve Bank in Canada. He pointed out that this proposal was not new and was probably suggested by the recent establishment of the Federal Reserve System in the United States. Sir Frederick reminded the Committee that the main reasons for the establishment of twelve Federal Reserve Banks in the United States were (1) the absence in that country of means whereby the banks could obtain temporary assistance to meet seasonal or other special requirements and (2) the lack of facilities by which the banking resources of the country could be transferred freely throughout the year to the area where the need for temporary advances might from time to time exist. Sir Frederick stated that Canada suffered from neither of these disabilities. Under the Finance Act of 1914 banks in need of temporary assistance could and did obtain from the Dominion Government that assistance, while the branch bank system insured an ample supply of currency at all times and places where it was needed for crop movements or other purposes. It had been suggested that it was the tendency of Canadian banks to borrow from the Government only with reluctance. The banker pointed out that similar conditions prevailed in the United States with respect to borrowing from the Federal Reserve Banks, and in England with respect to borrowing from the Bank of England. He asked if this was not as it should be.

Sir Frederick pointed out that the note issue of the National banks in the United States, being based on government bonds, did not expand and contract according to the requirements of the country, whereas Canada enjoyed a very flexible currency under the Canadian banking system. He contended this flexibility of the Canadian system fully met the needs of business, that it worked automatically and perfectly. He expressed the view that if a system similar to the Canadian banking system had been in existence in the United States, the Federal Reserve System would never have been established.[14] Sir Frederick stated that the estab-

[13] *Proceedings (Revised) of the Select Standing Committee on Banking and Commerce, 1923*, p. 297.

[14] Ibid.

lishment of a Federal Reserve Bank in Canada, as proposed by Mr. Ladner, was entirely premature and, at that juncture, entirely uncalled for.[15]

Mr. Ladner asked Sir John Aird, General Manager, Canadian Bank of Commerce and Vice-President of the Canadian Bankers' Association, what his opinion was relative to the wisdom of creating a Federal Reserve Bank along the lines outlined in the proposal. Sir John replied that he did not think that the time had arrived for that. He was of the belief that if the country developed and population increased the time would come when Canada would need greater banking facilities, either by the existing banks increasing their capital, or by the establishment of a bank on the lines suggested by Mr. Ladner, but he felt it was quite inadvisable at that time because it would entail too great a cost and would be too risky.[16]

In the opinion of Sir Edmund Walker, President, Canadian Bank of Commerce, there was no difference in principle between the operations of a Federal Reserve Bank and the issue of notes under the Finance Act.[17] He stated that the Federal Reserve System was regarded in the United States as a means of inflation but he was of the opinion that inflation could not continue under the Finance Act.

Sir Edmund's testimony relative to the non-inflationary features of the Finance Act is interesting in the light of later experience with the Act.

Bankers Disclaim Responsibility for Price Changes

The statements of Sir John Aird, General Manager of the Canadian Bank of Commerce, before the Committee are of very considerable interest to students of monetary problems as illustrating the fact that Canadian bankers, in general, were advocates of the banking principle of note issue.[18] When asked by Mr. W. C. Good, a member of the Committee, whether bankers influenced the general level of prices through the expansion and contraction of credit, Sir John replied that bankers have no power over prices, that bankers cannot influence prices since prices are governed by demand. When asked if he was familiar

[15] Ibid., p. 301.
[16] Ibid., p. 363.
[17] Ibid., p. 534.

with the quantity theory of money, Sir John replied that he could not say that he ever heard of it referred to in that way. The banker stated that the contraction and expansion of credit is not at the discretion of banks but is determined by the volume of business. Sir John refused to admit that bankers have it in their power to increase the volume of money in a country, using the term money in the broad sense as including cheque book money.

While admitting that bank credit constituted probably 80 or 90 per cent. of the means of payment used in Canada, Sir John Aird failed to see that an increase in the quantity of funds influences demand and therefore prices. In supporting the banking principle, Canadian bankers stressed the demand side of credit. They stressed the state of business as determining the amount of credit. They apparently did not perceive that the volume of credit might affect the volume of business. Their argument is not convincing since it neglects the supply side. If the argument of the banking school were granted then credit control would be useless since the supply of credit is a result of prices and not a factor in the course of price changes.

Irving Fisher Submits a Plan for Stabilizing the Dollar

One of the most important of the many witnesses appearing before the Committee was Professor Irving Fisher of Yale University. After dealing at length with the evils arising from fluctuations in the level of prices and the desirability of a stabilized price level, Professor Fisher explained his plan of the compensated dollar as a means of achieving greater stability in the purchasing power of the monetary unit and of bringing about currency reform which would obviate the evils suffered by Western farmers, business men, investors, and all classes in the country. This plan in the form of the Goldsborough Bill was, at that time, before Congress in the United States.

Fisher proposed a gold standard, with a goods dollar. Under this plan gold would not circulate in the form of coin but would be held in the vaults of the Government in bullion form. Gold certificates or warehouse receipts representing claims to gold would circulate and would entitle the holders to variable amounts of gold which always had the same purchasing power. Behind the

[18] The testimony of Sir John Aird may be found in the *Proceedings of the Select Standing Committee on Banking and Commerce, 1923*, pp. 352-356.

gold certificates Fisher proposed a 100 per cent. reserve of gold. A rise in prices as indicated by an index number of prices would entitle the holder of a gold certificate to a greater weight of gold. This would effect a reduction in gold reserves and bring about a fall in prices. Conversely, a fall in prices would entitle the certificate holder to less gold.

In explaining his plan to the Committee, Professor Fisher said: "My proposal is that these gold certificates be changed in character somewhat, so that instead of a dollar entitling the holder to a definite amount of gold, they will entitle the holder to that amount of gold which has always the same purchasing power . . . This gold certificate instead of entitling me to 23.22 grains of gold will entitle me from time to time to 24 grains, 25 grains, 20 grains or whatever is necessary to have the same purchasing power it had to start."[19]

The chief defects of Fisher's plan appear to be in the practical limitations of the theory of index numbers and the looseness in the relation between the quantity of money and prices. It would also tend to give the dollar a fluctuating international exchange value. Even if the plan did stabilize the average level of prices, it could not stabilize the individual prices, some of which would go up while others went down.

In reply to a question of one of the members representing the agricultural interests as to whether in case there is an inflation of prices of manufactured goods and a deflation in the prices of other products the remedy proposed could bring about a readjustment, Mr. Fisher stated: "My answer is that the readjustment of classes of prices is not a part of any banking system. That cannot be controlled and ought not to be controlled by the bankers or the monetary system. They will have to seek their own price level."[20]

In view of the fact that many agricultural leaders believed that it was the business of the banking system to bring about readjustments between agricultural prices and costs and those obtaining in the manufacturing industries, Professor Fisher's pronouncement is important.

[19] *Proceedings of the Select Standing Committee on Banking and Commerce of the House of Commons, 1923*, p. 592.
[20] Ibid., p. 548.

Bankers stated, in evidence, that it was no part of the business of banks to attempt to affect the general level of prices. Fisher, on the other hand, pointed out that the great function of banks is to so adjust the rate of discount as to avoid convulsions in prices. He favoured a centralized control of rates of interest, because he regarded it as a public function belonging to the entire nation. In his opinion the broad policy of the relations of the rate of discount to the price level is overwhelmingly more important than anything else.[21] Professor Fisher expressed himself in favour of the Bank of England rediscount rate where the rediscount rate is above the lending rate. The operation of the rediscount rate under the Federal Reserve System he regarded as a weakness of that system.[22]

One of the members of the Committee, Mr. Hughes, pointed out to Mr. Fisher that Canada is a large producer of a few commodities, like wheat, which have to be sold in the markets of the world. In view of this fact, he asked Mr. Fisher if it would not be preferable to have stable conditions in external trade even if they were not so stable in internal trade. Mr. Fisher replied that he did not think it really would.[23]

When asked if Canada would gain in the end, Mr. Fisher replied, "In the end, and in the beginning too, because your foreign trade would be subject to evils more apparent than real . . . Your external trade would not be injured, the injury would be registered in the rate of exchange, instead of being registered in the price level."[24]

Professor Swanson Opposed Centralized Control of Credit

Professor Swanson of the University of Saskatchewan, in evidence before the Committee, differed with the view expressed by Professor Fisher relative to a centralized control. He expressed the belief that credit is a private matter and not a government matter, that credit can best be taken care of by those who are dealers in credit. In his opinion it is a very dangerous thing for the Government or any semi-official banking authority representing the interest of the Government to go into the credit

[21] Ibid., p. 609.
[22] Ibid.
[23] Ibid., p. 590.
[24] Ibid., p. 591.

business.[25] He was of the opinion that credit control could be administered better by men who not only understand business but also the nature of the business organization of the country. The banker is in the best position to do this. While agreeing that stabilization of prices was desirable he did not agree with Fisher that it was quite possible to stabilize prices in Canada. Professor Swanson failed to see how that could be done unless Canadians ceased to trade with other nations, because as long as they import and sell goods, those importations are bound to have an effect on price making in the Dominion.[26] In any event he regarded money as only one factor in the stabilization of prices. Stabilization of prices would not prevent inflation.

In the opinion of Professor Swanson there was no urgent need to establish a Federal Reserve System in Canada or any type of central bank. The system had been established in the United States for a number of reasons. Rediscounting is necessary in the United States because the local independent banks that were in existence before the establishment of this system in 1913, in a time of financial stringency even, not to speak of panic, were not able to furnish sufficient credit to their customers and consequently one expedient after another had to be adopted by the banks such as clearing association agreements and the like. It was essential to introduce the Federal Reserve System into the United States to unify the system and to get the strength that comes with unity. Canada had seventeen strong banks which Professor Swanson believed could take care of all the legitimate requirements for short-term credit that the country needed. Professor Swanson was opposed also to handing over to any government the sole right to issue notes.[27]

Western Canada in Favour of a Central Bank

Mr. A. M. Carmichael, M.P., testified to the effect that throughout Western Canada there was a growing feeling that the establishment of a central bank in Canada, similar to the Commonwealth Bank of Australia would be a great boon to agricultural interests in that part of the country. He stated that a great many Westerners felt that the establishment of such a bank

[25] Ibid., p. 609.
[26] Ibid.
[27] Ibid., p. 782.

which could compete with the chartered banks would solve many of their ills.[28]

Mr. Carmichael's views are important in that they show that some Westerners were thinking in terms not only of credit control but of a bank being set up by the Government which would operate in competition with the commercial banks. This may be accounted for by the fact that there was a good deal of misconception, as there is today, as to the functions of a central bank, and to the fact that many were thinking in terms of socialized credit.

Space does not permit an extensive statement and analysis of the various views—many of which were extremely naïve, to say the least—which were presented in evidence at the Proceedings of the Committee. Extensive, interesting, not to say extremely unorthodox views or theories were presented by George Bevington and Neil East of Alberta and Major Douglas of England.

A Provincial Banking System Recommended

George Bevington, an Alberta farmer, stated before the Committee that he considered there was too much power in the hands of a few men in the matter of the control of money and credit. In his opinion credit is a social asset. To him the basis of a nation's credit is the number, intelligence, and industry of the people plus the capital equipment and natural resources within its boundaries. Its control should, therefore, be vested in the "supreme governing body". He was of the opinion that there was an insufficient amount of funds because "the right of issue of credit instruments (bank notes) granted to banks is ordinarily limited to the narrow base of their capital assets. They are, therefore, unable to meet the requirements of a continually expanding business without increasing their capital or running the risk of having too small a proportion of their resources in liquid form."

To meet the shortage of funds Bevington proposed the establishment of local incorporated units with a nominal capital to which individuals wishing to secure a loan would take property. This property would be handed over by the local unit to provincial banks incorporated under the Dominion Bank Act in

[28] Ibid., p. 858.

exchange for notes with which to make the loan. The provincial bank would then deposit the securities or property so obtained with the Treasury Board of the federal government, obtaining Dominion notes.

While Mr. Bevington would not eliminate the banking system, he stated it was to the interest of the country to start another system which would function concurrently in competition with the chartered banks.

Bevington's use of the term credit rested upon a completely wrong concept of credit. His analysis reveals no clear conception of the difference between money, credit, and capital. His views seemed to call for a distribution of capital and not money. His proposal in the end would result in the Dominion Government supplying a constant stream of legal tender notes, a definite and continuous redemption of which was not contemplated and which ultimately would lead to dangerous inflation. His plan, moreover, called for decentralized banking institutions rather than a central bank.

Substitution of Dominion Notes for Bonds Proposed

Another Western farmer, Neal East, of Vermilion, Alberta, who appeared as a witness before the Select Standing Committee expressed the view that Canadian banking institutions were run for the benefit of the shareholders and contrary to the welfare of the people. He stated the banking system was interested in building up debts through loans while the people of the country were striving to get out of debt. In his opinion the private control of the banking system was wrong. He contended "the people should have enough money to enable all the people to do business on a cash basis."[29]

Mr. East proposed the Dominion Government should issue notes instead of bonds; thus it could do away with the huge interest burden on the national debt. "I take this stand, that if a Government bond is good enough for the investor, a Government note ought also to be good enough for the people."[30] He thought conditions would be improved if the Dominion Government issued a greater volume of notes and loaned it on the pledge of securities, the value of the securities to be determined by the Government.

[29] *Proceedings of the Select Standing Committee on Banking and Commerce, 1923*, p. 214.
[30] Ibid., p. 218.

In his opinion there was no distinction between having 2½ billions of bonds held by the public and 2½ billions of Dominion notes issued since he regarded the credit the same in both cases. While acknowledging the result would bring about inflation, he observed: "This is my point in connection with inflation, that if it were inflated through the process of government, the people would get the benefit of it; it would not create an interest-bearing debt; whereas if you inflate the system through private institutions it creates a great burden."[31]

Mr. East's plan appears to have been nothing but a very thinly disguised inflation scheme by means of printing-press money. His statements reveal a confusion between government bonds which are issued on the general credit of the country and Dominion notes which are, up to a certain amount, based on a specific gold asset.

Major Douglas Urged Adoption of Social Credit

Major Hugh Douglas of England appeared before the Committee and contended that under the present financial system, wages, salaries, and dividends received over a given period of time are not available to the public in sufficient amounts to buy the production of that period. In his view the problem facing the world was not a production problem but rather the acquisition of sufficient purchasing power on the part of purchasers to purchase the goods produced. In other words, his criticism of the existing order was that it failed to distribute sufficient purchasing power. He proposed giving the great mass of the population more purchasing power and asserted that it is possible to devise, without interfering with the management of the present banks, the management of industry, and without interfering with the daily habits of anybody, a scheme by which the average individual can get more purchasing power than he gets at the present time.[32]

When asked by members of the Committee as to how this was possible, Major Douglas proposed that since the general public did not have sufficient purchasing power to buy all that had been produced the public should pay the owner something less than

[31] *Proceedings of the Select Standing Committee on Banking and Commerce, 1923*, p. 217.
[32] Ibid., p. 444.

the existing price and the national credit should make up the difference. When asked what proportion the public should pay, Mr. Douglas replied, "The proportion that you would pay would be the proportion that the total consumption of the community bore to the total estimated possible production over the same period."[33] Reduction below the existing price Major Douglas regarded as essential to his system. Who would pay the difference was looked upon as a mere matter of detail. Mr. Hughes, a member of the Committee, asked, "Then either the national credit in Canada, represented by Mr. Fielding, or the banks would pay the difference?" To this Major Douglas replied, "If you like to put it that way."[34] He could see no reason why the banks should refuse to pay the difference since he stated there would be no loss by the banks.[35]

[33] Ibid., p. 472.

[34] Ibid., p. 474.

[35] Major Douglas, in outlining how his plan would work without the banks losing, said, "Suppose that you arranged with a large number of departmental stores that they should sell the whole of the products that they dealt in at cost, plus 10 per cent. on turnover, not 10 per cent. on their capital, or anything of that sort, yet 10 per cent. is not vital—one, two, three, four, five, six, seven, eight or nine per cent. it makes no difference, plus an agreed percentage on turnover. In consideration of their agreeing to put the costs on the table in proper form, at proper periods of time, you would authorize them to issue with each sale,—the sale would take place in the ordinary way —the ordinary amount of money, the ordinary price, et cetera. You might authorize departmental stores to issue vouchers to a percentage of the purchase cost, and such a percentage might be given which would meet the provisions that I shall come to later on. These discount vouchers might be turned in to the private accounts of the ordinary purchaser at any bank, and the bank would treat these discount vouchers as a credit. They would write up the private account of the person concerned by the amount of these discount vouchers. Now, they would get, at a certain period of time, over any given period of time, three months, or six months, anything you like— that is only a very general sort of proposition—they would get a credit from the Government to make up the amount of these credits which had been applied to private accounts. That would be a transfer of the collective credit of the country to the private accounts of the individuals of the country. Now the credit of a country is something of which the country or the officials of the country stand in beneficial trusteeship for the individuals of that country, and if it is a beneficial thing to transfer the public credit to a private account, then it seems to be a perfectly legitimate operation. The result of that would be that you would have these stores we are discussing— they would be in a position to undersell by a very considerable amount—it might amount to any considerable amount, perhaps more than fifty per cent.; they would be able to undersell anybody who would not agree to the provisions which might be made for the working of this system, such as the keeping of proper costs and things of that sort. It would not mean that two or three stores would vary so you would have exactly the same competition that you have at the present time, but you would simply lower the range of prices. The whole validity or the whole sanity of anything of that sort, of any proposal of that sort, rests on whether you agree that public credit is only held in trust for individuals of the community."

Major Douglas held that his proposal was not a subsidy. "A subsidy is money which is collected by taxation and applied to a particular purpose, the reduction of prices or anything of that sort. It is taking money from one part of the process and putting it on the other. This money for this process is not collected by tax. It is derived by a creation of credit, and the fact is that there is a possibility for the creation of this credit. That possibility and the mechanism are in existence at the present time, and is the monopoly of the banks to a large extent."[36]

Mr. Douglas failed to explain to the Committee what would happen ultimately to the country's credit if his scheme were adopted.

A Federal Farm Loan Fund Recommended

The establishment of a Farm Loan Fund was suggested to the Committee by Mr. A. N. MacLeod, a merchant from the Province of New Brunswick, as a means of aiding agriculture.[37] He expressed the view that the chartered banks were in no way to blame for the condition of affairs existing among the agriculturists. He felt that if the right kind of legislation was enacted the banks would be only too willing to do their share in co-operating with the Government and the farmers. Mr. MacLeod pointed out that it is the function of commercial banks to make short-term loans. They must keep their assets in a liquid condition. On the other hand, farmers require loans for a longer period than commercial banks can grant them. Mr. MacLeod recommended no change in the Bank Act but suggested that the federal government could, by issuing bonds, secure funds and establish a federal fund to be known as the Federal Loan Fund under the control of a Farm Loan Board. Applications for term loans from this fund could be received by the chartered banks. The Federal Board could have an inspector in each province, if necessary, to investigate and pass on loans. The bank manager, without liability, might make any remarks that would be helpful in regard to information concerning the credit standing of the applicant when the application for a loan was forwarded to the Farm Loan Board. The Federal Board would have the final word regarding the disposition of the application for the loan.

[36] *Proceedings of the Select Standing Committee on Banking and Commerce, 1923*, p. 475.
[37] Ibid., p. 650.

Postponement of Bank Act Revision Denied

At the close of the proceedings of the Committee, the Progressives in the House of Commons asked for a postponement of the revision of the Bank Act for a year or so that they might have an opportunity to go into the mass of evidence which had been submitted by witnesses before the Committee. The request was refused and a revised Bank Act was enacted. The 1923 revision of the Act embodied no far-reaching changes. No revolutionary changes were made in the credit and financial organization of Canada. No provision was made for the establishment of a central bank, the Minister of Finance contending that the Finance Act, as it existed, performed all the functions of a central bank, and, therefore, such a bank was superfluous. The new provisions enacted were rather in the direction of greater supervision and publicity and in the direction of conservatism.

CHAPTER IV

GROWTH AND DEVELOPMENT OF THE CENTRAL BANKING IDEA IN CANADA 1924-1934

BANK ACT UNDER REVIEW AGAIN IN 1924

IN 1924 the Progressives again endeavoured to have an investigation made of a central bank for Canada. As a result of the failure of the Home Bank in 1923 the House of Commons directed the Select Standing Committee on Banking and Commerce "to consider the provisions of the Bank Act with a view to recommending such amendments to the Act as will better protect the interests of the depositors generally and will prevent similar occurrences in the future." Taking advantage of the investigation, one of the members, Mr. L. J. Ladner, moved, seconded by Mr. W. C. Good:

> "That a Report of this Committee be presented to the House requesting that the Order of Reference be enlarged so as to embrace the study and consideration of the purpose and organization of some type of properly administered Central or Reserve Bank."[1]

The motion was carried and the recommendation was submitted by the Chairman, Mr. Thomas Vien, M.P., to the House of Commons for consideration. In presenting the recommendation Mr. Vien stated that he thought it was altogether inadvisable to enlarge the order of reference if the purpose of such was the immediate consideration of the creation of a federal reserve system in Canada.[2]

PROGRESSIVES ADVOCATE THE ESTABLISHMENT OF A CENTRAL BANK

A somewhat lengthy debate took place on the floor of the House. The Progressives advocated the creation of some type of permanent central agency or supervisory board of skilled, competent men which would manage and co-ordinate the financial

[1] *Proceedings of the Select Standing Committee on Banking and Commerce, 1924*, p. clii.
[2] *Debates, House of Commons, Dominion of Canada, 1924*, p. 3917.

system of Canada in such a way as to use most effectively the resources of the country for the greatest public benefit. They did not believe that the regulation and control of credit should be in the hands of the chartered banks. Some Progressives went so far as to accuse the banks of exploiting the use of credit for the purpose of their own profit. The Finance Act was criticized in particular. One of the leading Progressives, Mr. J. T. Shaw, in his criticism of the Statute said:[3]

> "The Finance Act of Canada, which provides rediscounting facilities to the banks, and to the banks alone, is operated by the Treasury Board. Strange to relate, this Treasury Board has come to the conclusion—although I believe all modern economists take the other view—that the interest rate cannot be used as an agency in either preventing unwise inflation or safeguarding against unnecessary and harmful deflation. Another illustration will suffice to indicate that the operation of this particular Act certainly invites some criticism: I need only mention the fact disclosed in evidence that while the banks under this Act can borrow money at the rate of 5 per cent. when the Government goes to the banks it has to pay 5¼ per cent. Surely that does not speak well for the efficiency of our rediscounting facilities."

A variety of views were expressed by those desirous of effecting some change in the monetary mechanism of the country. Some favoured a central bank which would control credit and take complete control of the note issue. The existing system was criticized, in part, because it did not provide a sufficient volume of credit, in part, because of failure to vary the discount rate to prevent fluctuations in business activity, and, in part, because it was felt that control of credit was a public and not a private function. Only a casual reading of the various speeches reveals the fact that at this time the matter of securing an additional supply of funds was what was uppermost in the minds of most of the advocates of a central bank. Most of those who advocated a central bank had no clear idea as to what its functions should be. There was also a diversity of views as to the nature of the institution which should be established. Those who opposed a change stated existing facilities were ample for the needs of the country.

[3] *Debates, House of Commons, Dominion of Canada, 1924*, p. 3921.

Probably the clearest views as to the functions of the proposed central banking organization were expressed by Mr. G. G. Coote and Mr. W. C. Good. While not exactly sure as to the nature of the institution which should be set up, Mr. Coote did not advocate exactly the same system as had been established in the United States. Although not altogether opposed to the Finance Act, he did favour a set-up which would have much wider functions than those being exercised by the Treasury Board. He suggested that if the Finance Act were made permanent it should be administered by some sort of permanent board.[4] Mr. Coote referred to the widely fluctuating exchange rates and pointed out the desirability of the establishment of a national bank to control such rates in the interests of the country. He charged that as things were, the rate of exchange was absolutely in the control of the chartered banks, and this control was exercised by them for their own advantages.[5]

Mr. Coote set forth his conception of the functions a central bank should exercise in Canada in the following language:[6]

> "To sum up, we should have a central bank, first of all for the issue of notes, and secondly for the handling of the rediscount privilege for small banks and rural credit societies, for I am firmly convinced that the people will not be satisfied to continue with the few banks that exist today. We must have some more small banks and if these are to be established in such a way that they can operate successfully and compete with the big banks, they must have a rediscounting privilege. That rediscounting privilege must be handled by practical bankers. There should also be some safe place for people to put their deposits. I believe the Banking Committee is opposed to the removal of the note issue privilege from the banks and the people should, therefore, have some safe place for deposits provided by the Government. There is also the handling of the rate of exchange. Surely the logical and the proper plan of dealing with the entire situation is to establish a central bank."

Mr. Coote believed, apparently, that a central bank for Canada should receive deposits like any other bank and therefore be a competitor with the private banks. Apparently, he was also of the opinion that a central bank such as Canada could establish could be an effective agent in the control of exchange rates.

[4] *Debates, House of Commons, Dominion of Canada, 1924*, p. 3935.
[5] Ibid., p. 3935.
[6] Ibid., p. 3937.

Many Elements of a Central Banking Organization Present in Canada

In the debate on central banks, Mr. Good stated that he had a memorandum on a central bank for Canada prepared by a former professor of banking at one of the Canadian Universities. Referring to the memorandum, Mr. Good said:[7]

> "His argument in brief is simply along the lines of the argument that has been presented by the Honourable Member (Mr. Shaw). We have at the present time . . . all the necessary elements for a Federal Reserve or a central bank. We have our discount facilities under the Finance Act, we have our Central Gold Reserve, we have the Bankers' Association, we have practically a centralization of financial power in this country in this private organization . . . We have then these various elements or functions or aspects of a Federal Reserve system, either in being or prospect. We have everything except Government notes. Now the proposition is that we should link up these elements in a co-ordinated scheme under the supervision of a board of experts and they do not need to be very many. Here is something that can be established in Canada in the near future at practically no expense because it means substantially nothing in addition to what is now in existence or in immediate prospect. It simply means that these activities are to be co-ordinated and managed if you like, by a Board of experts, of bankers. We know the procedure in the rediscounting process. The Deputy Minister of Finance advises the Treasury Board. Naturally they take the advice of the Deputy Minister of Finance. He admitted the other day in the Committee that he had never even thought of altering the rate of interest, that the matter had never been discussed. Why it is recognized by all the authorities that one of the most feasible means of checking inflation and deflation, of stabilizing price levels and the purchasing power of money, is the adjustment of the rediscount rate. It is recognized by the Bank of England authorities, by the Federal Reserve authorities of the United States, indeed by economists all over the world, that this is the method which is best adapted under existing conditions—and I think it is particularly true in Canada,—for the stabilizing of the price level."

Later in the debate Mr. Good argued the necessity for a managed currency. "If the economic and industrial world is to survive we have to have a managed currency. I submit, in all earnestness, that there is no means of securing a managed currency in the immediate future that is more feasible and more

[7] *Debates, House of Commons, Dominion of Canada, 1924*, p. 3938.

practical than some type of properly administered central or federal reserve bank. It is possible by a managed currency to prevent these alternate periods of boom and depression—what is known now among economists as the business cycle."[8]

One of the members, Mr. E. J. Garland, was of the opinion that one of the functions of a central bank should be to guarantee deposits.[9]

Liberals State Finance Act Meets All Requirements

The Government opposed widening the scope of inquiry by the Committee. Honourable J. A. Robb, Acting Minister of Finance, expressed pretty well the attitude of the Liberal Government when he said:

> "As to the advantages of a rediscount system the present Act under the Finance Act has been demonstrated to be quite sufficient for the requirements of the country. It works well and is well suited to the Dominion of Canada . . . Under the Finance Act the people of Canada will get proportionately just as much revenue as the people of the United States will under their Federal Reserve System, so that for that reason no good purpose can be served by referring the matter back."[10]

Mr. H. H. Marler, another Liberal, in the course of the debate, expressed similar views:[11]

> "Now let me repeat that our Finance Act as it is now and our branch bank system as it is now fully cover the necessities, elasticity of credit and banking in this country, and our Finance Act as it exists is quite sufficient to meet the requirements without any question of a Federal Reserve Bank being taken into consideration at all.
>
> "The administration of our Finance Act practically costs the country nothing; the profits derived, it is true, are comparatively small, but comparing the cost of a Federal Reserve Bank with its various branches and its various officers, it is hugely greater than any cost under our Finance Act."

The House defeated the motion 109 to 32. Not many more than half of the members were present to vote. The smallness of the vote in a House of 235 members shows the relatively small interest at this time in a central bank for Canada.

[8] *Debates, House of Commons, Dominion of Canada, 1924*, p. 3951.
[9] Ibid., p. 3961.
[10] Ibid., p. 3924.
[11] Ibid., p. 3945.

Federal Reserve System in the United States Not Adapted to Canadian Banking System

In the opinion of John W. Pole, Chief National Bank Examiner of the United States, who appeared before the Select Standing Committee on Banking and Commerce in 1924, a Federal Reserve System as operated in the United States would not be well adapted to the banking system which prevails in Canada because the two systems are fundamentally different, the Canadian system being a branch bank system while the American is composed of thousands of unit banks. He was also of the opinion that the system in vogue would seem to be entirely adequate inasmuch as the Finance Act offered every facility, practically, that the Federal Reserve System offered at a much smaller expense of operation.[12]

Annual Demand for Central Bank

The demand for a central bank came up almost every year in the House of Commons. Mr. J. S. Woodsworth in 1925 moved a resolution that "It is not in the interests of the country at large that the privilege of issuing currency and of controlling financial credit should be granted to private corporations." The House refused to concur. Again in 1927 he demanded the establishment of a system which would make for a larger measure of control over the chartered banks.

The matter came up again in 1928. On February 3rd, Mr. Woodsworth moved the following resolution in the House:

"That in the opinion of this House the time has come for the establishment of a national system of banking."

Speaking in support of his resolution, Mr. Woodsworth said:[13]

> "My resolution would look to a larger measure of control of the existing chartered banks and more than that, to more widespread public banking. It is quite possible that with the enlargement of the functions of the present Treasury Board we might be able to work out a central bank which would be responsible for the issue of currency and would become a bank of rediscount. I have no clear cut and dogmatic scheme to propose to the House at this moment. It does not seem to me that it would be wise. I will say, however, that there is a very widespread feeling in the country that some better means

[12] *Proceedings of the Select Standing Committee on Banking and Commerce, 1924*, p. 142.

[13] *Debates, House of Commons, Dominion of Canada, 1928*, p. 387.

should be devised than that which exists just now for affording the public wider banking facilities and more properly controlling the issuance of currency and rediscounting."

Proposed Functions of Central Bank

The functions of the proposed central bank were enumerated by one of the members, Mr. H. E. Spencer, as follows:[14]

(1) It could perform the duties now carried out by the Treasury Board for discounting securities of existing or future banks.

(2) It could take over certain duties now carried out by the Canadian Bankers' Association with regard to notes.

(3) It could serve the purpose of the Central Gold Reserves.

(4) The note circulation fund could be handled by it.

(5) Through it could be done all government business.

(6) It could and should issue all notes.

(7) It could take care of the work of buying and selling securities (open market operations) to guard against sudden inflation or deflation which is so damaging to both trade and the standard of living.

Minister of Finance Claims Canada Already Had a Central Bank

While not opposing submission of the resolution to the Banking and Commerce Committee of the House, the Minister of Finance, Honourable J. A. Robb, stated that he did not feel that it was a good thing that the world should be told that Canada had no national banking system, when, as a matter of fact, under the Finance Act she did. He pointed out that this was not the first time the question had been proposed for submission to the Banking Committee, that it had been submitted to that Committee in 1923 and again in 1924. He further pointed out that in 1924 one of the leading banking officials of the United States had appeared as a witness before the Committee and had declared that the Finance Act was providing Canada with practically every facility that the Federal Reserve System offered the United States at far less cost.[15]

Mr. Robb acknowledged that it was true that under the Finance Act the Government had no authority to loan directly to the customer. In the light of the experience which the Government

[14] *Debates, House of Commons, Dominion of Canada, 1928*, p. 395.

[15] Mr. J. W. Pole, Chief National Bank Examiner of the United States.

had in connection with loans made for seed grain in the West, and under the Soldier Settlement Board throughout Canada, he felt it was a good thing the Government had not that authority.

The motion was amended to read as follows:

> "That in the opinion of this House the time has come for the consideration of the improvement of our banking system and that the Banking and Commerce Committee be instructed to study possible improvements and report thereon."

The Committee for the first time had the problem specifically referred to it for study.

Banking Committee Considers Suggestions for Central Bank in 1928

As directed in the Order of Reference, the Committee conducted a study of possible improvements in the Canadian Banking System. Many interesting and useful suggestions were made; but early in the proceedings one major proposal monopolized the attention of the Committee, viz.: that a Central Bank of Issue and Rediscount, somewhat analogous in its relations to the Canadian banking system as that of the Federal Reserve Banks to the United States system should be established in Canada. It was urged that through the "open market" operations of such a bank and variation in the rates of interest in accordance with changing monetary conditions, control of credit could, in some degree, be exercised, and that the institution might become a medium through which commodity price levels could be regulated.

A Central Bank Can Not Control Prices

A number of witnesses were heard, including the late W. P. G. Harding, sometime Governor of the Federal Reserve Board, and at that time Governor of the Federal Reserve Bank of Boston. Mr. Harding testified that:[16]

> "The Federal Reserve System does not attempt to fix commodity prices. Some economists believe that it could and should stabilize the price level and that its policies should be shaped with this end in view. Other economists think differently. In my opinion the Federal Reserve Banks can be helpful and have been helpful in stabilizing the money market. In so far as the money market is a factor in the price of goods

[16] *Proceedings of the Select Standing Committee on Banking and Commerce, 1928*, p. 75.

> a stable money market exerts a stabilizing influence on prices, but there are many things besides the cost of credit or the price of money that may enter into the prices of commodities. We cannot get around the very old law of supply and demand. If both the United States and Canada should produce an abnormally heavy supply of wheat, and the corn states should produce a light crop of corn, you would see low prices for wheat and high prices for corn irrespective of any Federal Reserve policy. Banks cannot boost the price of one stable commodity and reduce the price of another, regardless of the plethora of one or the shortage of the other . . . There are a good many things beyond the purview of banking which cut a very decided figure in establishing prices. All a banking system can do is to bend its efforts towards stabilizing the money market, so that in so far as money is a factor the price level will not be disturbed."

Mr. Harding said that he agreed with every word expressed by Mr. Andrew Mellon, Secretary of the Treasury of the United States, when he stated that neither the Federal Reserve System nor any other system can control prices; that the most that the system can do is to influence to a limited extent, from time to time, the total volume of credit and its cost. While credit is one factor in influencing prices, Mr. Mellon pointed out that it is neither the only factor nor the controlling one, and that it would be asking the Federal Reserve System to perform the impossible if it is to be charged with the responsibility for controlling prices merely because it can exercise limited control over the amount of credit available.[17]

Mr. Harding asserted that the control of the Federal Reserve Banks over the money market does not come through the discount rate as much as it does through the open market transactions authorized under Section 14 of the Federal Reserve Act. He regarded the discount rate as a negligible quantity in most sections.[18]

Bankers Maintain Canada Had a Central Bank of Rediscount

The chartered banks claimed there was in effect a central bank of rediscount and nothing more was needed. Mr. A. E.

[17] *Proceedings of the Select Standing Committee on Banking and Commerce, 1928*, p. 84.
[18] Ibid., p. 70.

Phipps, President of the Canadian Bankers' Association and General Manager of the Imperial Bank of Canada, in evidence before the Committee, stated:[19]

> "Anyone familiar with the development of our present system knows that there is today in Canada in effect a central bank of rediscount, with scarcely a dollar of additional cost and without any elaborate machinery which characterizes such institutions in other countries.
>
> "Emphasis has been laid upon the supposed control of credit by bankers. In a limited sense bankers control credit. That is to say, the banker can and does grant or withhold credit according as the enterprise seeking credit in his opinion will be successful from the standpoint of the borrower or the reverse. The banker is primarily and mainly concerned about the safety of his advances and the certainty that the advances will be returned within a reasonable time with adequate interest. He is not thinking about the volume of credit in the country nor the effect which the granting or withholding of credit in the particular instance will have upon the price level of commodities in the country. The banker, too, when he judges that speculation in any of its varying forms is getting beyond the safety line, limits credit in that direction, not because he wishes to discriminate against any class but because he believes the bank's advances are imperilled."[20]

In other words, according to Mr. Phipps, the banker is not concerned with the total amount of credit but with the safety of individual loans. He is interested in a qualitative and not a quantitative control of credit.

Recommendations of the Banking Committee of the House of Commons, 1928

The evidence adduced before the Committee did not convince the Committee that a central bank could fully achieve the claims made for it, that it might become a medium through which commodity price levels could be regulated. The preponderance of evidence indicated that the operations of a Central Bank of Issue, or Federal Reserve Bank as in the United States, exercized only an indirect or limited influence over price levels and that many of the functions attributed to such Central Bank of Issue and Rediscount were already being performed through the Finance Act. The Committee, however, was of the opinion that

[19] Ibid., p. 23.
[20] Ibid., p. 26.

owing to the rapid expansion of Canadian industrial, commercial and agricultural operations, it was desirable that a careful study should be made by competent experts of the facilities available under the Finance Act to determine if they were capable of ready expansion to take care of the possible need in the near future of a much larger volume of credit than had been required hitherto. The Committee expressed the view that such a study should further determine whether, under the scope of the Finance Act, it was possible for the Treasury Board to deal effectively with unusual variations in the rate of interest. If such a study should decide that existing legislation was too restrictive, consideration should be given to the determination of what measures should be adopted to adapt the existing system to the growing needs of the country. For some reason or other, not apparent, such a study was not made.

Commission for Study of Credit Control Advocated in 1929

In 1929 Mr. Ladner suggested the Government should appoint a Commission which, along with the Canadian Bankers' Association, could study the question of bank credit in order that some solution might be found whereby Canada could adopt some of the principles of the Federal Reserve System of the United States which might be applicable to the Canadian system, and some of the rediscount principles of the Bank of England, and make them applicable, in a practical way, to the Canadian system through a central reserve bank of rediscount. He stated that anyone who has made a study of the administration of the Finance Act must realize that the present method of control is far from satisfactory.

In Mr. Coote's opinion there seemed to be no intelligent control over the granting of advances or consideration of the effect which such advances may have upon the general business situation, particularly with regard to the evils of changing price levels.

Resolution for Establishment of Central Bank in 1931

In 1931, almost two years after the beginning of the depression, Mr. G. G. Coote, with the approval of the members from his corner of the House, moved a resolution "that in the opinion of the House there should be established in Canada a nationally

owned central bank."[21] This precipitated a fairly lengthy debate. The contentions of the Progressives were pretty much the same as they had stated at various times before when the subject came up for discussion. They pointed out that the depression had intensified the need for an institution to control credit, that farmers and business men were the innocent victims of a policy of deflation instituted by the banks.

At that time the Prime Minister turned thumbs down on a central bank and spoke in defence of the existing system of financing. He stated at that time, "to set up a reserve or central bank such as had been set up in other countries will do not a single thing beyond what we are now doing through the operation of the Finance Act without maintaining a bank at all."[22] He qualified his remarks by saying: "I am not, however, closing the door to convictions which may come to my mind with respect to the matter."[23]

From the above remarks of the Prime Minister there seems to be little doubt that at that time he was opposed to the establishment of a central bank. In view of subsequent statements the observations of Mr. Bennett at this point are worth noting.

It should be noted that the earliest initiative in Parliament for a central bank came from the third party. The Liberal and Conservative parties had consistently opposed the establishment of such an institution.

Influence of Depression on Demand for Central Bank

The force of economic circumstances resulting from the depression and the fact that an election was not far ahead changed the viewpoints of both the Liberals and the Conservatives. A farmer-labour party of the extremely radical variety, the Co-operative Commonwealth Federation, had developed considerable strength in the West and was spreading rapidly as far eastward as Ontario. It threatened for a time to hold the balance of power between the two old parties, and even to come into power itself. The views of this party, consequently, carried considerable weight. This party, like its friends in the United States, advocated the "socialization of credit". It criticized severely what it

[21] *Debates, House of Commons, Dominion of Canada, 1931*, p. 1547.
[22] *Debates, House of Commons, 1931*, p. 1562.
[23] Ibid.

called the "money power". In Canada the emotional appeal was strong, for there had been in fact a concentration of commercial banking power in fewer and fewer banks. This process of concentration had been particularly rapid in the last two decades. Between 1913 and 1931 twelve banks had been absorbed by larger banks, the total number of banks being reduced from 25 in 1913 to 10 in 1931.[24] As the banks became fewer their assets became larger.

The impulse that moved the two older parties to change their views relative to the establishment of a central bank of Canada was probably twofold: a gradually formed conviction that such an institution would be desirable, and a desire to meet public opinion. The conditions resulting from the depression led to a good deal of hostility on the part of members of all parties towards some of the policies of the chartered banks. Much of this hostility was actually unwarranted but many politicians are like weather vanes, susceptible to all political currents, particularly where there is political advantage.

Government Proposes Postponement of Decennial Revision of Bank Act, 1933

Sentiment in and out of Parliament had gradually undergone a change. When the matter of the renewal of the bank charters came up for consideration under the regular decennial revision of the Bank Act in 1933, there was a strong demand for some sort of central bank. The Government took cognizance of this. The speech from the Throne among other things stated:[25]

> "You will be invited to extend Canadian bank charters for one year in order that Parliament may be informed of the results of the proposed World Economic and Financial Conference, to be called to consider financial, economic, and monetary problems before undertaking the decennial revision of the Bank Act."

In March, 1933, the Minister of Finance introduced a bill into the House providing for the extension of the bank charters until July 1, 1934. At the same time the Minister of Finance announced that the Government proposed to appoint a Royal Commission to study the organization and working of the entire

[24] *The Canada Year Book, 1936*, p. 915.
[25] *Debates, House of Commons, Dominion of Canada, 1932-33*, Vol. 1, p. 2.

banking and monetary system, to consider the arguments for or against a central banking institution, and to make recommendations revising or supplementing existing banking and monetary legislation.[26]

Liberals in Favour of a Central Bank

The Liberals opposed such an extension. They were in favour of proceeding with the revision. Mr. King, leader of the Opposition, was of the opinion that the Government ought not to have brought down a measure to extend bank charters for a year. He defined the position of the Liberal party in the following words:[27]

> "Liberalism believes that credit is a public matter, not of interest to banks only, but of direct concern to the average citizen. It stands for the immediate establishment of a properly constituted national central bank, to perform the functions of rediscount, and the control of currency issue in terms of public need. A central bank is necessary to determine the supply of currency in relation to the domestic, social, and industrial requirements of the Canadian people, and also to deal with the problems of international commerce and exchange."

Mr. King's use of the term "national central bank" was ambiguous, possibly purposely so. In any event the term came in for a considerable amount of discussion a year later.

In the opinion of Mr. King the need had arisen for national control of credit, and he pointed out the advisability of establishing in Canada a central bank of rediscount. He contended that the making of advances to the chartered banks under the Finance Act was not a function that could be properly carried out by a government department. What was needed was an institution which would devote its time exclusively to matters ordinarily dealt with by a central bank such as the rediscounting of commercial paper and credit control.[28]

Mr. Bennett Reverses His Position Regarding Central Bank

The Liberals, as a party, were thus committed by their leader, Mr. King, for the first time to the establishment of a central bank

[26] Ibid., p. 3209.
[27] Ibid., p. 2511.
[28] *Debates, House of Commons, Dominion of Canada, 1933*, p. 29.

in 1933. As indicated earlier, members of the third party, under Mr. Woodsworth, had advocated the institution for a period of ten years. The Conservatives as a party were not committed to the establishment of a central bank until 1934 although the leader and Prime Minister, Mr. Bennett, stated in a speech at London, Ontario, in December, 1933, that he had decided in September, 1931, that Canada should have a central bank.[29] He stated that that conviction was arrived at when the United Kingdom went off the gold standard.

Mr. Bennett, who was both Prime Minister and Minister of Finance, stated:

> "I learned to my surprise that there was no direct means of settling international balances between Canada and London, that the only medium was New York, and the value of the Canadian dollar would have to be determined in Wall Street. I made up my mind then and there that this country was going to have a central bank because there must be some financial institution that can with authority do business for the whole of the Dominion with the other nations of the World. If Canada was to be financially independent there had to be a means of determining balances, of settling international accounts; and a central bank would furnish this."

When the matter of a central bank came up for debate in 1934, Mr. King, leader of the Opposition, twitted Mr. Bennett, the Prime Minister, regarding his statement that he had decided in 1931 that Canada should have a central bank. Mr. King expressed surprise that Mr. Bennett, who had been Minister of Finance for over a year before that, had not had knowledge of the situation existing.[30] Mr. Bennett, he pointed out, had not told the House in 1931, 1932, nor in 1933. Mr. King criticized Mr. Bennett for not having made known his decision to the House at a much earlier date, and in such a case if the matter of the advisability of establishing a central bank had been settled, then it seemed to him that if a Commission were appointed it should not have had to consider the advisability of establishing a central bank but should have directed its attention to the particular functions such an institution would have to perform and kindred subjects. Mr. King pointed out that most of the representations made before the Commission related to the advisability of

[29] Canadian press dispatch, December 7, 1933.
[30] *Debates, House of Commons, Dominion of Canada, 1934*, p. 35.

establishing a central bank and not to the particular manner in which a bank might carry on its business when established.

Mr. King inferred that the recent conversion of Mr. Bennett was founded on political expediency. This would seem to be true. The same thing could be said with equal truth about Mr. King and most of the Liberals. The establishment of a central bank would effectively spike the guns of the third party.

Banking Practices and Gold Standard Condemned

In 1933 leftist Liberals were quite as vehement in denouncing the existing banking system as the Co-operative Commonwealth Federation (C.C.F.) members. Mr. Ian Mackenzie, of Vancouver, one of the left-wing Liberals, declared that many Canadians were being driven into bankruptcy by the ruthless policies pursued by what he called the biggest monopoly in Canada, the Canadian Banking System.[31] Mr. Mackenzie asserted there was a credit shortage and that every municipality throughout Canada, and throughout the West in particular, was being throttled by the contraction of credit. He regarded gold as a "sham and a myth".[32]

There was much criticism by the C.C.F. and left-wing Liberals of the gold standard, the banking system, "money lenders" and "money changers". Possibly some of the members had listened intently over their radios Sunday afternoons to a diatribe on the American monetary system by a former Canadian resident and had borrowed his phrases, making them applicable to the Canadian system.

The members from the Canadian West were not alone in their condemnation of the bankers. Mr. Power of Quebec, during the course of the debate on the extension of bank charters, stated that he did not think it was going too far to say that a great deal of the distress which existed in Quebec was due to the harsh and ruthless policy of deflation which has been followed by the banks. He reminded the members that the Bank Act had been enacted and certain privileges had been given to the banks in order that they might be of service to the people. The banks had, however, become their masters. He expressed the view that there was now hardly anyone in the country who was not in some way or other working for the banks.

[31] *Debates, House of Commons, Dominion of Canada, 1933*, p. 4455.
[32] Ibid., p. 4441.

Mr. Coote was of the opinion that "we should have a central bank to enable us to control inflation for the definite purpose of raising and then stabilizing price levels." He also indicated that the work of controlling foreign exchange should be in the hands of a central bank.

Another member, Mr. Spencer, of Alberta, was of the opinion the banking system was too inflexible. He regarded the Finance Act as "more or less like a slot machine. When a bank brings in securities to it, it gets Dominion notes on a safe margin, and I have yet to find any limitation."[33]

Price Levels Not Purely a Domestic Matter

The Prime Minister, Mr. Bennett, on the other hand, praised the banking system of Canada. He pointed with pride to the fact that in spite of the great crisis through which the country had come the integrity of her institutions had been maintained. Canadian banks and financial institutions of all kinds had withstood the stress and strain of circumstances much better than those in most countries. This reflected the soundness of the banking system. Mr. Bennett stated that while he had never maintained that Canada had a perfect banking system, he did regard the banking system as a good one. He denied the truth of the assertions of some of the members that a credit shortage existed and asserted that there was no lack of credit in Canada nor had there been during the past two years.[34]

Mr. Bennett contended that price levels were not purely a domestic matter and could not, therefore, be regulated by a Canadian monetary authority. He pointed out that Canada was a great agricultural nation producing an exportable surplus, that industrially Canada, a nation of ten millions of people, was equipped to do justice to the demands of twenty-five millions rather than ten millions. "With the limitations imposed upon our consumptive power by reason of our relatively small population and by reason of our production being out of all proportion to that population, owing to the fertility of our soil and the resourcefulness of our people, and applying these facts equally to agriculture and industry, the maintenance of our export business becomes of utmost importance. But does anyone suggest in this

[33] *Debates, House of Commons, Dominion of Canada, 1933*, p. 4447.
[34] Ibid., p. 4449.

House that we can pull ourselves up by the bootstraps by issuing money in order to raise price levels in Canada? What settles the price of wheat in Canada? World supply and world demand, world requirements; not the requirements of Canada. What settles the prices of most of the commodities produced in this country?"[35]

Mr. Bennett stated that while he agreed that the banking system has much to do with credit facilities and the currency question, he failed to see what ten millions of people could do without the co-operation of the rest of the world.

The Minister of Trade and Commerce, Mr. Stevens, was of like opinion and expressed similar views. He confessed he failed to see how a central bank could affect price levels to any extent. In his opinion price levels are the result of world conditions.[36] As a result a central bank cannot fix prices, nor maintain price levels. Mr. Stevens contended that Canada had machinery under the Finance Act almost if not quite as flexible and effective as that of a central bank.[37]

Co-operative Commonwealth Federation's View of Objectives of a Central Bank

In advocating a central bank the C.C.F. members advocated a national bank, described by one of the members as "owned one hundred per cent. by the State, a bank whose policy should be laid down in black and white in its charter. The principal thing that should be outlined in the policy of such a bank would be that it should maintain stable price levels when they had been raised to a point approximately on the 1926 level."[38]

The advocates of reform often spoil their arguments by over-enthusiasm and by claiming too much. This obviously was true in the case of the C.C.F. Undoubtedly sincere in their claims and in their objectives, they failed to see that a central bank in Canada could not possibly raise price levels and stabilize them. Even if this could be done the question arises as to the desirability of a stabilized price level. They placed too great a reliance on monetary factors, and seemingly ignored all other influences. Both Mr.

[35] *Debates, House of Commons, Dominion of Canada, 1933*, p. 4450.
[36] Ibid., p. 3471.
[37] Ibid.
[38] Mr. G. G. Coote, *Debates, Houses of Commons, Dominion of Canada, 1933*, p. 3391.

Bennett and Mr. Stevens emphasized the difficulties in the way of a surplus-producing nation controlling its price level.

Criticism of Bank Profits

The agriculturists of Western Canada felt that something should be done to help them in the situation in which they found themselves as a result of falling prices for their commodities. Perhaps one line of thought which their minds took more than another was reform in banking and finance. They voiced criticism against the profits made by banks. Agriculture found it extremely difficult to exist, let alone make a profit, yet at the same time bank dividends ranged from 8 to 14 per cent. They found it extremely difficult to secure loans even at what they regarded as high interest rates. While banks paid very low rates of interest on deposits—3 per cent.—interest rates charged on loans in the West ran from 7 to 9 per cent.

Considerable criticism was voiced during the course of the debate relative to undue profits accruing to the banks as a result of the exchange situation between the United States and Canada. Much criticism was directed also at the decrease in bank note circulation.

Some members were in favour of a nationalized banking system. The more radical members were in favour of socializing the banking system while the most conservative favoured the system as it was.

Revision of Bank Act Postponed

Previous revisions of the Bank Act had been effected under the ordinary procedure of Parliament, but on the present occasion it was deemed advisable, in view of the unprecedented stresses and strains to which the economic and financial world had been subjected for the past two years, to appoint a Royal Commission to make a special examination of the banking situation from a somewhat wider point of view.

There can be no question that the past decade has seen the emergence of a number of new problems of a singularly complex and refractory character which have profoundly affected the banking world, while many of the old problems have assumed a new guise and a new importance.

In recognition of the importance of the changes contemplated and to enable the Royal Commission to make its investigation and prepare its report, the Bank Charters Continuation Act of 1933 was passed by Parliament, extending the charters of existing banks to July 1, 1934.

Some time in the future the period from 1913 to 1933 may become known in the history of Banking in Canada as the period of the growth and development of the central banking idea. This twenty-year span affords an interesting history of the gradual crystallization in the minds of Canadians of the need of a central institution to cap their banking system and give it unity. A study of the period reveals the fact that for some years a central bank had been advocated in academic discussions and in Parliament. At first it was a vision of "crazy reformers" but later it took on the cloak of respectability. Favourable action was long delayed largely on account of the satisfactory working of the existing system of chartered banks. It was also due in part to the fact that money, credit, and banking are the three things probably least understood by the average individual.

CHAPTER V

THE PROCEEDINGS OF THE ROYAL COMMISSION ON BANKING AND CURRENCY IN CANADA

THE World Economic Conference to which Canada sent representatives met and approved on July 27, 1933, the resolution embodied in the report of the Monetary and Financial Commission. The resolution stated:

> "The Conference considers it to be essential, in order to provide for an international gold standard with the necessary mechanism for satisfactory working that independent central banks, with requisite powers and freedom to carry out an appropriate currency and credit policy, should be created in such countries as have not at present an adequate central banking institution."[1]

APPOINTMENT OF ROYAL COMMISSION ON BANKING AND CURRENCY

Four days later, on July 31, the Acting Prime Minister of Canada presented to the Committee of the Privy Council a report which contained the following recommendations:[2]

> "That it is desirable that the approaching periodic revision of the Bank Act, which will precede the enactment of a measure to continue the charters of the existing banks, to which said Act applies, and which will expire on July 1, 1934, shall be based on a complete and detailed examination of the provisions of the said Act and of the functions and operations thereunder of the banking system thereby established;
>
> "That it is also desirable that such examination shall include a study of the facilities now afforded by the Finance Act and a careful consideration of the advisability of establishing in Canada a Central Banking institution, and, if so established, of the relation of such Central Banking Institution to existing banks and its proper authority and functions in the operating of the banking system of Canada;

[1] *Report of the Royal Commission on Banking and Currency in Canada, 1933*, p. 62.

[2] *Proceedings*, Royal Commission on Banking and Currency in Canada, 1933, p. 2.

"That such examination should also include a study of the entire monetary system of Canada, including credit, currency, and coinage, particularly in their relation to commodity price movements and fluctuation in international exchange;

"That it is also advisable to consider whether and in what respects the banking institutions and the monetary system of Canada may be modified, extended, or developed for the purpose of facilitating intra-Imperial and international co-operation in public policies designed to promote the revival of domestic and foreign trade and enterprise and the general increase of employment and to insure a greater measure of stability in respect thereto."

The report recommended the appointment of the following as Commissioners, under Part I of the Inquiries Act, "for the purpose of examining, considering and reporting upon all the matters hereinbefore recited."[3]

The Right Honourable Lord Macmillan, P.C., K.C., of the City of London, England;

Sir Charles Stewart Addis, K.C.M.G., of the City of London, England;

The Right Honourable Sir Thomas White, P.C., K.C.M.G., of the City of Toronto, in the Province of Ontario;

The Honourable John Edward Brownlee, K.C., M.L.A., of the City of Edmonton, in the Province of Alberta; and

Beaudry Leman, Esquire, B.Sc., C.E., of the City of Montreal, in the Province of Quebec.

The report further stated:

"That, without limiting the scope of their inquiry into the operation of the banking and monetary systems of Canada, the said Commissioners shall in particular examine the provisions of the Bank Act, the Dominion Notes Act, the Finance Act, and the advisability of establishing a Central Banking institution; and

"That said Commissioners shall report their recommendations for revising or supplementing the above mentioned Acts and for the adoption of such other measures as they may deem advisable to promote the revival of trade and enterprise and to facilitate intra-Imperial and international co-operation for the purpose of raising the level of commodity prices and for the purpose of ensuring increased domestic employment and the stability of the economic, financial and social institutions of this country."

[3] Ibid., p. 3.

It was recommended that the Right Honourable Lord Macmillan should be Chairman of the Commission.

The Committee concurred in the foregoing recommendations and submitted them to the Deputy Governor-General for approval. On the same day an Order-in-Council was issued authorizing the Royal Commission named to inquire into and make a complete and detailed examination of the banking and monetary systems of Canada.

The terms of reference, it will be noted, were wide, and broadly stated, provided for a study of the entire monetary and banking system of Canada, with recommendations for revising or supplementing this system. The Commission, composed of two representatives of Great Britain and three from Canada, was well balanced and very able. Lord Macmillan, an eminent British Jurist, member of the British Privy Council, had been Chairman of the Committee on Finance and Industry in 1931 which made a thorough inquiry into the financial problems confronting Great Britain. Sir Charles Addis, a prominent British financier, Chairman of the Hong Kong and Shanghai Banking Corporation, had been director of the Bank of England from 1918 to 1932, and Vice-Chairman of the Bank for International Settlements. Sir Thomas White, Vice-President of the Canadian Bank of Commerce, was Canada's War-time Minister of Finance. Mr. J. E. Brownlee, an able lawyer, was then Premier of the Province of Alberta. Mr. Beaudry Leman was General Manager of the Banque Canadienne Nationale.

Procedure of the Commission

The first public sessions of the Commission were held at Ottawa for the purpose of receiving preliminary historical and descriptive data from representatives of the Dominion Government and the chartered banks. Immediately following these hearings the Commission undertook an itinerary which included visits to important centres in each of the provinces. Public sessions were held at Victoria, Vancouver, Calgary, Edmonton, Saskatoon, Regina, Winnipeg, Halifax, Charlottetown, Saint John, Quebec, Montreal, and Toronto, in the order named.

At each city the Commission announced its arrival beforehand and invited all those who might so desire to put before it any special aspect of the problems the Commission was to consider,

to attend the meetings of the Commission and offer evidence. The inquiry was not limited to oral evidence, but written memoranda and representations were requested from provincial and local governments, public bodies and associations, and individuals. In addition to the testimony offered at the public hearings the Commission received many communications from organizations and individuals who did not find it convenient to appear at the public sessions.

Extent of the Testimony

The record of the testimony and examinations of these public hearings covers no less than seven volumes containing over thirty-seven hundred multigraphed foolscap pages. There are not more than fifty or sixty copies in existence. As a result few have the opportunity to become familiar with the evidence presented at the hearings.

The list of those who appeared before the Commission in the course of its inquiry included sixteen government representatives, twenty-eight officials of Canadian banks, eighty-one officials of public bodies, organizations and associations, and ninety-six personal representatives, making a total of two hundred and twenty-one. In addition the Commission received written submissions from no less than one hundred and ninety-six individuals and organizations. These also received the careful attention of the Commission. Those who gave evidence may be divided into a number of broad categories. There were the governments—provincial and municipal; political organizations; farmers and small merchants; the larger merchants and manufacturers; Boards of Trade and Chambers of Commerce; economists; banks; and monetary cranks.

A clear and concise account of the views expressed by the witnesses appearing before the Commission presents considerable difficulty. The economic views obtaining in different parts of Canada are very diverse. Each province has its own problems with which to deal, dictated in part by its climate, in part by its products and in part by its politics.

Hearings at Victoria

At the hearings in Victoria, British Columbia, complaint was made by the co-operatives that they could not secure banking

facilities. Representatives of the Pacific subsection of the Canadian Bankers' Association pointed out, however, that legal impediments prevented the banks from granting such loans. Section 88 of the Bank Act provided that banks should make loans only to the owners of goods. Inasmuch as the co-operative associations did not hold ownership to goods since the title remained in the hands of the individuals forming the associations, the banks could not legally lend to the associations. The bankers claimed, moreover, that in most cases the organizations had no assets.[4]

Strawberry growers also claimed they were unable to secure financial help from the banks.

In a memorandum of suggestions made to the Royal Commission by the Government of British Columbia it was stated that basic industries and industrial operations in British Columbia were unable to secure from the banks sufficient funds to enable them to operate successfully. The provincial government suggested a change should be made by the banks in their procedure in handling applications for loans. Instead of having them referred to a bank board two or three thousand miles away, a provincial board should be established with power to make the final decision on loans up to a fixed amount, say $50,000.[5] In reply the representatives of the chartered banks pointed out that lumbering is the principal industry of the province. Banks could be expected to find working capital for timber operations only to the extent where it is reasonably possible to liquidate such loans annually without impairing the efficiency of operations. Where the liquid position is satisfactory banks are ready to make loans. It is not the business of banks to supply fixed capital or all of the working capital. Fixed capital must come from other sources.[6]

Complaint was made against the alleged monopoly of the banks. It was claimed that industries were, to a large extent, in pawn to the monopoly of the chartered banks. Criticism was directed at the centralized character of the banking system. Banks were accused of sending the accumulated savings of the people on deposit in the branches to headquarters at Toronto and Montreal, thus drawing off the liquid resources from the outlying

[4] Ibid., p. 145.
[5] Ibid., pp. 216, 217.
[6] Ibid., p. 224.

areas.[7] Industries in Toronto and Montreal, as a result, could secure credit which was denied to industries in British Columbia. Consequently, the primary industries of the Province of British Columbia had difficulty in securing loans and could do so only at high rates of interest. It was alleged that due to the lack of funds the Province of British Columbia had to pay 6½ per cent. on its bond issues while municipalities found much difficulty in securing loans at all. The banks, in reply, asserted that many municipalities were in such financial shape that no loans could be made with safety.

The power of the chartered banks to issue notes was objected to by one witness.

One man, disclaiming he was a banker, appeared before the Commission for the purpose of bringing salvation to the Commissioners.

Various proposals were made. Some suggested that at least one bank should be established in each province, having the majority of its capital stock always in control of the residents of the province with the object of decentralizing credit control. This suggestion is in direct conflict with the purposes of a central bank. The suggestion was made that lending of money abroad for foreign purposes be prohibited, that call loans made in New York to a certain extent deplete the credit which might be available for distribution throughout Canada.

Vancouver Hearings

At the Vancouver hearings a representative of the Mayor and Council of Vancouver asked that municipalities be given the same facilities for securing funds from the Dominion Government under the Finance Act as the banks had.[8] It was stated that banks borrowed from the Dominion Government under the Finance Act at 2½ per cent. and re-lent funds to the municipalities at 6 per cent. The Teachers' Federation of British Columbia advocated practically the same thing when they presented a resolution to the Commission recommending that the same services accorded the banks through the Finance Act should also be made available to provincial and local governments.[9] The Federation favoured control by the Government of interest rates

[7] Ibid., p. 273.
[8] Ibid., pp. 405-408.
[9] Ibid., p. 668.

and complete nationalization of the banking system of Canada. It was of the opinion that commercial banking and the control of money and credit should be a State monopoly. One witness who advocated a nationalized system of banking stated that under such a system loans should be made through the national bank to the provinces, cities, and municipalities without interest and that such loans should be based on the security of the country.

Mr. Gerry McGeer, representing the New Westminster and Districts Trades and Labour Council, gave a four-hour oration, taking up the whole forenoon one day, rambling endlessly over the pages of history from Plato to Montesquieu, quoting copiously from the great masters of political theory. His address took up over one hundred and fifty pages of the *Proceedings* and then a document of about twenty-five pages was handed in for inclusion in the record.[10] He desired a nationalized system of banking and public finance.

Apparently the Chairman, Lord Macmillan, had heard about Mr. McGeer's oratorical marathons, for before calling on him to present his views, the Commissioner said, "I understand monopolies are not appreciated in the West, and I feel sure that no one would wish to monopolize our time."

A representative of the Co-operative Commonwealth Federation, in appearing before the Commission, advocated the "socialization of all financial machinery—banking, currency, credit, and insurance, to make possible the effective control of currency, credit, and prices, and the supplying of new productive equipment for socially desirable purposes."[11] A similar point of view was expressed by a representative of the League for Christian Social Acts. He stated that his organization was interested in the ethical side of economic life and favoured nationalization of banking, an increase in the volume of money, and a flexible monetary standard based on internal consumable production, whatever that is.

One gentleman, appearing as a witness, stated that the banking system, as operated in the West, had done more to deter prosperity and the growth of the country than all the hail, drought, and frost the country had ever experienced.

Some complaint was made that the banks' headquarters were three thousand miles away from Vancouver, that much of the

[10] Ibid., pp. 448-607 and 695-717.
[11] Ibid., p. 654.

criticism of the banking system would be relieved if the distance were annihilated so that the officers of the banks in the West could deal through a headquarter's organization in the West.

A number of farmers complained they could not secure funds while business men could. They testified that they paid eight per cent. interest and even then could not secure loans on unencumbered assets.[12] As a result they found great difficulty in financing operations. Other farmers recognized the fact that their assets are usually frozen and that banks are not mortgage companies. While they had been unable to secure loans they did not blame the banks.[13] They were of the opinion that some other provision should be made to enable farmers to secure credit and at lower interest rates. Some farmers stated they had found bankers quite sympathetic but unable to do anything.

The manufacturers who appeared or were represented at the hearings in Vancouver had no complaints to make. They experienced no difficulty, they stated, in securing reasonable credits from the banks, and no delay in getting funds. Representatives of the lumber, mining, and milk industries had no apparent complaints, neither had the canning industry nor the salmon industry.[14] The evidence presented brought out the fact that there had been little, if any, variation in the rates of interest on loans for a good many years. One manufacturer testified he had paid 6 per cent. interest for twenty-five years.[15]

A representative appearing before the Commission on behalf of the National Council of Women said that that organization was in favour of a central bank, reduction of interest, and was against banks issuing currency. She claimed capitalists through the banks controlled the Governments and made agriculture and industry suffer; that the banks were not fulfilling their duty to the public.[16]

Memorandum of Professor Carrothers

Professor Carrothers, who submitted a memorandum prepared by the Department of Economics of the University of British Columbia, favoured a central bank.[17] He stated that a

[12] Ibid., pp. 610-628.
[13] Ibid., p. 622.
[14] Ibid., pp. 292-348.
[15] Ibid., p. 326.
[16] Ibid., p. 350.
[17] Ibid., pp. 352-361.

central bank was necessary for the purpose of assisting in the control of the price level and in controlling exchange fluctuations. He was of the opinion that the existing banking system unintentionally and unconsciously tended to promote over-expansion of credit when economic conditions were good and over-contraction when business was depressed. A central bank would facilitate a co-ordinated national policy and bring about a close correlation between monetary, fiscal, and trade policies. He expressed the opinion that it was doubtful if ten independent banks could achieve such co-ordination as to make these controls effective and continuous. Professor Carrothers was very critical of the operation of the Finance Act, pointing out that the rate of interest charged to banks on advances had been largely arbitrary and bore no relation to the cost of rediscounting elsewhere, nor to any policy of credit control. As an instrument of credit control the Finance Act was not only ineffectual but actually mitigated against proper control. Further, the privilege granted the banks under the Finance Act of securing notes on the pledge of securities had tended to weaken the control of bank policy exerted through the clearing house. A bank, having unwisely extended credit out of line with the credit policy of other banks, was in a position under the Finance Act to protect its position in the clearing house by securing an advance.

Professor Carrothers attempted to allay the banks' fears of a central bank by pointing out that such an institution was in no way inimical to the interest of the commercial banks. The commercial banks could carry on their work without any direct interference whatever. Their contacts with the business interests in Canada would be the same as they had been; they could continue to make their loans on banking principles as they saw fit. In reply to the contention of some that if the chartered banks lost the right of note issue many branches would have to close, Mr. Carrothers stated that there were then too many bank branches, that commercial banking was too competitive. In any event, he did not think note issue was of sufficient importance to endanger seriously the banking system.

Calgary Hearings

At the Calgary hearings of the Commission the representatives of the United Farmers of Alberta urged that credit be

available to the agricultural producers at greatly reduced rates of interest. They asserted that interest rates paid by farmers varied from 8 to 12 per cent.[18] In their opinion Western farmers were at a distinct exchange disadvantage as compared with their competitors in Australia, New Zealand, the Argentine, and Denmark, the producers in some of these countries having an exchange advantage of at least 25 per cent. over the Canadian producer.[19] It was stated that the existing financial system had created an unprecedented volume of debt and that the system was unable to produce a volume of purchasing power sufficient to liquidate either principal or interest.

They suggested that Canada should have "a nationalized system of currency and credit unattached to any metallic base or to any specific commodity; that its objectives should be the effective control of currency and credit; stability of the price level; and regularity of production, consumption, and employment; control of foreign exchange and generally the maintaining of a proper relationship between the consumer purchasing power and the goods and services available for use."[20]

These objectives, they contended, could be attained only through a nationally owned government bank. A privately owned central bank was opposed on the ground that the operations of the bank would be directed primarily in the interests of producing profits for the shareholders instead of in the interests of the people as a whole.

The United Farmers of Alberta proposed that the nationally owned bank should be an arm of the Government, that it should have control of the issuance of credit, and be operated in the service of the people on a cost basis; thereby eliminating the present enormous interest charges. In their opinion the bank should be controlled by a Board of Governors, clothed with all the necessary powers to carry out its duties efficiently; the Board to be appointed by the Governor-in-Council from slates prepared by the various bodies representing the major economic activities of the country.[21]

They believed the first duty of the Board should be to raise the average price level to a point which would make possible the

[18] Ibid., p. 822.
[19] Ibid., p. 821.
[20] Ibid., p. 825.
[21] Ibid., p. 830.

liquidation of existing debts. After that point had been reached, it should be the duty of the Board to maintain a stable commodity price level.

It was further proposed that the bank should act as a fiscal agent for the Dominion Government and be prepared to act in a similar capacity for provincial and municipal governments. It should also act as an advisory board to the Government with regard to all matters of taxation. The United Farmers stated that they believed the importance of this function should not be overlooked, as taxation should be an instrument of monetary policy as well as a means of raising revenues.

It is apparent that the representatives of this group regarded a central bank as a means of securing cheap credit and as an engine for lifting the price level to any desired height and maintaining it there. The central bank was to be an instrument of social justice.

Not all farmers were critical of the banks.[22] Some had no complaints whatever to make. Some said the banks had been too kind to them. Others stated it would have been better for them if the banks had called a halt to their borrowing earlier than they did. The great majority, however, were critical of the control of credit by the banks and their inability to secure loans.

Ranchers testified that they had no difficulty in borrowing from the banks.[23]

There was a deep conviction on the part of Western Canadians that they had been unduly penalized by reason of the opinion too long prevailing in financial circles that the West was a pioneer country in which the risks of doing business were unduly great and that therefore high interest rates should be charged.

As in British Columbia there was a criticism of long-range control by the head offices of the banks located in large eastern cities. Some suggestion was made for a larger measure of regional and local autonomy.[24]

One of the aldermen of the City of Calgary contended that the West had laboured under economic injustice. He said that this was apparent in the fact that there was a differentiation in the rates of interest charged as between Eastern and Western

[22] Ibid., p. 946.
[23] Ibid., p. 915.
[24] Ibid., p. 1045.

Canada. The view was expressed that rates charged to Western municipalities, both for long- and short-term loans, in general, were too high. He felt that rates of interest should be uniform throughout Canada. Much criticism was levelled at the banks being allowed to borrow from the Department of Finance at 2½ per cent. and then being allowed to re-lend the funds to municipalities at from 5½ to 6 per cent. It did not appear equitable that the money of one government should be borrowed at one rate and lent to another smaller government at such an increase in rates. The suggestion was made that provinces and cities should be allowed to borrow money from the Dominion Government on terms no less favourable than those that applied to advances by the federal government to the banks.

There were some who appeared before the Royal Commission who wanted the Dominion Government to issue currency "at cost" for the purpose of putting the unemployed into remunerative work.[25] Their idea was to get currency into circulation without any interest tag attached to it. What they were advocating, in reality, was to put the printing presses to work.

Most of the complaints against the banking system came from farmers who were not able to put up collateral to secure loans. They had no property that could be hypothecated legally to the banks.

Replying to the attacks of the farmers, representatives of the chartered banks pointed out that there are many hazards in lending to Western farmers, hazards of a climatic nature, crop damage by insects, rust, frost, cutworms and rodents. There is also considerable risk attaching to such loans due to the fact that prices of agricultural products fluctuate very widely. Since the prices of Western farm products are established in world markets they are subject to world conditions and fluctuations in exchange rates.

In making loans bankers stated they had to keep in mind also the limitations and requirements of the Bank Act. They were prohibited from lending directly or indirectly upon the security of lands. They could lend to a farmer for the purchase of seed grain upon the security of a pledge in the form prescribed by statute by virtue of which the bank acquires a first and preferential lien upon the seed grain purchased and the crop to be

[25] Ibid., p. 1243.

grown therefrom. Since most farmers preserved from their crop sufficient grain to provide seed for use in the following year, they did not borrow from the banks to any great extent for this purpose. The power to lend on threshed grain could not be used in the case of funds needed during the growing period. Therefore, since banks could not lend on the security of a farmer's land, buildings, and equipment, they were unable, usually, to lend to farmers at all. The banks were restricted still further in making loans by certain statutory enactments of the province which affected credit and creditors' rights to recover. Under the Homestead Exemptions Act the homestead or home place of the debtor, provided it did not comprise more than 160 acres in area, irrespective of its location and value, was exempt from seizure, under writs of execution.

Testimony of Professor Hewetson[26]

Professor Hewetson of the Department of Economics of the University of Alberta in testifying before the Commission felt that the greatest defect in the Canadian Banking System was the lack of any machinery for regulating currency and credit for the purposes of stability. He stated that no conscious regulation of bank credit had ever been attempted in Canada, and the absence of any machinery for so doing must be considered a major defect of the Canadian Banking System.[27]

In his opinion two sorts of stability were desirable, stability of general price level and stability of foreign exchange. While admitting absolute stability of prices was impossible he believed an attempt should be made to prevent the wider swings in prices which later appreciably affected the value of money embodied in long-term indebtedness. Professor Hewetson suggested that the powers of the central bank should be subject to a minimum of legal regulation, the fewer the restrictions the more effective the acts of the central bank's directors.

He stated that contrary to what some advocates of a central bank thought it was not to be supposed that a central bank would cure all the country's economic ills. In his opinion no more than the roughest sort of stability of prices could be hoped for. All the country's economic troubles were not to be traced to credit

[26] Ibid., pp. 1052-1073.
[27] Ibid., p. 1053.

and currency. Canada could not be insulated from world depression, but through a central bank could co-operate with central banks in other countries and thus aid in formulating world credit policies. There was the danger that the Bank's policy might be dictated by the Government's fiscal needs. This would defeat the Bank's original aim.

Like Professor Carrothers, Professor Hewetson pointed out that a central bank was not a competitor of the chartered banks for the ordinary business of the country. In his opinion it should be debarred from accepting commercial accounts.

The value of the bank would depend on the confidence which it won for itself. Its contacts with other central banks would be most valuable. A central bank would enable Canada to speak in the financial gatherings of the world with a single voice.

During the course of the hearings Lord Macmillan explained that the sanctions which would attach to the advice of the central bank would not be legal sanctions; they would not be enforceable opinions so as to supersede the responsibility of the Government, but would depend for their force and effect really upon the prestige of the body itself.

While there were a great many varieties of central banks, Lord Macmillan suggested that Canada should adopt one to suit Canadian conditions and Canadian banks. In choosing the proper type of central bank cognizance would have to be taken relative to the special features of Canadian financial life.

In his opinion without some such organization Canada lacked an essential part of the equipment of a nation, from the viewpoint of financial management.

Sir Charles Addis asked Professor Hewetson how banks could control an internal price level which was largely determined by the world prices of her basic products. The latter stated, in reply, that he did not think a central bank could accomplish very much in the face of rapidly changing prices elsewhere in the world, that a central bank could accomplish very little under the circumstances.

Hearings at Saskatoon

At Saskatoon, Saskatchewan, a representative appearing on behalf of the Saskatchewan Association of rural municipalities advocated the enactment of legislation withdrawing some of the

special privileges enjoyed by the chartered banks and urged that a central bank should be set up which should issue all currency backed, not by gold, but by the assets of Canada. In his opinion such a bank should make available to the provinces and municipalities of Canada sufficient currency to carry on their ordinary work when adequate security by way of hypothecation of tax levies or otherwise had been deposited with it by the said provinces and municipalities.[28] A representative of one of the farm organizations told the Commission quite frankly that there was no basis for private credit. He suggested the best way to meet the situation would be by government action; there was no other way.[29]

Essentials of a Central Bank

During the course of the hearings at Saskatoon, Lord Macmillan stated the Commission had found generally a good deal of misconception relative to the functions a central bank should be expected to perform. He therefore entered into an exposition of what he believed to be the essential features of a true central bank and the nature of its activities.[30]

As properly understood, a central bank should not exist for private profit. It should occupy an entirely independent position, free from private interests and party politics. It should have as its special function the guardianship of the general financial interests of the country. It should keep its hand on every problem, problems of restraint and exuberant credit. One of the important functions of a central bank in Canada would be to make available expert knowledge to both provincial and Dominion governments. The bank would be able to tender financial advice but would have no power at law to interfere with the executive government. It would be able to give intelligent and informed opinion on financial matters. Such an institution would have the prestige and a fund of knowledge that could not otherwise be had by a public body. Lord Macmillan stated that while ultimately power resides in the Government, that governments are supreme, governments come and go, and one of the purposes of a central bank is to provide a permanent institution which is

[28] Ibid., pp. 1471, 1472.
[29] Ibid., p. 1502.
[30] Ibid., pp. 1286-1292.

the repository of information, and has access to all sorts of information a government would not possibly have.

Lord Macmillan pointed out that the rate of rediscount charged by a central bank and varied by the central bank according as economic circumstances change, has only an indirect effect upon the rate charged by the commercial banks. Through the rediscount rate, a central bank does not have complete control but can only influence the rate of interest charged by commercial banks.[31]

In his opinion the problem of the Canadian farmer was not a banking problem at all. The real need was for intermediate credit.

Need for International Co-operation Stressed

Professor Swanson in his testimony before the Commission advocated a return to the gold standard. He said that many things that were being advocated for the improvement of prices and the restoration of economic stability lay entirely beyond the power of Canadian institutions to achieve. Only by international agreement could progress be made toward such improvements. It was necessary to develop a financial mechanism by means of which Canada could co-operate with other nations to secure the desired results. In his opinion there was undoubtedly a weakness in the Canadian banking and financial system in so far as there was lacking centralized financial machinery for dealing with the rest of the world.

Professor Swanson, who was very critical of those who advocated a stabilized price level, said: "There is no available technique by which, even in theory, price levels can be established and maintained today. There is no way that the bank acting in and by itself can raise the price level and stabilize it. Our monetary control is not a simple matter; it is not the mere mechanical manipulation of guaranteeing a credit."[32]

Hearings at Regina

At Regina, Saskatchewan, the hearings were quite brief, few witnesses appearing. Farmers, in presenting their evidence, constantly emphasized the fact that the principal form of credit

[31] Ibid., p. 1292.
[32] Ibid., p. 1389.

which had been available came from the chartered banks and had been short-term loans drawn, for the most part, for a period of three months. They stressed the demand for intermediate credit to meet the needs of the farming communities.[33] Farm operations are such that money returns are not available until several months after their commencement. A longer term credit than three months is, therefore, a necessity.

Proceedings at Winnipeg

Lord Macmillan, in opening the hearings at Winnipeg, Manitoba, described the economic position of the Prairie Provinces as peculiar and unique and one which rendered them peculiarly susceptible to world causes and world adverse influences. Finance was only one of the causes of the distressing position in which the Western Provinces found themselves. While finance could not control the forces of nature, it could contribute much and it also could embarrass very much.

Premier Bracken of Manitoba, in appearing before the Commission, on behalf of the Government of that province, expressed himself in favour of providing machinery to make possible a deliberate policy of public control in Canada, of setting up an institution independent of outside political or commercial influence.[34]

He recognized the establishment of a central bank would not directly or sufficiently assist in the solution of existing credit problems facing the Western farmers. While indirectly such an institution would undoubtedly supply some advantages, the problem of intermediate credit to primary producers would still be an unsolved one, even though a central bank was established. He was of the opinion there should be greater provision for intermediate credit. He did believe, however, that a central bank could lessen the wide fluctuations in prices in so far as they were due to monetary causes. Fluctuating exchange rates produced harmful effects on the export sale of farm commodities. Mr. Bracken believed that a central bank could aid in stabilizing exchange rates through international co-operation with other central banks.

Mr. Bracken did not blame the commercial banks for failure to grant credit. The inadequacy of credit for the primary

[33] Ibid., p. 1688.
[34] Ibid., p. 1690.

producer, he stated, was no fault of the chartered banks. He was, however, of the opinion that Canadian banks of the future should build up a broader philosophy; they must recognize that they have a social obligation to the public as well as an individual obligation to their shareholders. The Premier felt that the banks ought to recognize that decentralization of authority with greater Western representation on their directorates, combined with greater consideration for the Western viewpoint, is desirable, not only in the public interest but in the interests of the banks themselves.[35]

Winnipeg Board of Trade

The Board of Trade of Winnipeg, in anticipation of the hearings, prepared and circulated a questionnaire relative to the character of the service furnished by the banking system. On the basis of the returns received the Board reported to the Commission that complaints varied considerably.[36] Some complained about high interest rates; others said that there were too many obstacles in the way of small borrowers obtaining banking accommodation. Criticism was directed at the centralization of bank control in the East to the alleged detriment of Western Canada. Complaint was made that the banks have an eastern and industrial outlook. Criticism was also directed at the concentration of banking power in few hands. Attention was directed to the lack of provision for farm credits and to the practice of banks of compounding interest on impossible short loans. Complaint was made that accommodation was not available when needed. Bankers were accused of encroaching on the domain of insurance men. Some objection was also raised against banks engaging in the stock and bond business. There was much criticism to the effect that there was too great a spread between interest allowed on deposits and interest charged on loans.

The view was expressed at the Winnipeg hearings that branch managers should have more leeway in making loans in order to serve more adequately local conditions. Criticism was directed at the interlocking of commercial bank directorates with investment bankers. Commercial banks should not act as providers of capital for company promotions.

[35] Ibid., p. 1704.
[36] Ibid., pp. 1711-1718.

There was the feeling on the part of Winnipeg business men that Canada's position in international commerce and finance was now too important and complex for central banking functions to be safely entrusted to a body of government officials, who might be quite competent as administrators but were seldom economists and certainly not bankers.

The Establishment of a Central Reserve Bank Urged

Professor Hurd of Brandon College presented a brief to the Commission urging the repeal of the Finance Act and the establishment of an independent Central Reserve Bank to serve as a depository for commercial bank reserves. This bank should take over the discount function, engage in foreign exchange operations, have charge of servicing the national debt, and handle the accounts of the Dominion Government.[37] He favoured the issue of central bank notes in place of the Dominion note issues and suggested that the note-issuing privilege of the chartered banks be retained by them substantially as under the Bank Act so that their commercial banking service need not be curtailed nor their profits materially affected.

The reason why Professor Hurd suggested the commercial banks should retain their right to issue notes was due to the fact that it was necessary to operate branch banks in many places where the costs of the service did not warrant it on a commercial basis. In order to make that possible Canadian banks should be allowed to retain their note issue privilege which was of considerable advantage to them, in return for the service they performed in developing the country.

He contended that banks unconsciously and involuntarily affect the volume of credit and thus affect the price level. There should, therefore, be a conscious and voluntary control. This could not be exercised by the ten banks independently. It could only be brought about by a central bank independent of all political influence. Its primary duty should be to control credit and act as the representative of Canada's financial interests.

The Grain Dealers' Association

The Grain Dealers' Association stated that the chartered banks had provided ample facilities for the handling of the crops

[37] Ibid., pp. 1718-1752.

in the three Prairie Provinces and had functioned efficiently.[38] The Association expressed itself as in favour of anything that could be done to reduce exchange fluctuations.[39]

A representative of the United Farmers of Manitoba expressed the view that banking in Canada had been developed more essentially to meet the needs of the commercial and industrial classes.[40] He recognized, however, that it was not the function of commercial banks to provide long-term loans. The suggestion was made that banks should be more conservative in the dispensing of technical and gratuitous advice to their customers. He stated bankers often had induced farmers to expand operations and had encouraged them to use the credit facilities of the banks.

Although complaining that the interest rate was high, many farmers stated that complaints against the chartered banks were unjustified. Farmers engaged in mixed farming had less difficulty in securing loans than those engaged wholly in grain growing or ranching. This would appear to be the result of greater stability in mixed farming operations.

Agriculturists throughout the province stated that they were becoming convinced there must be some other method found to supply credit to agriculture.[41] Through the closing of many branches of the chartered banks during the depression farmers had been inconvenienced and had found their credit facilities restricted.

One farmer, while not wishing to express an opinion concerning the advisability of establishing a central bank in Canada, stated, "I wish to say, however, in all frankness, that it is my opinion that our banking system is functioning properly. May I be permitted to say further, that, according to my observation, whenever our Governments have assumed control of public utilities, the functioning of such utilities has often been impaired by waste and political patronage, detrimental, indeed, to a sane and competent administration. In my mind, banking will be no exception at the hands of our law makers."[42]

[38] Ibid., p. 1863.
[39] Ibid., p. 1864.
[40] Ibid., p. 1800.
[41] Ibid., p. 1805 b.
[42] Ibid., p. 1870.

Reasons for Restriction of Credit to Farmers

The statement was often made in the hearings in the West that banks should be more generous in extending credit to small farmers. One cogent reason for the banks being unable to make loans as liberally as expected lay in the Exemption Acts of the provinces. Under these statutes, as noted before, one hundred and sixty acres of every farmer's holdings and certain of his chattels are exempt from seizure. In Manitoba, the Manitoba Debt Adjustment Act of 1932 protected the debtor class of farmers and affected the recourse of the banks and other creditors. The farmer was thus put in a preferred position. These assets, consequently, must be eliminated from a farmer's balance sheet, so far as the banker is concerned when considering a loan to a farmer. This restrictive legislation aided in drying up the sources of credit. Another reason for the refusal of banks to extend loans is found in the inherent risks in lending to farmers on the prairies. The production of crops which constitutes the means of repayment is susceptible to many unfavourable influences. This is particularly so in the case of grain farmers and ranchers.

It was the broad policy of the banks to supply credit to all deserving farmers where there was a will to repay and when the loan was not obviously in jeopardy from the beginning. The banks could not be expected to go out and make weak loans and at the same time provide the country with a sound banking system. Many of the restrictive measures were perhaps necessary emergency measures, but emergency measures are an interference with the ordinary flow of credit.

As Professor Clarke of the University of Manitoba stated, many of the criticisms to which the banks were subjected were based on a misconception of the true functions of commercial banks.[43] These banks must have a high degree of liquidity. They cannot, as was suggested, safely discount paper secured by "national resources in the process of development". By law the commercial banks are prohibited from making loans on real estate. While it is true the rates of interest charged in Western Canada were often high, in recent years the risks, general and personal, have been correspondingly high. A great part of what was termed interest was in reality insurance against the risk of loss, often

[43] Ibid., pp. 2026-2034.

considerable. Then, too, the expense of conducting business in sparsely settled districts was relatively high.

Professor Clarke was not definitely favourable toward a central bank. At the same time he was not satisfied with the conditions obtaining under the Finance Act. He explicitly stated that an economic advisory committee scarcely seemed a satisfactory substitute for a central bank.

Many Criticisms of Banks Unwarranted

A reading of the evidence presented at the hearings in the West leaves one with the impression that much of the criticism of the banks was not really warranted. What the West really wanted was easier credit facilities and loans on a basis that no sound commercial bank could provide either legally or safely. Much of the evidence presented had little connection with a central bank. The establishment of a central bank could do very little to meet the problems raised. Many advocated a central bank because they thought it would be a means of securing abundant credit at low interest rates.

Hearings at Halifax

The Royal Commission at the conclusion of the hearings in Winnipeg proceeded to the Maritimes, commencing their work at Halifax. In contrast to the hearings in the West which were somewhat prolonged and controversial, those in the East were calm and relatively short. The attitude toward monetary problems in the Maritimes affords a great contrast to that of the West.

The Prime Minister of Nova Scotia told the Commission that throughout the difficult period through which the province had gone the relationship with the banks had been thoroughly satisfactory.

The business men of Halifax expressed themselves as quite satisfied with the attitude of the banks and had a feeling of "let well enough alone". As one Nova Scotian put it, "It would appear that one of the chief factors under consideration in the revision of the Canada Bank Act is the situation of the wheat farmers that back the demand for a central bank in the hope of better terms of credit for the prairie farmers."[44]

The Halifax Board of Trade expressed itself as of the opinion that the federal government at Ottawa and the heads of the

[44] Ibid., p. 2055.

larger banks were quite capable of providing for the financing of the country, the movement of its crops, and the meeting of any emergencies that might arise from time to time. The Board was opposed to a central bank.[45]

One of the questions raised during the course of the Halifax hearings involved the question of provincial rights. The question was how far the provinces of Canada would be content to have their borrowings and financial policy determined by a central bank.[46]

During the investigation the question of exchange rates came up. It was stated that fluctuations in exchange rates restricted the fish trade and made the trade more speculative, in many cases tending to paralyse it.[47] Fishermen agreed that stabilization of exchange rates would be advantageous to them.

The fishing industry and the lumbering industry had no fault to find with the Canadian banking system.[48] They did want stabilized exchange rates. The amount of their sales was largely influenced by the position of Sterling.

The session was very short, relatively few appearing before the Commission.

The majority of the business men who appeared before the Commission seemed quite uninformed as to the functions of a central bank. They opposed such an institution but stated that if they had more information they might have different views. In Nova Scotia there appeared to be no demand for a central bank or for any drastic changes in the Bank Act.

Both in Halifax and Charlottetown, Prince Edward Island, Lord Macmillan stated that in some quarters there were exaggerated ideas of what could be done by financial expedients. He pointed out, however, that no financial expedient can overcome the forces of nature when we have drought, pestilence, earthquakes and other calamities of that sort. Financial expedients may come to the aid but cannot prevent such calamities.

Proceedings at Charlottetown

At the hearings at Charlottetown, Prince Edward Island, Honourable W. J. P. Macmillan, Acting Premier of the province,

[45] Ibid., pp. 2056-2058.
[46] Ibid., p. 2066.
[47] Ibid., pp. 2079, 2080.
[48] Ibid., p. 2082.

presented a brief prepared by the members of the Government with the assistance of the Associated Boards of Trade of the province, representatives of the farm associations, and other affected interests. While not wishing the brief to be interpreted as a plea for too easy credit, it was contended that those engaged in the basic industries of the province—farming and fishing—were handicapped by lack of funds. Briefly stated, the farmers of the province felt that they did not enjoy the borrowing power their assets warranted.[49]

Farmers, in their criticism of the banks, stated the loans they did receive were made at too high a rate and for too short a period. They said the opinion was quite general that interest rates on loans were too high, and that there should be some flexibility in the rate.[50] The Acting Premier suggested that the provision for giving security under the Bank Act should be extended to foxes, fertilizers, and prepared fish.[51] Fox farming had become an important branch of the farming industry since a great many of the farmers of the province raised at least a few foxes.

The bank regulation requiring the payment of a minimum of fifteen cents on every cheque drawn on a bank and cashed by one of its branches, or by another bank outside the local area but within the province, was severely criticized. Under questioning by Commissioner Leman, it was brought out during the course of the hearing that the charge of fifteen cents for collection is, in reality, not so much a charge for collection as a charge to cover interest for the use of the money since credit is given at the moment the cheque is deposited although some days may elapse before the bank secures the funds.

Hearings at Saint John

At Saint John, New Brunswick, Mr. F. M. Sclanders, Secretary of the Saint John Board of Trade, appeared before the Commission and stated the Board was conscious of no cause of complaint with respect to the banks. On the contrary, the Board had sound reason to commend them highly for the admirable manner in which they had borne the burdens placed upon them by the depression. In the opinion of the Board it would be unwise, and

[49] Ibid., p. 2117.
[50] Ibid., p. 2119.
[51] Ibid., p. 2120.

possibly disastrous, to make fundamental changes in a system which had so successfully stood the test of time without recorded parallel.

Instead of centralization the Board advocated decentralization. The opinion was expressed that the Maritimes had not prospered equally with the other provinces, that economically they were the least developed section of Canada. This was attributed largely to the head office concentration in Central Canada. Mr. Sclanders said:

> "The remedy which we venture to suggest for this situation is through an Amendment of the British North America Act or by means of Federal legislation; the Government of each province comprising this Federal Union of British Provinces should be granted joint authority over banking, just as is provided in the case of agriculture and also of immigration. Such joint authority would assure each province of fair treatment, and the adoption of this suggestion might go far to check or modify the economic centralization to which we have referred and which we sincerely believe to be adverse to the national well-being."[52]

In general, the view was expressed at Saint John that there was no need for a central bank, that the functions of such were being provided under the Finance Act, and that Canada had sufficient financial machinery for her existing needs. The opinions expressed in Nova Scotia and New Brunswick were in striking contrast to those set forth in British Columbia and Alberta.

During the hearings throughout Canada there was no suggestion that politics had interfered in the working of the Finance Act. A great many of the witnesses appearing before the Commission had the utmost confidence in it.

Hearings at Quebec

At the Quebec City hearings of the Commission the Treasurer of the province stated that the banks have in practice rendered reasonable financial assistance at reasonable charges to public institutions. He went on record as opposed to a central bank. He feared the following effects if a central bank were established:[53]

[52] Ibid., p. 2178.
[53] Ibid., p. 2254.

1. An increase in the financial burden to be borne by the public resulting from the cost of organizing and directing the bank's activities.

2. The bank would be subject to political control. This would have an unsettling effect on business generally.

3. It would bring about friction between the provinces. If any one of the provinces should be a political supporter of the federal authority there was the possibility that in its borrowings it would receive favourable treatment not accorded to another province of a different political colour.

The Quebec Branch of the United Farmers of Canada felt that interest rates were too high and that banks should give greater assistance to the farming class. The suggestion was made that branch managers of the banks should have more authority to use their judgment in assisting individual farmers. With regard to a central bank they felt "that as you (referring to the Commission) must be men of ability or you would not be in the positions you hold, we are willing to leave it to you and the Government to decide whether or not we need a central bank."[54]

The Insurance Brokers' Association of the Province of Quebec recommended that neither the chartered banks nor their branch managers should be permitted to engage either directly or indirectly in the business of insurance.[55]

The Quebec Board of Trade was not enthusiastic about a central bank for Canada. The members could not see how it would improve matters. The view was expressed that the banks had really made it too easy for municipalities to borrow.[56] If the banks had been less ready in the past to grant loans, it would have been much better for all concerned. Banks should have exercised a greater restraining influence upon municipal governments. Business men could not understand how a central bank could help their business.

Professor Gregoire of Laval University stated the banks had met all demands and therefore he saw no necessity for a central bank.

The hearing in Quebec City like those in the Maritimes was very short. One hearing in the Maritimes lasted somewhat less than two hours. In Quebec City little interest was shown in a

[54] Ibid., p. 2399.
[55] Ibid., p. 2406.
[56] Ibid., p. 2277.

central bank. There was not a single advocate for a central bank. There seemed to be a general lack of knowledge regarding the functions of a central bank. Apparently there was little agitation for such an institution.

Hearings at Montreal

Mr. Scott, a Member of the Legislative Council for Quebec, appearing on behalf of the Government of the province at the Montreal hearings, stated the Quebec Government had been able to secure all the banking accommodation required and had no criticism to make concerning the chartered banks.[57]

In Montreal the economist for the Board of Trade stated that he was of the opinion that central banking functions were being fulfilled very satisfactorily by the banks and by the Government under the powers derived from the Finance Act.[58] If a central bank should be established and the right to issue notes were taken from the chartered banks, many branches would have to be closed. This would result in a curtailment of credit facilities. One function of a central bank in other countries is that of controlling the monetary market, but in Canada no real money market existed.

The suggestion was made to the Commission that an advisory board might be appointed by the Government. This Board could be given many of the functions which in other countries have been assumed by a central bank.

Many witnesses were apprehensive of any steps which would weaken in any way the banks of the country. There was some apprehension as to the cost of such an institution. No institution was desired which would result in an added expense. This fear had been expressed also in the Maritimes.

M. Montpetit (Université de Montreal), whose memorandum was presented by M. Vezina, believed that most central banking functions were satisfactorily performed by the existing machinery and that monetary policies might be guided by a "commission of experts". His memorandum stated that a central bank ought not to be considered a panacea for all the economic ills of a nation. Several banks of this kind existed in different parts of the world, and their number had increased, especially since the Conference

[57] Ibid., p. 2422.
[58] Ibid., p. 2363.

at Brussels. In spite of this the economic situation had changed but little. In his opinion the solution of present economic difficulties did not lie in monetary measures.

A representative of the Canada Permanent Mortgage Corporation gave expression to a feeling that while there was a great clamour in Canada for a central bank, very few of those asking for it knew exactly what they wanted. Most of them were really asking for a central bank in the belief they could secure more credit and on easier terms. He was of the opinion that the chartered banks had erred fundamentally in being too liberal with credit. The West wanted a central bank as a means of securing credit they could not otherwise get.

Hearings at Toronto

Mr. Glazebrook (Special Lecturer in Banking at the University of Toronto), in his testimony before the Royal Commission at Toronto, did not expect that a central bank could do much good. While he was opposed to a central bank he felt that the pressure for some new form of monetary machinery was too great to be wisely resisted. He stated that the inevitable failure of many people to obtain the credit they required had tended to accentuate the unpopularity of the banks. When oppressed by a business depression there was a tendency on the part of the public to demand some new machinery. For so complicated a phenomenon as a business depression the public inevitably looks for a single cause.

Mr. Glazebrook was of the opinion that in Canada the control of credit by a central bank was doubtful without the existence of a money market in which to operate. He could see no real necessity for a central bank and was of the opinion that the banks in Canada had carried out the functions of banking admirably.

In Lord Macmillan's opinion this was not sufficient; "modern conditions have placed upon banks a new type of responsibility, so that they have now to look not only at the ordinary domestic problems of administering a bank but have to consider the wider question of policy as to how far they can control the creation of credit, or restrict it, as to how far they can go in relation to international exchange and its fluctuations; in how far they can go in maintaining price levels, and other large topics of quasi-financial

matters, and with which they come in contact in a larger way than ever before."[59]

Recommendations of Professor Parkinson [60]

A conscious and deliberate monetary policy exercised through a central bank was favoured by Mr. Parkinson (University of Toronto). He recommended a bank with a Board appointed by the Government. The central bank should be the repository of the reserves of the chartered banks and the source of all note issues. The establishment of a central bank would provide the opportunity for a long overdue centralization of the gold reserves of Canada. The Bank should exercise its monetary control to stabilize the rate of economic development in Canada and to provide for the effective use of all resources human and natural.

Mr. Parkinson went much further in his recommendations than anyone else who had appeared before the Commission. In his opinion monetary control was not enough. It would be incapable of completely controlling price levels or exchange rates. He doubted whether the money markets in Canada would be sufficiently responsive to central bank controls which are adequate in international financial centres. "The theory that changes in prices are the direct result, at all times, of changes in the quantity of money is quite untenable. The initial and more fundamental causes lie elsewhere . . . perhaps the most important cause lies in the spasmodic and fluctuating character of the rate of new capital development, and in the unbalanced and uneconomic direction so frequently given to such expenditures."[61]

In his opinion, a survey of the methods of financing Canadian industry, commerce, and government leads to the conclusion that certain features appropriate to early conditions no longer were desirable.

National Investment Commission Proposed

Mr. Parkinson suggested the appointment of a Commission of National Investment, the function of which would be, broadly, to establish a system of national controls over investment in order to supplement the policies of the central bank.[62] The Commission

[59] Ibid., p. 2604.
[60] Ibid., pp. 2855-2927.
[61] Ibid., p. 2875.
[62] Ibid., p. 2880.

would be expected to attempt to stabilize the rate of capital investment by exercising powers of restraint at periods of rapid expansion and by a policy of active interference at periods when a revival of capital investment was essential to economic revival. Among other things the Commission would be expected to exercise a strict supervision and control over the new foreign borrowing of public and private authorities in order to keep such borrowing within the limits imposed by Canada's ability to meet her foreign obligations in the future out of the balances of international payments, to provide a more even distribution of maturities, and to reduce the cost of foreign financing.

Without discussing the merits and the feasibility of the recommendation of Mr. Parkinson, the proposal, on the face of it, would seem to provide for a dual control of the financial system, a control which might not at all times be harmonious. In such a plan there are possibilities for conflict between the central bank and the proposed commission. If control of investment were desired there seems to be no real reason why it could not be exercised through the central bank.

What Mr. Parkinson proposed was federal control of long-term investments exercised through a Commission. This Commission would formulate plans for the rationalization of the whole processes of municipal and provincial borrowing. The proposal involves constitutional difficulties which need not be discussed here.

Testimony of Professor Gregory

The only academic economist, not connected with a Canadian University, who presented evidence before the Commission was Professor T. E. Gregory of the University of London. He was in Canada at the time, attending the Conference of the Institute of Pacific Relations, and met the Commission in Toronto.

Professor Gregory regarded the position of the competitive commercial banks in Canada as circumscribed, first of all, by the fact of competition, and secondly, by the environment in which they work. He was of the opinion that the banks and the credit system of Canada work within a framework which is really controlled by forces operated partly in Europe and partly in the United States, and that any responsibility which devolves upon

Canadian bankers must be regarded as being dependent upon these external forces.

The opinion was expressed that the absolute volume of credit as a factor in the causation of prices is rather receding into the background, and that economists are disposed to pay much more attention than they formerly did to the question why the so-called "velocity of circulation" goes up and down. As regards Canada, Professor Gregory was inclined to say that the dynamic factor in the fluctuation of the price level is not so much the absolute volume of credit in Canada as the rate at which capital investment takes place, and that itself is related to the ease or the difficulty with which the provinces, the Dominion, and the industries can borrow in foreign markets.

On the other hand, Professor Gregory was of the view that the absolute volume of credit in Canada is primarily dependent upon Canadian export prices. It appeared to him that the real reserve of the Canadian banking system is the cash position which is maintained in New York and London. That cash position is a variable of the prices paid for Canadian goods abroad. For example, if world prices for wheat and other exports are high, that involves an immediate increase in the cash reserves of the Canadian banks both in London and New York. Moreover, when world prices for wheat and other products are high, the income of the Canadian farmers goes up, and there are at once secondary repercussions on credit expansion in Canada itself. There is a temptation on the part of the sheltered trades and other industries to expand, and for the provinces to embark on programmes of public works. The high price of Canadian export products has a direct influence upon the industrial development of Canada. Further, if the Canadian provinces are prosperous it becomes much easier to borrow in New York and London. In that way the high prices for Canadian export products and borrowing abroad have a cumulative effect upon one another; that is to say, they both tend to rise and fall together.

This would rather indicate that the price of Canada's export products really constitute the predominant factor in the whole situation. Canada's economic position depends upon the sale of products to the older industrial countries.

Professor Gregory raised the question as to whether Canadian bankers have always been aware of the effect upon Canadian

economic life of the two factors stated above, and whether they have always been sufficiently careful to damp down the enthusiasm of the municipalities and the provinces on the one hand and whether, on the other hand, the amount of secondary expansion which results from high prices and loans in other markets have always been sufficiently kept in check. Doubt was expressed as to whether a competitive banking system is capable of checking undue development, even if bankers are made fully aware of the nature of the problem.[63]

During the course of the hearings throughout Canada much criticism had been directed at the practice of the Canadian banks in keeping deposit rates and loan rates at a rigid level. It was regarded as deflationary. Professor Gregory, while stating that such a practice might have some slight influence in prolonging the depression, stated he would be very chary of giving it any very great quantitative significance.[64] Moreover, he was very sceptical of the value of lowering the interest rate paid on savings.

Professor Gregory was strongly in favour of a central bank for Canada, although he recognized Canada already possessed a kind of central banking institution in the shape of special powers conferred upon the Minister of Finance under the 1923 Act.

Speaking of the advantages of a central bank, Professor Gregory stated:[65]

> "It is of great advantage to any country to have a centre not only for rediscounting, but as a centre of moral authority in moments of crisis and an authority which is also capable of exerting and expressing a certain volume of moral critique in moments of exaggerated optimism or of exaggerated pessimism. These two functions, the function of acting as a rediscount agency and the function of acting as a centre or inspiration of moral authority, ought to be conferred upon an institution more regular in its functions and in its authority than a mere department of the Ministry of Finance. These are two of the main reasons for favouring the establishment of some kind of central banking machinery . . . Canada suffers in comparison with other parts of the world by reason of the fact that there is at the present time in this country no single authority which can attend monetary conferences and confer with other central banking institutions, and which can

[63] Ibid., p. 2985.
[64] Ibid., p. 2987.
[65] Ibid., p. 2992.

really speak in the name of the Canadian people on the financial and banking situation as a whole."

In view of the bitter parliamentary debate which followed a few months later relative to the relationship which should exist between the central bank and the Government of the day, it is of interest to note the opinions expressed by both Lord Macmillan and Professor Gregory. In answer to a query by the Commissioner as to whether the Bank should always occupy a subordinate position in its relation to the executive government of the country, Professor Gregory replied, "subordinate but not necessarily dependent".[66]

Lord Macmillan then observed, "I think the words are well chosen. Subordinate in that the ultimate responsibility for the country's policy lies with the government of the day, but the bank ought to be an independent adviser accessible to the government at all times, with a special fund of knowledge and able to give special authoritative advice."[67]

Professor Gregory agreed and said, "I would like to formulate it in this way, that in the end, since the government of the day possesses sovereign power, it must necessarily have the last word in disputes, if they unfortunately arise, between itself and any other agency whatever in the state."[68]

The Chairman replied: "I agree, Professor Gregory, but I would also urge that the fruitful functioning of a central bank depends upon the government insisting upon objectives which are within the scope of the instrumentality which it has created. Furthermore, nothing could be more fatal to the prestige of a central bank than constant interference with the details of its administration or with its day-to-day operation of any policy whatever. No man with self-respect is going to act as an office boy of the administration if he is going to carry out his work properly."[69]

Control of Note Issue Not Essential to a Central Bank

Various views had been presented to the Commission relative to the issue of notes by the chartered banks if a central bank should be established. Some witnesses believed it was absolutely

[66] Ibid., p. 2995.
[67] Ibid.
[68] Ibid.
[69] Ibid.

essential to the successful operation of a central bank that it should have the sole right to issue notes. Others were of the opinion that the chartered banks should be allowed to retain the note-issuing privilege. Professor Gregory did not think it was absolutely essential to the functioning of the proposed central bank that the private note issues of the Canadian banks should be transferred to it.[70] It was essential, he said, that the central bank should take charge of the Dominion note issue. He would leave the private note issues very much in their present position.[71] He felt that the matter of private issues had been enormously exaggerated on both sides.

Problems of Control in Canada

Professor Gregory was of the opinion that due to the fact that an open market does not exist in Canada, and the method of deflating the volume of purchasing power by the sale of securities may take a long time before it is effective, a central bank in Canada would come face to face with the fact that it must establish novel methods of control to make its influence felt.[72] He expressed himself as being uncertain whether it would be possible to create a money market in Canada.

The witness felt that a central bank could exercise direct influence in two ways. If the commercial banks were required to keep at all times minimum reserves, and in periods of super-excitement excess reserves at the central bank, then if credit demands continued to expand the commercial banks would be forced to rediscount at the central bank, and that would, of course, be a direct instrument of control.

In the second place it would be absolutely indispensable that the provincial governments and the federal government should conduct their borrowing operations through a central bank. That would give the central bank a certain measure of control over the public works policies of the country.

During the course of the hearings throughout Canada, many witnesses thought it should be the duty of a central bank to stabilize prices and the volume of employment. Professor Gregory stated that in framing an Act he would be very chary of specifically

[70] Ibid., p. 2997.
[71] Ibid., p. 2998.
[72] Ibid., p. 2997.

stating either objective. These terms are capable of more than one interpretation. Even though stabilization of prices should be properly interpreted, he was not sure that such stabilization was in itself a desirable thing. He expressed himself as being opposed to imposing on a central bank the definite task of eliminating the trade cycle. Such a function was not stated in the charter of any central bank in Europe or in the charter of the Federal Reserve System, and it would be absolutely futile to insert it in the charter of the central bank of a country the economic life of which is largely dependent on what happens outside its frontiers.

When queried relative to the desirability of establishing an equalization fund in Canada, Professor Gregory stated that it would be difficult to find objectives for it since he believed Canadian economic policy must necessarily be largely influenced by the half-way house position in which Canada finds herself. As to the size of the stock of gold necessary for a central bank, the English economist stated the size should be governed solely by the requirements of redeeming international balances. He was not impressed with the view that the size of the gold stock influences public opinion.[73]

Central Bank Favoured by Queen's Economists

Both Professor W. A. Mackintosh and Professor F. A. Knox of Queen's University favoured a central bank, in their memoranda to the Commission. Professor Mackintosh was opposed to a revamping of the Finance Act as a substitute for a central bank as had been proposed by some witnesses. In his opinion, the proper thing to do was to set up a central bank which would exercise deliberate control of credit. It should be an independent and permanent institution capable of accumulating the experience and establishing the practices necessary to the accomplishment of the difficult tasks of credit control. It was not contended that a central bank could perform miracles, that it would restore prosperity, solve the Western debt problem, or revive depressed industries. In the carrying out of sound policies to meet the economic problems of the country it would be a valuable and an essential aid. Canada's prosperity, it was pointed out, was peculiarly dependent upon world prosperity. "A central bank is no

[73] Ibid., p. 3039.

panacea. It is merely an instrument to perform well-defined functions which must be performed whether intelligently or unwittingly."[74]

Peculiarities of the Canadian Economy

Professor Knox emphasized the fact that the conditions under which a central bank in Canada would operate are set by some features peculiar to the Canadian economy and by the implications these carry as to the type of monetary policy Canada should pursue. Canada's dependence on the results of international trade implied that a purely domestic policy, such as the stabilization of the level of wholesale prices, must be subordinate to the achievement of stability of the foreign exchange value of the Canadian dollar in terms of the currencies of the countries with which Canada trades.

He pointed out that Canada will be subjected continually to the necessity of adjusting her internal economic arrangements to considerable changes in the net income received from abroad from the export of commodities or from the import of capital. That is to say, Canada will be subjected to the shocks which may originate in economic conditions largely beyond her own control, as for example changes in the world price of raw materials or changes in the willingness of the foreign investor to buy Canadian securities.[75]

In the opinion of Professor Knox, the future task for a central bank is the stabilization of exchange rates with other countries, not direct operation on prices in the pursuit of a purely domestic currency policy such as the stabilization of prices. The Canadian problem is one of keeping the movement of prices in Canada roughly in line with price movements in the major countries.[76]

No Need for Extensive Open Market Operations in Canada

Open market operations are forced on large world central banks like those in London and New York because of the large volume of short-term funds which move so readily from one international market to another in response to conditions other than those arising directly from a changed balance of payments situation which needs correction. These banks have to undertake

[74] Ibid., p. 3059-A.
[75] Ibid., p. 3062.
[76] Ibid., p. 3065.

open market operations to offset the effects of movements of international funds in order that the country's international trading position be maintained unchanged. In Professor Knox's opinion the absence of a money market in Canada, to and from which such funds might flow, would relieve a central bank in Canada from the necessity of undertaking these offsetting open market operations. Occasions on which such operations would be undertaken in Canada should therefore be few.[77] The restrictions of a too rapid expansion of credit in boom periods would probably be the most usual instance. In such times Professor Knox believed the simple sale of government securities to the Canadian market should be all the open market operations needed to make the rediscount rate effective. In his opinion the absence of a bill market in Canada presented no obstacle to the successful operation of a central bank in Canada.

A central bank in Canada could not take its methods of operation wholly from the experience of other countries but would have to develop its own traditions and technique within the Canadian environment and under the conditions which future world monetary policies and events would impose.

Farmers Favour a Central Bank

Mr. W. C. Good, representing the United Farmers of Ontario, was quite emphatic in his denunciation of the banking system.[78] He opposed interlocking directorates, the concentration of financial power in a few hands and the prevailing rates of interest which he thought were too high. He was of the view that there were too many branches and that the banks had too costly buildings. He strongly favoured a central bank.

The Economic Reform Association, the Douglas Credit League, and similar organizations appeared before the Commission to advocate their pet nostrums.

Professor Michell of McMaster University was opposed to embarking on a policy of inaugurating a central bank and strongly favoured continued use of the Finance Act.[79]

The Investment Bankers' Association complained that the Canadian banks had, through bond departments established for

[77] Ibid., p. 3065.
[78] Ibid., pps. 2652-2704.
[79] Ibid., pp. 2737-2745.

that purpose, carried on a bond business in competition with the investment bankers. To remedy this situation the Association recommended that in the next revision of the Bank Act banks should not be permitted:[80]

1. To advertise, circularize, or appear in a public prospectus or to solicit orders for securities;
2. To negotiate for, or purchase (either alone, or jointly as members of a syndicate) new issues of securities other than Treasury bills, in the ordinary course of banking;
3. To deal in securities except
   (a) As agent for their customers,
   (b) For their own investment account.

The banks defended their position by stating that they had been forced into the bond business at the request of their customers. During the War the Dominion Government had required the banks to act as agents in the placing of Victory loans, and as a result many thousands of the banks' clients had become bond holders. Customers appeal to the banks for assistance and advice in buying and selling securities. The banks pointed out they had no salesmen on the road and it was not their intention of competing with bond houses for new issues of securities. On the contrary, instead of being competitors of bond houses they were really co-operating with them and purchased securities through them.

No criticism of the banking system was made by business men and manufacturers. Apparently they had little or no difficulty in securing adequate credit.

Summary of Complaints Made Against the Canadian Banking System

A clearer picture of the alleged defects of the financial system may be obtained by a summary, at this point, of the main criticisms submitted to the Commission in its long itinerary across Canada.

Criticism of the Canadian banking system was particularly rife in Western Canada where the main complaints were made by representatives of the agricultural interests. At various sittings of the Commission evidence was submitted both by individual farmers and representatives of farm organizations to

[80] Ibid., p. 3115.

show that as a result of declining revenue due to the low prices prevailing for agricultural products, the maintenance and operating costs of farms could not be met and that a large percentage of farmers were unable to obtain new credit from the banks to meet the operating costs incidental to sowing and harvesting the crop. Those who were able to secure loans complained of unduly high interest rates, and charged that the West was being discriminated against since interest rates were considerably lower in the East. Criticism was frequently made concerning the discrepancy between the currency of loans and the period of the farming operations which the loans were intended to finance. Complaint was also made of the practice of compounding interest, thus increasing the interest charges. It was acknowledged that the common practice of the Canadian banks has been to take notes drawn for a period of three months, although repayment was not expected before six to twelve months. Farmers criticized the lack of facilities providing for short or intermediate credit.

Representation was made that too great a spread existed between the rates of interest paid by the banks to depositors or to the Government under the Finance Act and those asked by the banks on their loans. Some complaint was made regarding charges for collecting cheques. To this the banks replied that a bank cannot undertake the encashment or collection of cheques, whether drawn upon its own branches or those of other banks, without incurring expenses for postage, stationery, clerical work and the maintenance of clearing houses and messenger services.

The Investment Bankers and representatives of a number of Boards of Trade strongly urged upon the Commission that banks should be prohibited by statute from dealing in securities, save as regards purchases and sales for the banks' own portfolios.

It was alleged that the boards of directors of the Canadian banks, who decide the general policy of the several banks, included too large a proportion of members domiciled in the central provinces and that accordingly the attitude of the banks was more sympathetic to Central than to Eastern and Western requirements. Representations were received by the Commission to the effect that, under such a centralized system, application for loans from Eastern and Western communities or business interests had to be passed upon by head officials who were not sufficiently conversant with Eastern and Western conditions and

who might be inclined to favour enterprises near at hand. Eastern and Western interests felt that they were subordinated to those of the Central area. The banks vigorously denied these charges, and asserted that their boards were, as far as possible, representative of the entire country and that of the thousands of loans applied for, nearly every loan was granted before reference was made to the head office.

Attention was drawn at several of the hearings to the fact that many bank directors were also directors of other corporations and, as a consequence, it was suggested that such corporations were specially favoured in the credit policy of the banks to the detriment of individual customers engaged in agricultural and primary industries generally, as well as of traders with comparatively small credit requirements. No evidence was adduced to show there has been such discrimination in banking policy.

Evidence was heard on behalf of insurance agents to the effect that the banks were engaging in or influencing insurance business and so invading their sphere.

Criticism was directed at the tendency of the existing system to promote an expansion of credit when conditions are good and over-contraction when business is depressed, thus accentuating the business cycle. The Finance Act was severely criticized as an ineffectual instrument of credit control.

Four of the provincial governments declared unequivocally in favour of a central bank. These were the three Prairie Provinces of Manitoba, Saskatchewan, and Alberta, and the Province of Prince Edward Island. Quebec was the only province definitely opposed. The other four provincial governments were non-committal, confining themselves largely to words of praise for the banking system. The municipalities which expressed any views on a central bank differed in their expressions of opinion.

Most of the farmers' organizations favoured a nationally owned and controlled central bank as a step toward the nationalization of credit. The Trades and Labour Congress expressed similar views. Business men, Boards of Trade, and Chambers of Commerce were divided on the central bank question. The Canadian Chamber of Commerce had endeavoured by means of a questionnaire to find out the attitude of their members toward a central bank. The Chamber reported that the replies received showed that opinion in Alberta, Saskatchewan, Manitoba, and

Prince Edward Island leaned toward a central bank whereas in the other provinces business opinion was otherwise inclined. Even in the Prairie Provinces the evidence showed business opinion was far from being in entire agreement on the necessity or advisability of a central bank. The preponderance of feeling in British Columbia, Ontario, Quebec, Nova Scotia, and New Brunswick was strongly set against such an institution.

Among the economists who appeared at the hearings there was a difference of opinion, the great majority favouring a central bank for Canada. While there was a close agreement among those favouring a central bank, in regard to the objectives and the nature of its operations, there were differences of opinion regarding its structure and powers. Some favoured a Board appointed by the Government. Some did not. Some would prescribe minimum reserves, others would allow the bank the utmost freedom in carrying out the execution of its policy.

The banks opposed a central bank, favouring instead a reform of the Finance Act.

The hearings in the West were somewhat long and controversial while those in the East were relatively short and calm. In the Maritimes almost all the witnesses were from the upper economic strata.

The Commission made every effort to secure the widest possible range of information and expert opinion. All submissions received the most careful attention of the Commission. Probably no Commission in so short a period of time ever received as much information and touched so widely the people of Canada as did the Royal Commission on Banking and Currency.

Testimony of the General Managers of the Chartered Banks Presented at Hearings at Ottawa

On completion of the hearings at Toronto the Commission returned to Ottawa where it heard the evidence presented by the chartered banks. While local representatives of the banks had appeared from time to time at hearings of the Commission at different centres in Canada and had supplied information and answered questions relative to local conditions, all questions of general policy had been reserved until the Commission returned to Ottawa. Some time before the close of their itinerary across

Canada the Commission had prepared and submitted to the banks a memorandum on matters upon which the opinion of the banks was desired. This document summarized the matters upon which the Commission had received evidence. It was divided into four sections, "Matters of General Policy", "Special Matters", "Points of Detail" and "A Central Bank".

A summary of the criticisms made and the banks' rejoinders together with the Commission's recommendations was incorporated in Chapter VII of the Report of the Commission.

The views of the banks upon "Matters of General Policy" and "A Central Bank" were presented by a number of the general managers. It represented the collective views expressed through the Canadian Bankers' Association.

The memorandum of the Canadian Bankers' Association dealing with the control of credit was presented by Mr. M. W. Wilson, General Manager of the Royal Bank of Canada, at the request of Mr. MacLeod, President of the Canadian Bankers' Association.[81] He stated that while bankers conferred with one another continuously and had frequent opportunities to discuss specific problems as well as the general trend of affairs with high government officials, there existed no properly constituted body which admitted responsibility for the control of credit in Canada. The Canadian Bankers' Association had never functioned in this respect nor was it intended that it should.

Mr. Wilson said Canada had no bill market and no market for bankers' acceptances. Bills of exchange bought from their customers by the banks were not subsequently negotiable in Canada. Outside the banks there were no portfolios of acceptances or commercial bills in Canada. The memorandum stated that there was no money market in Canada in the sense that these words are used to describe the banking organization of London and New York. Because of the special circumstances obtaining in Canada it would be difficult to create such a market or the mechanism of control which exists elsewhere. There were no facilities in Canada for open market operations either in the case of short-term self-liquidating commercial obligations or in the case of short-term government obligations.

[81] Mr. Wilson's memorandum, pp. 3154-3165 of the *Proceedings of the Royal Commission.*

In consequence of this situation, the Canadian banks had generally followed the practice of maintaining in New York not only the reserves on behalf of some of their branches abroad, but also a part of their immediate reserves against demand obligations in Canada. These were either invested in acceptances or loaned at sharp call. Thus these reserves which in normal times were equivalent to gold in Canada, were available at all times to meet local needs in Canada, and yet they were made revenue producing.

The memorandum stated it would be a great mistake to regard Canadian financial centres as being repositories of large foreign short-term balances, in the sense in which London and New York might be so described.

Working under these handicaps, the bankers believed a Canadian central bank, attempting to control domestic fluctuations of credit would be somewhat restricted in its choice of methods.

Mr. Jackson Dodds, General Manager of the Bank of Montreal, while presenting the memoranda on Matters of General Policy, stated before the Commission,[82]

> "We are of the opinion that commercial banks of a debtor country cannot safely undertake to influence the movement of domestic commodity prices, whether or not our dollar is stabilized to the currencies of the great creditor countries.
>
> "We think it desirable to emphasize that any attempt to raise domestic prices (whether the country is on or off the gold standard) by measures designed to increase arbitrarily the volume of credit in use, is bound to disrupt the normal economic process in unpredictable directions and to cause disequilibria difficult to eradicate later."

Mr. Dodds submitted extracts from the Report of the Committee on Banking and Currency, United States House of Representatives, 1926, to support the view that neither the Federal Reserve System nor any other system can control prices.

Mr. S. H. Logan, General Manager of the Canadian Bank of Commerce, stated that in so far as the financing of Canada's foreign trade is concerned, whether outwards or inwards, the existing machinery has proved entirely adequate. The foreign correspondents of Canadian banks in London, Paris, Amsterdam, New York, and elsewhere had at all times been found ready,

[82] *Report of the Royal Commission on Banking and Currency in Canada, 1933*, p. 3174.

and indeed eager, to place at the disposal of the Canadian banks whatever credits might be required to consummate commercial transactions. In fact, he stated, there is evidence that this form of financing is capable, without the slightest check or ripple, of whatever expansion may prove necessary.[83]

Loss of Privilege of Note Issue Would Impair Bank Earnings

The General Manager of the Royal Bank of Canada, Mr. M. W. Wilson, claimed that the loss of the right of note issue by the chartered banks would seriously curtail the earnings of the banks.[84] The privilege of note issue enabled the banks to concentrate their reserves at central points and to use their own unissued notes as the cash reserves of smaller branches. This has made it possible for the banks to expand their branch system into smaller communities to an extent that would not have been possible otherwise. Apart altogether from losses from bad debts, 1,380 or 42.3 per cent. of the 3,262 branches in Canada operated at a loss in 1932. In Saskatchewan the percentage had been over 80 per cent. Cancellation of the note-issuing privilege would penalize less populous communities, it was contended.

Weaknesses of a Canadian Central Bank

A central bank in Canada would inevitably possess many weaknesses, the bankers believed. The first source of weakness to claim attention was the undue expectations entertained by the public as to the possibilities of a central bank in Canada.

It was pointed out that the practical effectiveness of central banks was everywhere circumscribed by local conditions. In very few countries do local conditions give the central bank a dominating position. Moreover, executives of central banks have uniformly been unwilling to admit that they possess the power to control the level of prices and the direction of credit which the public conceives them to possess. While in both Great Britain and Sweden the central banks seemed to have stabilized the level of commodity prices with fair success, in both instances a local explanation of whatever success that had been achieved existed.

[83] Ibid., p. 3233.
[84] Ibid.

In the case of Great Britain, the structure of the money market gives the central bank an unusually close control of fluctuations in credit, and this credit has been supplemented by the Exchange Equalization Account.

In the case of Sweden, the central bank appears to have achieved its object almost wholly by means of operations in the foreign exchange market; but these were simplified by the fact that Sweden is, on balance, neither a debtor nor a creditor country; and so faces neither the problem of making regular payments of interest abroad, nor the problem of receiving such payments at home.

A central bank in Canada would not have at its disposal the money market machinery to make its will effective as does the Bank of England, nor could it operate in the foreign exchange market with the freedom of the central bank in Sweden inasmuch as Canada has to furnish on the average between half a million and one million dollars per diem in interest payments abroad.

A Canadian central bank would possess neither the technique of control nor the prestige which would permit it to use with complete confidence even the limited financial resources which would be available to it.

The bankers critically examined the four methods usually used by central banks in attempting to control fluctuations of credit;

1. The exercise, in public and private, of its moral authority. (Moral suasion.)
2. The purchase and sale of bonds in the open market in Canada. (Open market operations.)
3. The purchase and sale of foreign exchange. (Foreign exchange operations.)
4. The raising and lowering of the rate charged on advances to the commercial banks. (Rediscount rates.)

Regarding moral suasion the bankers stated, "the results to be gained by moral suasion naturally depend upon the good judgment and prestige of the person or groups of persons offering advice. This in turn depends, in the case of a central bank directorate, in part on the care with which the personnel is selected, and in part upon the record of actual achievement in

the conduct of the bank itself. Prestige is a matter of slow growth."[85]

Moral suasion must be backed, if necessary, by action.

Turning next to open market operations, the bankers said,[86]

> "The purchase and sale of bonds in the open market would, as a procedure, be very simple, for the central bank's purchase of bonds in Canada would, in the final analysis, presumably be by means of a book entry, thus increasing the balance of the commercial banks with the central bank, and, per contra, the sale of bonds in Canada by means of a corresponding entry, would diminish the balances of the commercial banks with the central bank.
>
> "In this manner, the central bank would increase or decrease at will the cash resources of the commercial banks in Canada, subject to the qualifications that changes might occur in their assets abroad, independent of those being brought about in Canada, which would perhaps affect the situation in Canada materially.
>
> "But there are other qualifications to be made in addition.
>
> "In the first place, before the central bank could apply this procedure with any confidence, an intricate technique would have to be learned on the basis of experience.
>
> "In the second place, recognition must be given to the limited nature of the Canadian security markets. Inasmuch as a number of the principal issues in which the central bank would deal are largely held in the United States, as well as in Canada, an energetic buying policy might merely prompt an importation of Canadian bonds formerly held in the United States.
>
> "In the third place, even if such an open market operation should be conducted by the central bank in Canada without ulterior consequences, it is doubtful whether they could have positive effects of such importance since so many of Canada's major products sell on an export basis that, so long as the exchange rate is stable, our index of wholesale prices closely reflects changes in world prices over which we have no control. The discount or premium on Canadian exchange in relation to the currencies of other countries is the major factor in any discrepancy between the Canadian and world price levels."

In their memorandum the bankers were of the opinion that operations in foreign exchange would have an equal or even more immediate effect than the purchase or sale of securities in the open market, and would present no problems not paralleled in

[85] Ibid., p. 3160.
[86] Ibid., p. 3161.

other markets.[87] Thus if Great Britain, the United States, and Canada all returned to the gold standard, the Canadian central bank could expand the cash resources of the banks in Canada by purchasing United States funds and accumulating balances in New York. In carrying out the reverse operation it would, of course, find it impractical unless at the moment it held balances available in New York or London or arranged for credit in these centres.

Concerning the fourth method of control, varying the rediscount rate, the bankers stated,

> "In classical theory, borrowing could be effectively checked as the bank rate is raised, and stimulated as the bank rate is lowered. The extent to which borrowings could be affected by changes in the rate is, however, extremely difficult to estimate. Certainly reductions in bank advances could be brought about through the central bank management adopting a policy of credit rationing in addition to rate increase, but it is doubtful whether, on the other hand, the central bank could hope by rate reductions alone to effect an expansion of loans by commercial banks."[88]

The conclusion of the memorandum was that:[89]

> "In the light of these four groups of considerations, it may be seen that the mechanism at the disposal of a central bank in Canada would necessarily be somewhat crude. It would be visionary to hope that the directorate of the central bank, no matter how strong and wise it would be, would find itself able to enforce its will merely by means of open market operations and the rediscount rate."

It was pointed out that "the possibility remains, of course, that under certain circumstances, and by manipulating the rate of exchange, the central bank might effectively produce the desired results, which direct action in the domestic market alone could not secure. This presupposes that we should remain off the gold standard."

Bankers Oppose Statutory Reserve

The banks were opposed to any statutory rule with regard to the reserves which the commercial banks should carry with a central bank. It would limit their freedom of action. They would

[87] Ibid., p. 3163.
[88] Ibid., p. 3164.
[89] Ibid., p. 3164-A.

inevitably find it necessary to carry substantial reserves with the central bank in any case.

Sir Charles Addis differed with the banks when they contended the prices of so many of the primary products of Canada are fixed in world markets that a central bank would have no influence or control over the general price level. Sir Charles thought that the banks had some control, that a stable exchange between any two countries does not necessarily imply similar credit positions and costs. When the tremendous interest of Canada in foreign trade in relation to her internal business was pointed out by one of the bankers, Sir Charles stated that he felt it was putting it too strongly to say that banks could take no action which might exercise some influence on prices. The credit position of the country might be quite independent of external prices.

The banks averred there were constitutional difficulties in the way of the effective operation of a central bank in Canada. They contended the operation of the British North America Act precludes the possibility of any central bank ever being in a position to exercise effective control over the volume and direction of a large portion of the long-term issues that may be made in the country.

Canadian Foreign Exchange Mechanism

A particularly fine description of the mechanism of the Canadian foreign exchange market was given by Mr. R. E. Knight of the Bank of Montreal at a special session on Exchange and Statistics held by the Commission. He pointed out that operations in foreign exchange in Canada were practically confined to the banks. Brokers are employed for all operations between banks. The brokers merely act as intermediaries and do not operate on their own account. In the case of purchase of sterling, banks take the latest New York rate and add or deduct therefrom the premium or discount on United States funds in Canada, as the case might be. If sterling is required it is acquired in the New York market or United States dollars are sold in London. This, in turn, involves the purchase of United States dollars in Canada or the sale of Canadian dollars in New York. He pointed out that the London market for Canadian dollars is limited.

The impression of the general public was that a direct market for sterling could be created independent of New York influences. There was the feeling that Canadians in the purchase or sale of exchange were paying tribute to New York on all exchange operations. This Mr. Knight pointed out was not the case.

Mr. Knight referred to the report of the sub-committee, named by the President of the Canadian Bankers' Association on January 7, 1932, which considered the feasibility of establishing an exchange market in Montreal to function independent of the New York market. The report stated Canadians were better served by having access through exchange dealers to the markets in other centres than they could be by having any one group attempting to regulate exchange values between Canada and any other country.

The banks' memorandum on the establishment of a central bank and the discussion following were undoubtedly the most important section of the hearings. As the banks viewed the situation there were three possible ways of remedying the existing situation: (1) The Finance Act could be repealed, reverting to the pre-war situation; (2) a central bank could be created; (3) the existing system could be developed through proper amendments to the Finance Act. The banks rejected the first two ways. They rejected the first on the ground that the currency would lose its elasticity. The establishment of a central bank was rejected for the reasons already indicated. Moreover, they were afraid that the establishment of a central bank would result in political interference with financial policies.

Bankers Advocate Reformed Finance Act

Canadian bankers favoured as little change as possible. The attitude of the bankers as a whole was based on a healthy fear of the purely inflationary desires which were at the back of much of the reformist agitation. There was, in addition, a natural reluctance to part with their privilege of note issue. They found it impossible to contemplate a return to the completely inelastic note issue arrangements of pre-war days. Nor would they justify a continuance of the post-war mechanism, in which it was possible for the banks to regulate credit inconsistently with gold movements without it being anyone's business to decide whether or not such action was in the country's interest.

The banks recommended the retention of the Finance Act with certain amendments.[90] They proposed the establishment of an independent "Administrative Board" composed of experts in finance and currency and broadly representative of the business and agricultural interests of Canada to supervise the borrowings of the chartered banks under the Finance Act. It should be endowed with authority to see that the total amount of credits granted to the chartered banks was in keeping with the requirements of the country, and that the rates charged on such advances fluctuate in accordance with credit conditions. The members of the Administrative Board should be appointed for a stated term and should be free from all political bias and chosen only for their technical knowledge and equipment for the task.[91]

Criticism of Bankers' Plan

Sir Charles Addis questioned the value of such a Board. He pointed out its shortcomings as follows:[92]

> "You suggest as an alternative to a central bank the appointment of an Administrative Board. I should just like to say here that in considering that point as you have put it forward, the impression left on my mind, and this is only my own impression, is that this Administrative Board would have no means of control other than through the rate on borrowing under the Finance Act, the effect of which is comparatively small. It would have very wide responsibility and both the banks and the government would very naturally be disposed to place upon it all blame for any mistakes of policy which might occur. It would be unable to establish any foreign contacts, unless, indeed, it took such a form as would render it indistinguishable from a central bank.
>
> "If I might sum it up in one word, I fear, gentlemen, that it would prove to be a fifth wheel of the coach. I do not believe it would improve your present system in any way."

While critical of the plan they had proposed, Sir Charles was impressed with the submissions of the bankers. He addressed the President of the Canadian Bankers' Association in the following words:

> "Mr. MacLeod, I am proud of my profession. You have been subjected to a searching questionnaire and you have

[90] Ibid., p. 3230.
[91] Ibid., p. 3232.
[92] Ibid., p. 3447.

given us a straight reply. You have refuted many ill-formed and, I may add, in some cases, malicious charges which have been levelled at the banks. You have done so with a dignity, with a moderation, and with a frank sincerity which compels conviction. I believe that your document will stand as an historical defense of the Canadian banking system."[93]

[93] Ibid., p. 3412.

CHAPTER VI

REPORT OF THE ROYAL COMMISSION

ON SEPTEMBER 27, 1933, within two weeks of the close of the public hearings in Ottawa, and within two months of its appointment, the Royal Commission finished and signed its report on Banking and Currency in Canada. This would seem to constitute a record for speed, having regard to the magnitude of the investigation, the breadth of territory covered and the mass of material submitted to the Commission. In November the report was placed in the hands of the general public.

The report itself covers seventy-two closely printed pages and is supplemented by fifteen pages of addenda and memoranda of dissent on various points by Sir Thomas White, The Honourable J. E. Brownlee, and Mr. Beaudry Leman. An appendix contains a suggested outline of the main features of the constitution of a central bank for Canada. This is followed by a series of tabulated statistical statements relating to the banking system of Canada. At the close of the appendix is a list of government representatives, Dominion and provincial, officials of banks, public bodies, and individuals who appeared before the Commission in the course of its inquiry together with a list of persons and organizations from whom written submissions were received. The report contains a carefully prepared yet concise index.

Both the report itself and the memoranda of dissent are characterized by clarity and directness.

The plan of the report is simple. The Commission sets out briefly in the first place the history and present methods of operation of the Canadian banks and other financial institutions. Next appears a description of the salient features of the general economic position of Canada as the Commission found it. This is followed by a discussion of the monetary and financial problems to which such a situation gives rise. This led the Commission to consider how far the existing banking and financial mechanism is adequately equipped to cope with the problems indicated. Certain

matters of banking practice and administration raised in the course of the hearings are then commented upon by the Commission. Finally appear the recommendations of the Commissioners as to the legislative and other measures which they suggest should be adopted.

The first chapter is briefly introductory and deals largely with the occasion for the appointment of the Commission and the distinctive features of the Canadian banking system.

The Commission found the Canadian banking system had been adapted, through a long process of evolution and statutory regulation, to the special requirements of Canada. But, with the exception of the Finance Act, it had been developed within the sphere of routine banking and had been devised in a world steadied by the more or less automatic control of the gold standard.

New and Increasing Responsibilities of Bankers

Attention was directed by the Commission to the increasing responsibilities and functions of modern banking systems. In the past the commercial banker confined his attention largely to safeguarding the interests of his depositors and shareholders and to making judicious loans and investments with the funds entrusted to him. Post-war developments have brought a considerable change in the character of the banking business and in the public attitude towards the banks. The recent upheavals of the world's finances and the general departure from the gold standard have created new problems and have led to an increased recognition of the influence which the monetary system of a country has upon its general economy. The Commission stated that it is now coming to be realized that other less obvious but important responsibilities rest upon the banking system of the country. "It must bear a share in trying to maintain stability and to regulate the quantity and flow of credit. It must interest itself in price levels, in the fluctuations of exchange, in international monetary co-operation—in short, in all the matters which concern national finance. In judging of the adequacy of a modern banking system its ability to lend assistance in these wider spheres of action must be taken into account."[1]

[1] *Report of the Royal Commission on Banking and Currency in Canada, 1933*, p. 12.

The second chapter comprises an historical sketch of the financial institutions of Canada. It deals with the histories of the chartered banks, of the Dominion note issue, the Royal Mint, the savings banks of the Dominion and the provincial government savings offices, the savings institutions of Quebec, stock exchanges, investment bankers, loan, mortgage and trust companies, rural credit institutions, insurance companies, and the penny banks.

Origin of Canadian Banking System

The Commission pointed out that it is generally agreed that the Canadian banking system is a direct descendant of the first Bank of the United States, and that an examination of the bills incorporating the early banks of Canada exhibits this influence.[2] Most of the bank charters of Upper and Lower Canada followed the charter of the Bank of Montreal, which embodied all the essential clauses and even some of the phraseology of the Charter of the first Bank of the United States. The Bank of Montreal's charter (granted in 1822) is thus typical and indicates the lines along which the Canadian banking development then proceeded. The Commission further stated that the Canadian financial system is the result of a process of gradual growth and development extending over rather more than a century. This evolution has been influenced by a number of factors, geographical, political, and economic.

Influence of Economic Development on the Banking System

Comment was made on the fact that the economic development of Canada has so profoundly affected its banking system that it is possible to trace a correspondence between the stages of Canadian banking organization and the stages of the country's economic progress. The Commission stated there have been three stages in the country's economic development. Local economy characterized the first. In this period money rather than banking facilities was needed. The second stage was that of trade over a wider area with a consequent need for at least local banking facilities. The third stage was that of industrial development when wider markets made necessary increased banking facilities. These stages

[2] Ibid., p. 15.

of development have resulted in the growth of the Canadian banks from small local concerns to the present large institutions with branches throughout Canada and in many foreign countries.

The Commission pointed out that during the present century an important feature in the development of the Canadian banking system has been the reduction in the number of banks by amalgamation, from thirty-eight in 1900 to the present number of ten.[3]

Bank Act Required No Specific Cash Reserves

A short account of the functioning of the Canadian financial system is given in Chapter Three. The operation of the chartered banks is first dealt with under the general headings of branch banking, deposits, reserves, current loans, investments, money markets, financing external trade, the foreign exchange market, competition, the Canadian Bankers' Association, note issue, and clearings. In connection with reserves the Commission pointed out that the Bank Act of Canada, in contrast to legislation in the United States and South America, made no provision for specific or minimum cash reserves. The Act did require that 40 per cent. of the cash reserves of the Canadian banks should be in Dominion notes. The classification of assets adopted in Canada differed from that followed in other countries, Canadian banks classifying their assets as "Cash Assets" and "Quickly Realizable Assets".[4]

No Money Market in Canada

The Commission stated that no money market exists in Canada such as exists in London and New York where highly specialized financial houses undertake the accepting and discounting of foreign bills of exchange.[5] In Canada the chartered banks make "call loans" upon the security of bonds or stocks to investment bankers, stockbrokers, and individuals. In times of general stringency Canadian banks have to have recourse to outside sources.

Canada also lacks a market outside the banks for bills of exchange. In the case of export trade the general practice is for the exporter either to draw upon the consignee and sell his bill

[3] Ibid., p. 18.
[4] Ibid., p. 32.
[5] Ibid., p. 33.

outright to the bank (in which case it will be forwarded to London or New York, or as the case may be, for collection at maturity, or for negotiation), or to borrow against the security of the bill of exchange, which, in either case, comes into the possession of the bank. The consignee may open a credit with a Canadian bank in favour of the Canadian exporter. In this case the exporter secures payment from the bank after consigning his goods and upon surrender of the bill and documents.

In the case of imports the importer can purchase from a Canadian bank a draft in favour of the consignor abroad, or borrow on the security of the goods imported or upon his general credit and remit; or by arrangement between the Canadian consignee and the consignor abroad, a credit can be established in a Canadian bank in favour of the consignor who will, in that case, draw upon the Canadian bank and either sell the draft with documents to a branch of the bank abroad, or sell it to his own bank and leave the final settlement as between his own bank and the bank in Canada.

Each bank has a foreign exchange department in which are concentrated the supply of, and the demand for, foreign currencies. As far as possible each bank sets buying orders against selling orders and then enters the local market in order to sell or buy according as they are over or short. If the local market cannot absorb all the orders, and it seldom can, then recourse is usually had to the wider markets of New York and London, but chiefly New York. The banks deal through brokers. The foreign exchange market in Canada is chiefly concentrated in Montreal and Toronto.

Economic Characteristics of Canada in Relation to the Financial System

In Chapter Four the Commission broke new ground. In this chapter the Commission dealt with the relation of some of the economic features of Canada to the financial system and pointed out what it regarded as the principal characteristics of the Canadian economy. Of these, Canada's excess production per unit of population, her dependence on international trade and her heavy debt burden, both domestic and foreign, and her relative economic instability are the most important. As a result, these

characteristic features of Canadian economic life made it desirable, the Commission stated, that the financial system of the country should[6]

(1) be accommodated to the great seasonal variation in volume of business;

(2) possess sufficient strength to withstand the vicissitudes of the highly specialized regions of the country;

(3) provide for the financing of external trade;

(4) assist in providing the mechanism requisite for borrowing at home and abroad;

(5) possess instrumentalities for the exercise of a measure of control over (a) domestic speculative tendencies and (b) foreign exchange rates;

(6) be in a position to participate in international co-operation regarding financial policies which may affect the world prices of Canada's exports, and other matters.

The Commission reported that certain of these requirements have been met by the high degree of development in Canada of the ordinary functions of banking.[7]

The Finance Act Inadequate as an Instrument of Control

The Commission found that while the post-war monetary problems of the world had multiplied, necessitating more efficient instruments of control, the only significant difference between Canada's pre-war and post-war financial structure was the addition of the Finance Act. The return of Canada to the gold standard in 1926 obligated Canada to maintain the convertibility of her dollar into gold; and presupposed, among other things, means of regulating the credit base so as not only to permit expansion but also to operate in a restrictive direction. Yet, the Commission found that an examination in the light of contemporary conditions of the rates charged from time to time on Finance Act advances suggests that these rates were not used as an instrument of credit expansion and contraction, but were mainly varied to meet the exigencies of the Dominion Government's finances. The volume of advances was not subject to the restriction of a gold reserve. The Treasury Board did not assume the responsibility of ensuring that the uses made of the Finance

[6] Ibid., p. 57.
[7] Ibid.

Act were consistent with the requirements of a convertible currency. The banks, on the other hand, which could take the initiative of expanding the credit base through advances of Dominion notes under the Finance Act, were under no obligation to use this initiative in maintaining the gold standard. Thus the Finance Act did not provide Canada with the organization needed to undertake the tasks which the maintenance of the restored gold standard implied.[8]

Sir Thomas White dissented from many of the above findings and conclusions of the majority of the Commission.

No Single Banking Authority in Canada

In Chapter Five, the most important of all, the Commission considered whether the Canadian financial system required the establishment of a central bank. In considering the adequacy of the existing equipment of the banking system of Canada in view of the part which a modern banking system is called upon to play in the national and international economy, having regard particularly to Canada's own problems, the majority of the Commission reported that it has been manifest that in so far as the ordinary functions of banking are concerned, the Canadian banks have given admirable evidence of security, efficiency, and convenience. In a time of universal economic difficulty, the Canadian banks have stood firm and have continued to render to the people of the Dominion the same high quality and the same wide variety of services as in the past.

The Commission, however, believed that it was necessary to ask whether there are any functions which a modern banking system may reasonably be expected to perform which either are not performed or are inadequately performed by the existing Canadian system. From this point of view, the Commission stated that the observer cannot but be impressed by the absence in Canada of any single banking authority which, while linked by its activities with national finance and commerce, is nevertheless detached by its constitution and the temper of its administration from the ordinary pursuits of commercial banking.[9]

In considering the question of credit control the Commission asked the following questions:

[8] Ibid., p. 59.
[9] Ibid., p. 61.

"To what extent and through what organization should the volume of credit and currency be regulated? On what body should lie the primary responsibilities for maintaining the external stability of the country's currency? To what institution may the Government of the day most suitably turn for informed and impartial advice on matters of financial policy?"[10]

RECOMMENDATIONS OF INTERNATIONAL MONETARY CONFERENCES

The Commission answered its own questions by stating that, in the majority of countries, the answer has been found in the existence or the creation of a central bank. Reference was made to the resolutions favourable to the establishment of a central bank emanating from various financial conferences, the last of which was the World Monetary and Economic Conference of 1933, "to which", the Commission stated, "Canada was a party."

The International Financial Conference held at Brussels in 1920 unanimously recommended that:

"The Conference is of the opinion that in countries where there is no central bank of issue, one should be established."

At the World Monetary and Economic Conference of 1933, resolutions were adopted that:

"The Conference considers it to be essential in order to provide an international gold standard with the necessary mechanism for satisfactory working, that independent Central Banks, with the requisite powers and freedom to carry out an appropriate currency and credit policy, should be created in such developed countries as have not at present an adequate Central Banking institution.

"The Conference wish to reaffirm the declarations of previous conferences with regard to the great utility of close and continuous co-operation between the Central Banks."

Reference was made by the Commission to the fact that after the adjournment of the World Monetary and Economic Conference the Canadian delegation joined with other delegations of the British Commonwealth of Nations in stating that they:

"Now reaffirm their view that the ultimate aim of monetary policy should be the restoration of a satisfactory international gold standard," and that

"Effective action in this matter must largely depend on international co-operation."

[10] Ibid., p. 62.

Objectives of a Central Bank

The objectives that should guide a central bank in its operations are laid down by the Commission in its report as follows:

> "In the first place, from a national point of view, the central bank, within the limits imposed by law and by its capacities, should endeavour to regulate credit and currency in the best interests of the economic life of the nation and should so far as possible control and defend the external value of the national monetary unit. In the second place, from the international point of view, the central bank by wise and timely co-operation with similar institutions in other countries, should seek, so far as may lie within the scope of monetary action, to mitigate by its influence fluctuations in the general level of economic activity."

The Commission pointed out that these functions do not exhaust the tasks of a central bank, that within a State the central bank should, in addition, be a ready source of skilled and impartial financial advice at the disposal of the administration of the day.

The central bank is reminded that its distinguishing characteristic is public service, that in return for the privileges conferred on it by the State, it should utilize its store of experience in the interests of the community without the desire or the need to make profit a primary consideration.

A warning was sounded by the Commission that it is easily possible to expect too much or too little of central bank action.

A central bank is characterized by the Commission as at the same time an instrument and a force. Conceived of as an instrument "it is the means by which the State—which must necessarily retain ultimate sovereignty in matters affecting the currency—can give effect to the national policy." As a force "the central bank has certain powers in its keeping which can be used to achieve the ends of national policy." "These powers", the Commission stated, "are of differing efficacy according to the aim of the policy."

A Central Bank Should Not Be Charged With Any Responsibility for the General Price Level

Many proponents of a central bank in Canada believed that one of the functions of the Bank should be to raise and maintain

the general level of prices. A considerable number of the witnesses who appeared at the hearings of the Commission had entertained such views.

In their report the Commissioners stated quite emphatically that a central bank cannot be expected to influence directly the price level of a particular commodity. In their opinion a central bank should not be charged specifically with any responsibility for the general price level of a country. Too many factors of a varying nature combine to influence that level, and a central bank, working as it does purely in the monetary sphere, cannot be expected to have complete control, though it may have a measure of influence.[11]

It was felt that while a central bank should not be charged with any responsibility for the general price level, it may have some measure of influence in controlling it by regulating the quantity of credit, through appropriate action upon the reserves of the commercial banks or by altering the cost of securing such reserves, thus setting in motion a process of expansion or contraction through the ordinary channels of banking.

An attempt to reassure banking interests was made by the Commission when they pointed out the fact that a central bank is in no wise a competitor of the commercial banks.

Inter-Relations of Central Banks

Extended reference was made to the potential value of a central bank in the international monetary sphere, particularly in the matter of co-operation with other central banks and with the Bank for International Settlements. The Commission pointed out the need for regular and continuous interchange of views between the responsible authorities of the various national central banks. The Commission conceded that it may be a matter of opinion as to the precise degree to which concerted monetary action may influence the level of economic activity in the world. On the other hand it was beyond dispute that a common direction in monetary policy may have an important influence in avoiding economic excesses or in stimulating business revival. If nations wished to continue that mutual interchange of goods and services which in the past have stimulated the economic life of all parts of the

[11] Ibid., p. 63.

world, then they must use all possible means of bringing order into the realm of international relations. In the monetary sphere the germ of such order is to be found in the inter-relations of central banks working to harmonize national policy with the needs of the international situation.[12]

Intra-Imperial Co-operation

Within the narrower, but no less important, sphere of intra-Imperial co-operation, the report noted, a central bank has already become an indispensable element in the financial structure in the Dominions of South Africa and Australia. Mention was made of the fact that at the time the Commission was preparing its report bills were before the Legislature in New Zealand and India for the creation of a central bank. The inference appears obvious, that if Canada did not set up a central bank she would be alone among the self-governing nations of the Empire without such an institution.

Principles Governing the Establishment of a Central Bank

Definite principles which should be observed in the institution of a central bank were laid down in the report. The Commission stated that it was essential that the central bank should hold a suitable proportion of the reserves of the commercial banks in order that it may regulate currency and credit. It should have the sole right to issue legal tender notes. The Bank should act as the financial adviser of the Government, hold the various government accounts and carry out the major financial transactions for the Government.[13]

In carrying out its functions and policies a central bank should be free from political interference.

Profits of a Central Bank

The Commission pointed out that a customary provision in the constitution of central banks is that the profits of the note issue accrue to the State and that a limit is set to the profits which may be distributed to the shareholders. Provision is also made that the State should have a final voice in the appointment of the

[12] Ibid., p. 64.
[13] Ibid., p. 65.

Governor and Deputy Governor and sometimes of certain of the directors. However, the technical functions of a central bank should be entrusted to a body not subject to the vicissitudes of political life.

In the succeeding paragraphs of the chapter (paragraphs 227-236) the Commission considered whether conditions exist in Canada for the successful functioning of a central bank, and whether other means are available for achieving the same results with equal efficacy. It was also considered whether the time was opportune for the establishment of a central bank.

Central Bank Preferred to Administrative Board

The majority of the Commission expressed itself of the opinion that the Finance Act, regarded as part of the normal financing machinery of the country, was unsatisfactory. Consideration was given to the recommendation of representatives of the Canadian Bankers' Association that an administrative board be created, such a board to be composed of experts in finance and currency and broadly representative of the business and agricultural interests of Canada, to which the functions discharged by the Treasury Board under the Finance Act should be entrusted. The Commission opposed the creation of such a board on the following grounds: (1) it would be difficult to safeguard its freedom from political interference; (2) such a board would find it difficult, if not impossible, to win the prestige, whether internally or externally, which a central bank might be expected to acquire. It would not find it possible to establish satisfactory relations either with central banks in other countries or with the Bank for International Settlements.

In any event, in so far as the administrative board attempted to overcome these difficulties, the Commission was of the opinion that it would require powers and an organization so essentially similar to those of a central bank that it would be better to set up a central bank in the first place. The Commission reported that it had no hesitation in concluding, therefore, as between an administrative board and a central bank, the latter alternative was clearly preferable.[14]

[14] Ibid., p. 67.

Time Opportune for Establishment of a Central Bank in Canada

While admitting that, in the absence of a highly developed money market, central bank control in Canada could not be as sensitive as that of the Bank of England, the Commission felt that the use of the discount rate, of open market operations and of foreign exchange operations would give such a bank a decisive influence on the credit situation in Canada.[15] In considering the opportuneness of establishing a central bank under existing conditions the majority of the Commission felt that far from being inopportune there were cogent reasons for its early establishment. The fact that the Canadian dollar was an inconvertible currency was regarded rather as an advantage than a disadvantage for the early operations of the bank, for the bank would not be faced at the outset with any legal obligation to ensure convertibility.

Canada Well Equipped for Central Bank Management

The Commission found no reason to suppose that Canadians lacked the skill and integrity required in the management of a central bank. On the contrary, it was convinced that there are resources of intelligence combined with experience and public spirit fully adequate to ensure the successful management of a central bank. While conceding that the conduct of central banking operations requires a technique and an outlook somewhat removed from those of commercial banking, the Commission stated this fact has had to be faced in every country which in recent years has established a central bank. It appeared to the Commissioners that Canada was better equipped than many other countries have been to provide the necessary administrative talent.[16] This was a fine tribute to the ability of Canadian bankers.

Cost of Operating Central Bank Not Burdensome

In considering the cost of establishing and operating a central bank in Canada the Commission stated that such an organization need be neither large nor expensive; its capital could be of modest dimensions so that there would be no necessity of large

[15] Ibid., p. 67.
[16] Ibid.

earnings in order to pay the statutory dividend. In the distribution of currency the services of the central bank would simply be substituted for those being performed by the Offices of the Receiver-General. The main activities of the bank would be concentrated in a single head office.

It was recognized that at the outset a problem would be involved in the transfer to the central bank of the Dominion note issue. The Commission apparently had in mind the fact that, in order to establish the central bank on a sound basis, the Dominion Government, when transferring to it the Dominion note issue, would have to place real assets behind the outstanding issue, which was backed by neither gold nor Dominion Government interest-bearing securities. The Government, on the other hand, would be a substantial participator in the profits of the bank. While the commercial banks would suffer a loss in income as and when the central bank took over the note issues of the commercial banks, it was pointed out that this was not a loss to Canada, but rather a transfer of income within the financial system.

The expenses involved in procuring physical equipment for the Bank and the salaries of the staff of the Bank were not regarded as of major importance.

Central Bank Not a Panacea for All Economic Ills

The chapter concludes with a note of warning as to the degree to which such an institution could fulfil all the expectations that the public mind might attach to it. The Commission pointed out that a central bank could not cure all the economic ills of Canada; it would not be a source of unlimited credit for all borrowers on all occasions; indeed, its operations might as often be restrictive as expansive.[17]

Recommendations Relative to Agricultural Credit

At various sittings of the Commission considerable evidence had been presented by farmers and representatives of farm organizations to show that a large proportion of farmers could not carry on their operations without some form of credit. The credit needs of the farmers were of such a nature that they could not be met by ordinary commercial bank loans. The Commission was satisfied the need was a real one. It therefore recommended that

[17] Ibid., p. 69.

the Dominion Government, preferably with the co-operation of the provincial governments, should forthwith institute a special investigation into the whole problem of the provision of short and intermediate rural credits with a view to the preparation of an adequate and comprehensive scheme for submission to Parliament.[18]

During the course of the enquiry many questions had been raised regarding various phases of the operations of the chartered banks. While a great many of these had little or nothing to do with the institution and operations of a central bank, the Commission felt called upon, under the circumstances, to make certain recommendations with regard to them.

A repeated complaint of farmers and farm organizations concerned the rate of interest on loans. Subsection 1 of Section 91 of the Bank Act provided:

> "The bank may stipulate for, take, reserve or exact any rate of interest or discount not exceeding seven per cent. per annum and may receive and take in advance any such rate, but no higher rate of interest shall be recoverable."

The Commission found that much controversy centred around this enactment both as regards its precise effect and as regards its expediency. The public regarded it as a prohibition against the banks charging interest or discount in excess of seven per cent. Seven per cent. had become the recognized rate for loans in the West, but where banks thought the risk warranted it, they charged eight per cent. or a higher rate. The banks believed they were justified in doing so by the decisions of the Privy Council in *McHugh vs. Union Bank of Canada* (1913) A.C. 299. In that case their Lordships had refused to allow past settled transactions in which eight per cent. had been paid to be opened up under the well-known legal doctrine that money paid under error in law is not recoverable. The Commission was of the opinion that this decision gives no countenance to the idea that a charge of interest or discount in excess of seven per cent. is ever legitimate under the statute. The banks, apparently, had taken the view that if a client agrees to a higher rate than seven per cent. and actually pays it, so as to render the payment irrecoverable, the transaction was quite legitimate. The Commission expressed itself of the opinion that in so doing the banks had laid

[18] Ibid., p. 71.

themselves open to the allegation that they had been evading the law.[19]

The Commission carefully weighed consideration for and against the statutory provision referred to earlier but were unable to reach an agreement as to the recommendation they should make. Four of the Commission (The Chairman, Sir Charles Addis, Sir Thomas White, and Mr. Beaudry Leman) were of the opinion that a statutory maximum rate of interest is nowadays anomalous and an undesirable interference with freedom of contract, and that the provisions of the Bank Act limiting the rate of interest to seven per cent., whatever justification it may have had originally, ought to be abolished. Mr. Brownlee, however, was of the opinion that the statutory maximum still served a purpose and that it ought to be retained. The majority of the Commission recommended the repeal of the provision in question.

The Commission had heard many complaints from farmers who were irritated by the banks' practice of taking notes for three or four months although repayment was not expected before six to twelve months. The Commission felt that it was reasonable to expect that banks catering to the needs of a farming community whose normal operations require credit facilities for a period of time running from six to twelve months should endeavour to accommodate their practice to the legitimate requirements of their customers. The Commission was of the view that matters of this kind could be adjusted better through mutual good will, with such moral suasion as might be exerted through some central authority qualified to exercise a regulating influence than by legislation.[20]

The Commission suggested that the banks should carefully consider the advisability of eliminating charges on cheques and recouping themselves for this service in a way more convenient to their customers.[21]

It had been represented to the Commission that too great a spread existed between rates of interest paid by the banks to depositors or to the Government under the Finance Act and those asked by the banks on their loans. The Commission did not feel that excessive rates were being charged.[22] The members of the

[19] Ibid., p. 72.
[20] Ibid., p. 74.
[21] Ibid., p. 75.
[22] Ibid.

Commission were definitely of the view that if the Government were to issue Dominion notes to finance the requirements of provincial governments, municipalities, and school boards, as was suggested by radical critics at some of the Western hearings, it would be embarking on a dangerous policy.[23]

Considerable criticism had been directed against the banks for alleged infringement upon the business of the investment bankers. The Commission reported that while there was no doubt as to the legal right of banks to deal in securities, it was quite evident that there had been abuses. As regards trading in stocks the Commission was of the opinion that the banks should act only as agents of their customers in placing such orders as they received through the regularly constituted channels provided by the brokers and investment bankers.[24]

Directors of Chartered Banks

It had been alleged before the Commission that the boards of directors of the Canadian banks included too large a proportion of members domiciled in the Central Provinces and that accordingly, the banks were more sympathetic to Central than to Eastern and Western requirements. The Commission could not see how this feeling could be allayed by any form of legislation. The suggestion was made that the shareholders of the Canadian banks should, in their own interest, consider the advisability of providing a generous proportion of directors from the Eastern and Western sections of the country.[25]

The attention of the Commission had been directed to the fact that many bank directors were directors of other corporations. The inference was made that in consequence of this such corporations were specially favoured by the banks to the detriment of individual customers engaged in agricultural and other primary industries. The Commission found no evidence that there had been such discrimination in banking policy. On the contrary, it was pointed out that since the field of banking is co-extensive with the entire economic facilities of the Dominion, it was necessary that the directors of the banks should be men of affairs, actively engaged in business enterprise or at least having a wide

[23] Ibid., p. 76.
[24] Ibid., p. 77.
[25] Ibid., p. 78.

knowledge of commercial and financial conditions. It was suggested that banks without by-laws preventing their directors from being present at meetings of their boards when loans in which they were personally interested were being considered, should adopt such by-laws.[26]

Majority of Royal Commission Recommend Central Bank

After having considered all the matters brought to their notice, with appropriate suggestions as to their solution, the Commission made two specific recommendations for the improvement of the Canadian financial structure. These recommendations were as follows:[27]

> "By a majority (The Chairman, Sir Charles Addis, and Mr. Brownlee; Sir Thomas White and Mr. Beaudry Leman dissenting) we recommend that a central bank for Canada be forthwith established.
>
> "We unanimously recommend that an inquiry be instituted by the Dominion Government, preferably with the co-operation of the Provincial Governments, to investigate the existing organizations for the provision of rural credit with a view to the preparation of a scheme for the consideration of Parliament."

The terms of the dissent of Sir Thomas White and Mr. Beaudry Leman are to be found in paragraph 238 of the Report and are as follows:

> "Sir Thomas White, and Mr. Beaudry Leman dissent from the arguments and conclusions contained in this chapter as to the need of the establishment of a central bank at the present time and under existing conditions and also as to certain features of the suggested constitution of such a bank should it at any time be established in Canada."

Memorandum of Dissent of Sir Thomas White

Sir Thomas White, in his memorandum of dissent, expressed himself as not in agreement with many of the statements and conclusions contained in Chapter Four of the Report and particularly those relating to the administration and operation of the Finance Acts of 1914 and 1923 during the war and post-war periods particularly. It was his belief that no central bank in the world during the War period functioned more smoothly or was

[26] Ibid., p. 78.
[27] Ibid., p. 81.

capable of being utilized more promptly or with greater immediate effect in serving the purposes of the nation and business than the Canadian Finance Act of 1914.[28] It was also his view that during the period in question and in the very trying reconstruction period following the Armistice no other monetary system proved more efficient or better adapted to national needs than that of the chartered banks of Canada supplemented as it was by the provisions of the Finance Act of 1914.[29]

Sir Thomas White was not in agreement with respect to the following statement in the report, "An examination in the light of contemporary conditions of the rates charged from time to time on Finance Act advances suggests that these rates were not used as an instrument of credit expansion and contraction but were mainly varied to meet the exigencies of the Dominion Finances."[30] He pointed out that the rates charged on the advances referred to were practically in keeping with the rediscount rates of the Bank of England and (which is a much fairer basis of comparison so far as concerns Canada) with those of the New York Federal Reserve Bank during the period in question.[31]

Sir Thomas pointed out that even if the suggestions were correct that Canadian rates were mainly varied to meet the exigencies of the Dominion Government's finances, the Dominion Government's action would not have been in any way singular or open to criticism since rediscount rates of both the Bank of England and of the Federal Reserve Bank System of the United States have been frequently and properly fixed to meet the exigencies of their respective Governments' finance. He pointed out that it is central bank practice in all countries to regard government exigencies as a factor in the fixing of discount rates when occasion so requires. A Canadian Central Bank would have to have regard to the exigencies of the Government's finances.

In any event, Sir Thomas asserted, it must be borne in mind that it is only in large international financial centres, such as London, Paris, and New York, that a rise or fall in rediscount rates exerts an important effect upon credit expansion and contraction.[32] He might have added that even in the United States

[28] Ibid., p. 85.
[29] Ibid.
[30] Ibid., p. 86.
[31] Ibid.
[32] Ibid., p. 87.

it is not a very effective intrument of credit control. The opinion was expressed that managers of Reserve institutions are no wiser than other financiers and possess no greater insight into conditions or prescience as to their outcome than the general mass of contemporary business men. Sir Thomas stated the assumption that supermen may be found who can diagnose an era and wisely control expansion or contraction of credit (save in international financial centres such as London) was not, in his opinion, well founded. He expressed the view that the real check upon undue expansion of the currency issued under the Finance Act was the caution exhibited by the banks themselves.[33]

Sir Thomas White said that since Mr. Leman in his memorandum had set out the main grounds for their dissent, he would, in his own memorandum, make only general observations relative to the proposed central bank for Canada. While conditions some time in the future might require that Canada have a central bank, he was definitely of the view that the present was not a suitable time for its establishment. He felt that an institution of this kind would hamper rather than help the Government.

Sir Thomas White favoured a return to the international gold standard as the ultimate aim of monetary policy. In his opinion the international co-operation necessary to accomplish this desired end could be achieved only by direct negotiations of governments with governments. He had no confidence that international conferences of central bank officials could bring about the restoration of gold as a universal medium of exchange.

He dissented from the view that a board of directors of a central bank, wholly independent of the Government of the day, should in a country such as Canada where domestic prices so greatly depend upon world prices, be vested with the power to endeavour, at least, to influence the levels of economic activity and prices. He believed that action towards this end would be not only nugatory, so far as concerned its purpose, but fraught with grave potentialities for causing business disturbance through its indirect effects. He expressed the opinion that no Board of Directors, no matter how eminent its personnel, would be wise enough to be entrusted with such a duty.[34]

[33] Ibid., p. 87.
[34] Ibid., p. 90.

Sir Thomas White did not regard the establishment of relationships between a central bank in Canada and central banks in other parts of the world or with the Bank of International Settlements as being of sufficient importance to warrant the expense of establishing and operating a central bank in Canada.

The provision in the proposed set up of the central bank, authorizing the Bank to become the banker for provincial governments (in which is an implied control over the conduct of their financial operations and expenditures) Sir Thomas regarded as unwise and likely to lead to undesirable friction between provincial governments who might become customers of the bank and the officials of the bank, and ill-feeling on the part of other provinces which might continue to transact their financial business without the aid of the bank.

Sir Thomas was in entire agreement with his colleague, Mr. Beaudry Leman, in his strong criticism of granting to the Board of the proposed bank the power to carry their cash reserves either in gold or foreign exchange.

If a central bank for Canada should be established, Sir Thomas hoped that it would not be entrusted with the management of an Exchange Equalization or Stabilization Fund.

Memorandum of Dissent of Mr. Beaudry Leman

Mr. Beaudry Leman's memorandum of dissent was stated under five headings. These may be briefly summarized.

(1) The time was inopportune for organizing a central bank in Canada because of the great existing economic difficulties;

(2) Possible constitutional difficulties were foreseen since the British North America Act assigned banking and currency matters to the federal government and property and civil rights to the provinces. These fields Mr. Leman regarded as interpenetrating and overlapping.

(3) Certain features of the suggested constitution of a central bank for Canada appeared unacceptable. In Mr. Leman's opinion there was no differentiation between the ratio of deposits to be made in the central bank in respect of notice deposits on the one hand, and of demand deposits on the other. Strong exception was taken to a clause which stated: "The Bank should maintain a proportion of 25 per cent. in gold and foreign exchange against its outstanding note issue and sight liabilities." Mr.

Beaudry Leman objected to this feature on the ground that no provision was made for the holding by the bank of a minimum amount of gold or of a minimum percentage of gold against liabilities, nor did it even provide that the foreign exchange held by the bank should be convertible into gold. It was quite possible under such a power as was proposed (of carrying foreign exchange as cash reserves) for Canada to be stripped of all her gold reserves.

(4) In Mr. Leman's opinion sufficient stress had not been laid upon the factors of national recovery. While outside markets for Canada's surplus production should be sought, he pointed out that world markets are uncertain and unreliable, and that the countries of the world are becoming more and more nationalistic. Canada should not await upon the results of international conferences between bankers, but should endeavour to build up as rapidly as possible her own domestic markets.

There seems to be little point to this argument as it related to the establishment of a central bank. It seems to be little more than a suggestion of a protectionist sentiment. Possibly the Commissioner was afraid the proposed central bank would become too international in its outlook.

(5) Mr. Leman's last reason for dissent would seem to imply that he was somewhat suspicious that a central bank in Canada would simply be an instrument for bringing about a greater measure of Imperial co-operation within the Empire and would thereby reduce Canada's independence. Those in favour of a central bank were warned of the implications of intra-Imperial monetary co-operation. Mr. Leman said that measures calculated to develop intra-Imperial co-operation or Imperial monetary co-operation should not be developed beyond the scope of providing ample facilities for the interchange of goods and services, unless the people of Canada understood and decided in full knowledge of the consequences, that close monetary co-operation may lead to close economic association which in turn is a step towards common political action.[35]

Memorandum by Honourable J. E. Brownlee

The Honourable J. E. Brownlee signed the Report of the Commission without reservation other than his dissent from the

[35] Ibid., p. 97.

recommendations of the majority of the Commissioners with reference to interest rates on loans. He was of the opinion that "the Provinces in Western Canada may now be regarded as settled communities" and the rates on loans made in Western Canada to provincial governments, municipalities, and school boards should be no higher than those prevailing in the East.[36]

The majority of the Commissioners had suggested that the capital of the central bank should be subscribed by the public. This meant there should be established a privately owned bank with the shareholders appointing the directors and the chief executive officers. Mr. Brownlee dissented from this view and recommended that the capital be subscribed by the Government of Canada, and that all directors and executive officers be appointed by the Government, each appointment to be for a fixed number of years.[37]

Suggested Constitution of a Central Bank for Canada

In the Appendix of their Report the Royal Commission outlined suggestions for the structure of a Central Bank for Canada.[38] In addition to a head office it was recommended the bank should be allowed to establish branches to act as note depots, and to take over the offices of the Assistant Receivers-General.

Capital

The Commission suggested the capital of the bank be small, and stated it should be $5,000,000 offered for public subscription. All shareholders should be British subjects resident in Canada. It was pointed out that there was no necessity for a central bank to have a capital larger than sufficient to provide for its initial expense, office buildings, etc. It was explained that with a small capital there was less necessity to make profits for dividend purposes. By having the shares of small denominations and limiting the amount which any shareholder could hold, a wide distribution would be effected and a large number of shareholders ensured.

In setting forth the above provisions for the capital structure of the Central Bank, the Commission was really suggesting that Canada should establish a Central Bank somewhat along the lines of the Bank of England, a privately owned bank.

[36] Ibid., p. 92.
[37] Ibid., p. 93.
[38] Ibid., pp. 98-100.

MANAGEMENT

The Bank should be managed by a Board composed of a Governor, a Deputy Governor, an Assistant Deputy Governor, and six to eight Directors. The Commission pointed out that the Governors should be men of tested banking experience and the directors men of diversified occupations. It was recommended that no director should be a banker or bank director and no member of the Board should be a member of the Dominion Parliament or of any Provincial Legislature or a Civil Servant.

In establishing the Bank, it was suggested that the first Governor, Deputy Governors, and directors should be appointed by the Governor-General-in-Council. The directors should retire in rotation. Future appointments of the Governor and Deputy Governors should be subject to the approval of the Governor-General-in-Council.

NOTE ISSUE

As a central bank is responsible for the control of the volume of credit and the maintenance of the value of the currency it was recommended that the Bank should have the sole right of note issue. The Commission suggested that the right to issue notes should not be taken away from the commercial banks immediately, but there should be a gradual redemption of their issue over a specified period of years.

DIVIDENDS

It was suggested that the dividend payable to shareholders should be limited to 5 per cent. or 6 per cent. cumulative. After providing for the payment of dividends and setting aside suitable reserves the remainder of the profits should go to the Government.

FISCAL AGENT

The Bank should be the banker of the Dominion Government and it might also, by agreement, become the banker of the provincial governments. If the governments kept their accounts at the central bank, the Bank could more effectively control credit. The Commission suggested that the Government of Canada should conduct its temporary borrowings through only one channel, the Bank. The Bank should act as financial adviser to the Government. It was further suggested that the Bank should

take over the issue and the management of the public debt of the Dominion Government and possibly also that of the provincial governments.

Reserves

Since the volume of credit extended by the commercial banks is predicated on the amount of their cash reserves, the Commission stated it was essential that the central bank should have the custody of part of these cash reserves in order that the Bank may be able to make its policy effective. The suggestion was made that a minimum deposit of five per cent. of the deposit liabilities in Canada should be maintained by each commercial bank with the Bank.

Central Bank Operations

It was suggested that the principal operations which the Bank should be allowed to conduct should be:

(a) to buy and sell gold;

(b) to buy and sell silver;

(c) to buy and sell foreign exchange;

(d) to buy and sell 90 days' (or 120 days') prime bank or commercial bills;

(e) to buy and sell a limited amount of six months' agricultural bills;

(f) to buy and sell short-term (up to 12 months) domestic Dominion and Provincial Government securities;

(g) to buy and sell a limited amount of long-term Dominion and Provincial securities;

(h) to buy and sell short-term securities of the United Kingdom, British Dominions, the United States, and France;

(i) to buy and sell a limited amount of long-term British and United States Government securities;

(j) to grant advances on any of the foregoing (or any other readily marketable securities);

(k) to accept deposits without interest;

(l) to discount promissory notes suitably secured of banks up to say 15 days' currency.

Prohibited Operations

The Bank should be prohibited from:

(a) engaging in trade;

(b) making unsecured loans;
(c) paying interest on deposits;
(d) allowing the renewal of bills;
(e) advancing to the Dominion Government in excess of say 33 1/3 per cent. of the income expected during any one year, or to a Provincial Government in excess of say 25 per cent. of the yearly income, in both cases the repayment of advances to be complete by the end of the first quarter after the close of the fiscal year.

Gold Holdings

It was recommended that the gold holdings of the country should be concentrated in the hands of the Bank.

Reserves Against Note Issue and Liabilities

The Commission stated the Bank should maintain a proportion of 25 per cent. in gold and foreign exchange against its outstanding note issue and sight liabilities. The Commission observed that it is now widely recognized that in order to allow central banks a large measure of freedom their minimum legal reserve proportion should be relatively low. The minimum of 25 per cent. reserve had been recommended at the World Monetary and Economic Conference.

The Macmillan Commission was the first of its kind ever to be held in Canada, in so far as banking is concerned, and needless to say, the Report of the Commission contains a fund of valuable information not available elsewhere.

The bankers of Canada were unanimous in their appreciation of the great services rendered by the Commission. While bankers in Canada, generally, opposed the establishment of a central bank, they gave their assurance that in the event that the majority recommendation was adopted by Parliament, they would fully co-operate with the Bank.

CHAPTER VII

DEBATES IN THE HOUSE OF COMMONS ON THE BANK OF CANADA BILL

ACCEPTING the recommendation of the Commission, a Bill to establish a central bank in Canada, drafted closely along the lines suggested by the Commission, was introduced at the beginning of the next session of Parliament, on February 22, 1934, by the Government.[1] The Minister of Finance, the Honourable Edgar N. Rhodes, moved:

> "That it is expedient to introduce a measure to incorporate a central bank in Canada, and to provide for the appointment and salaries of the officers and staff of the Bank and the appointment and fees of the directors, and to make further provision in respect to the functions, powers, and administration of the Bank as recommended by the Royal Commission on Banking and Currency in Canada."[2]

In introducing the Bill, Mr. Rhodes said:

> "The Bill marks an advanced stage in our economic and financial development as a nation. The proposed central bank should not, I submit, be regarded as a break with the past; we are not departing from the system which has served us well. Rather, the central bank should be regarded as another stage in the natural evolution of our banking system."[3]

REASONS FOR A CENTRAL BANK

Mr. Rhodes said the establishment of a central bank in Canada should not be construed as implying the Canadian banking structure had deteriorated in recent years, making it necessary to supplement it. Rather, the changes which had rendered such action desirable were largely external. The complex postwar conditions within which the banking and currency system of the country must operate had engendered forces which were not amenable to the highly simplified statutory control over the

[1] Bill No. 19.
[2] *Debates, House of Commons, Dominion of Canada, 1934*, Vol. 1, pp. 823, 824.
[3] Ibid.

financial structure such as had sufficed until then. Changed and changing conditions demanded constant supervision and an active rather than a passive mechanism of control. The main reason why the Government proposed the creation of a central bank for Canada was to provide an institution whose primary function would be to meet the new demands for increased control and supervision of the financial structure.

The Minister of Finance pointed out that the exercise of the functions of a modern central bank lies outside the power of any single commercial institution or group of commercial institutions. No purely profit-making institution, operating in a competitive system, can afford to place social interests before its own in regard to credit policy. Neither can the management of a chartered bank be expected to regard the maintenance of the monetary standard as a duty prior to its obligations to its stockholders. Therefore, he said, it is clearly impossible to visualize any effective international co-operation for the purpose of mitigating world fluctuations in business unless a high degree of internal unity and control is possible. Canada lacked such control. While the Finance Act had performed a useful function in emergencies in providing an elasticity in the nation's credit structure, and while it offered some of the advantages of a central bank, it lacked the powers ordinarily associated with such an institution.

The Government did not propose the Bank should be directly responsible for the general level of prices within Canada.[4] Certainly the prices of particular commodities were not to be its direct concern. On the other hand it was believed desirable that the Bank should have a definite measure of control over the total volume of credit and thus be in a position indirectly to exert an influence over the general price level. It was pointed out that the ability of a central bank to maintain any monetary standard depends largely upon its control over internal credit policy and its ability to co-operate with other nations in financial programmes of mutual benefit.

Central Bank Not a Competitor of the Chartered Banks

Mr. Rhodes stated that while there had been some apprehension that the creation of a central bank would injuriously affect

[4] Ibid., p. 826.

the chartered banks, there was, in reality, no ground for such fear. On the contrary, experience in other countries had demonstrated the fact that the whole banking system had been strengthened to the benefit and not to the detriment of other banking institutions. The proposed central bank for Canada would not be a competitor with the chartered banks. Its functions were intended to be supplementary and regulatory.

The Minister of Finance stated that the Macmillan report and the suggestions contained therein provided the foundation and largely the material for the structure of the proposed bank. The task of the Government had been to implement and where necessary to supplement rather than to create outright. The aim of the Government had been to provide Canada with a central bank best suited to her own particular needs.

Only the main features of the Bill need be sketched.

Functions of Proposed Bank

In its preamble the Bill set forth the functions of the proposed bank as follows:

> "To regulate credit and currency in the best interests of the economic life of the nation, to control and protect the external value of the national monetary unit and to mitigate by its influence fluctuations in the general level of production, trade, prices, and employment, so far as may be possible within the scope of monetary action, and generally to promote the economic and financial well-being of the Dominion."

The Bill provided for a privately owned institution with the head office at Ottawa and branch offices at such points as convenience demanded.

Capital

The Bill provided the capital of the Bank should be $5,000,000 divided into 50,000 shares of $100 par value.[5] This amount was deemed adequate by the Macmillan Commission. These shares should be held only by British subjects ordinarily resident in Canada or by Canadian corporations.[6] Chartered banks, bank directors, officers, and employees were to be strictly prohibited from holding shares directly or indirectly.[7] In order to secure a

[5] Section 16 (1 and 2).
[6] Section 17 (8).
[7] Section 18 (1).

wide distribution of ownership, the Bill provided that no more than fifty shares—$5,000—might be held by or for the benefit of any one person other than the Minister of Finance.[8]

PROFITS

Although private ownership was contemplated, the Bank was not to be a profit-making institution. Provision was made that dividends to shareholders should not exceed six per cent.[9] Profits in excess of this and after reasonable provision had been made for reserves and other purposes were to be paid into a consolidated fund.

MANAGEMENT

The Bill provided that the management of the Bank should be under a Board of directors composed of a Governor, a Deputy Governor, an Assistant Deputy Governor, and seven directors.[10] The initial appointments of Governor, Deputy Governor, and Assistant Deputy Governor were to be made by the Governor-in-Council.[11] The term of office of these executives of the bank was to be seven years.[12] They were to be eligible for reappointment.[13] Subsequent appointment of these officers was to be made by the directors with the approval of the Governor-in-Council. Likewise, the first directors were to be appointed by the Governor-in-Council.[14] Thereafter they were to be elected by the shareholders and were to be eligible for reappointment for terms of five years.[15] Provision was made in the Bill to have the original directors retire in rotation as follows:

1 after the third annual meeting
2 after the fourth annual meeting
2 after the fifth annual meeting
2 after the sixth annual meeting

Sole powers were given the Minister of Finance to cast proxy votes of shareholders absent from annual meetings.

[8] Section 19.
[9] Section 31.
[10] Section 5 (1).
[11] Section 8 (2).
[12] Section 8 (1).
[13] Section 8 (4).
[14] Section 9 (1).
[15] Section 9 (3 and 5).

Powers of Bank[16]

In defining the powers of the Bank, the Bill attempted to provide ample scope for the exercise of all legitimate central banking functions and at the same time to restrict the Bank's assets to the most liquid and highest grade securities. The Bank was to be allowed to buy and sell coinage and gold and silver bullion, transfer funds within and without Canada, and deal in bills of exchange of specified types and maturities. It was also to be permitted to purchase or sell on its own initiative certain types of investments. These were to include short- and long-term securities, issued or guaranteed by the Dominion or any province, with strict limitations, however, on the amount of such long-term securities which could be held. The Bank was to have power to purchase the short-term securities of the United Kingdom, other British Dominions, the United States, and France as well as a limited amount of long-term securities of the United Kingdom and the United States. These provisions were framed to allow the Bank to hold earning assets in a suitable range of currencies. Limitations on the holdings of long-term securities were for the purpose of assuring a high degree of liquidity at all times.

The chartered banks were to be given access to central bank credit under a set of provisions which would afford them privileges comparable to those which they were enjoying under the Finance Act. The Central Bank, thus, was to be allowed to buy and sell or rediscount a wide range of bills of exchange and promissory notes endorsed by a chartered bank. Loans and advances might also be made to the chartered banks for limited periods on pledge of suitable collateral.

The Dominion and provincial governments were also to be eligible for loans and advances, but in accordance with the suggestions in the Macmillan report, they were subject to appropriate limitations.

Fiscal Agent

Deposits were to be accepted from the Dominion and provincial governments and from the chartered banks, but such deposits were not to bear interest. It was expected that the provisions for chartered bank deposits would greatly facilitate clearing operations.

[16] Section 21 and subsections thereto.

For the purpose of carrying on open market operations the Bank was permitted to buy and sell in the open market securities, cable transfers, bankers' acceptances, and bills of exchange of specified kinds and maturities, with or without the endorsement of a chartered bank.

The Bank was to be required to act as fiscal agent of the Dominion without charge. By agreement it might act as banker or fiscal agent for the government of any province.

The Bill contained provisions prohibiting the Bank from engaging in or having a direct interest in any industrial or commercial undertaking. Nor should the Bank make loans or advances on real or immovable property. Unsecured loans and renewals of loans and advances were not to be made except under rigid limitations and in exceptional circumstances.

NOTE ISSUE[17]

The Minister of Finance stated, in introducing the Bill, that the Bank eventually should possess the sole right of note issue, as recommended by the Macmillan Commission. In order to bring this about the Bank Act was to be amended to provide for the gradual retirement of the notes of the chartered banks. The Dominion Notes Act together with the Finance Act were to be repealed as of the day the Bank of Canada should open for business. It was provided the Minister of Finance should transfer to the Bank on its opening the gold held by the Government against Dominion notes, silver bullion to the limited amount necessary to implement the London Agreement (1,671,802 ounces), and securities of the Dominion equal to the balance of Dominion notes outstanding. Thereafter the Bank was to become responsible for the redemption of notes.

Bank of Canada notes were to be legal tender in Canada. It was not contemplated that they should be redeemable in gold coin. Provision was made, however, that when suspension of specie should not be in effect, Bank of Canada notes should be redeemable in gold bars containing approximately four hundred ounces of fine gold. The Bill thus made provision for following the practice adopted by Great Britain when gold payments were resumed in that country in 1925, and subsequently adopted by a

[17] Section 24.

number of other countries. This arrangement is usually called the bullion standard.

Reserves

Against its notes and deposit liabilities the Bank was to be required to hold a minimum reserve of 25 per cent. in gold.[18] In addition to this minimum reserve the Bank might hold silver bullion in an amount limited to the obligation by Canada under the International Silver Agreement, signed at London in the summer of 1933, and foreign exchange in the form of bank balances, short-term treasury bills of the United Kingdom or the United States, and short-term bills of exchange payable in sterling or United States funds, or funds of any country on the gold standard.

In fixing the minimum reserve ratio at 25 per cent. in gold and in providing that notes be redeemable only in gold bullion, the Government was observing the resolution passed at the London Conference in 1933. Possibly in deference to the dissents of Sir Thomas White and Mr. Beaudry Leman it went beyond the recommendation of the Macmillan report which suggested that part of the minimum reserve of 25 per cent. might be held in the form of foreign exchange. The Bill provided that such foreign exchange as the Bank might hold might be regarded as part of the Bank's reserves, but it must be in addition to the minimum gold reserve of 25 per cent.

In order that the central bank might be able to exercise the necessary control over credit policy in Canada, the chartered banks were to be required to maintain with the Bank of Canada deposits equal to five per cent. of their deposit liabilities within Canada.[19] This provision was designed to concentrate the bank reserves of the country and to enable the Bank by appropriate action to influence the volume of chartered bank reserves and thus to exert its influence over the total volume of credit.

Gold

The Bill provided that the chartered banks should be required to transfer all gold held by them to the Bank of Canada when it commenced operations.[20] The value of the gold so transferred

[18] Section 26 of the Bill dealt with the reserves of the Bank of Canada.
[19] Section 21 of the Bill dealt with the reserves of the Chartered Banks.
[20] Section 28.

should be computed on the basis established by the Currency Act, that is to say, $20.67 per ounce. Profits derived from such gold transferred to the Bank of Canada by the chartered banks, in so far as such gold had been held against their liabilities in Canada, were to accrue to the Dominion Government. Similarly the Government was to secure any profit that might result from the revaluation of the gold which had been held as security against Dominion Notes, and which was to be transferred to the Bank of Canada.[21]

Provision was made for weekly, monthly, and annual reports.

Public Debt

The Macmillan Commission had recommended the Bank should take over and manage the public debt of Canada. Provision was made in the Bill for the Bank, if and when required by the Government, to act as the agent of the Government in the payment of interest and the principal and generally in respect to the management of the public debt of Canada.[22]

Issues Involved in Debates

While there had not been complete agreement between members of the Commission regarding the need for and advisability of establishing a central bank in Canada, there was immediate and unanimous acceptance of the principle by the House of Commons. Opposition to the Bill was confined wholly to matters of organization and detail. Conservatives, Liberals and Progressives, and Independents all favoured the establishment of the Bank, but there was a sharp difference of opinion as to the structure of the Bank.

The features of the Bill which produced the greatest amount of discussion and division of opinion in the House were: (1) whether the Bank should be a privately owned institution with the shares held by the public, the shareholders electing the directors and the latter appointing the officials, or whether the Bank should be a nationally owned institution with the Government appointing the directors and officials; (2) whether the Governor and Deputy Governor should be Canadians, or other British subjects; (3) whether the notes of the Bank should be bilingual or

[21] Section 30.
[22] Section 23 (2).

not. The first was a fundamental issue. The second involved a clash of nationalistic and imperial views. The third, seemingly a trivial matter, developed into a warm controversy due to the fact there are in Canada "two nations within the bosom of a single state."

The greatest struggle in Parliament—and in public discussion earlier—was the control of the Bank. A large body of opinion, represented in the Commons by Liberals and the Co-operative Commonwealth Federation, favoured government ownership and control as the only safeguard against dominance either by the chartered banks or by the Bank of England. The Commission had suggested a shareholders' bank managed by a Governor, Deputy Governor, and an Assistant Deputy Governor, and six to eight directors, all appointed by the Government in the first instance, subsequent appointments being made by the shareholders, subject to the Government's approval of the appointment of the Governor and the Deputies. The Bill provided for a shareholders' bank, though the Government deferred to opinion so far as to exclude from shareholding directors and employees of other banks.

Reasons for Private Ownership

The Minister of Finance stated that after due consideration the Government of the day had concluded that private ownership with independence of management in conducting the operations of the Bank, surrounded by proper controls, was preferable to public ownership. Precedent within the Empire and the experience of other nations favoured private ownership. Moreover, the Royal Commission in its report had recommended it.

Mr. Rhodes pointed out that the only British country in which there was a central bank publicly owned was Australia. That bank had been established originally by a Labour Government, not for the purposes of a central bank at all, but as a commercial bank in the ordinary sense in competition with privately owned banks in Australia, and only recently had it evolved into a central bank. Of the thirty-six nations with central banks, Sweden, Latvia, Finland, Bulgaria, Australia and Russia were the only countries with public-owned institutions. Of the remaining thirty, seventeen had central banks wholly privately owned. This list included such leading countries as England, France, Italy,

Belgium, Holland, Germany, and Switzerland. In the United States the member banks owned the Federal Reserve Banks. In the Union of South Africa the banks and private shareholders owned the Reserve Bank. The Central and South American nations represented a combination of public and private ownership. In Czechoslovakia, Greece, Japan, Jugoslavia, Lithuania, Roumania, Poland, and Esthonia the State owned only a limited portion of the shares of the central bank.

It was stated that while the tendency in the nineteenth century was in the direction of statutory control by the State over the central bank, the post-war trend has been strongly against granting the State power to interfere with the functions of a central bank. This reaction has grown out of the experience of many countries during the War period. This period exhibited in extreme degree the danger of direct State ownership and control. In the League of Nations reconstruction schemes for Austria and Hungary the independence of the central bank was stressed as a cardinal feature, as it was also in the new states constructed during the post-war period. In other countries where central banks had existed before the War the tendency has been to divorce the institutions from active political control. When the Reichsbank was reorganized in 1924 the necessity for independent action was stressed to such a point that the new German Bank Act begins with the following sentence:

"The Reichsbank is a bank independent of Government control."[23]

The Government of Canada in providing for the private ownership of the central bank had followed the advice of the various post-war international monetary conferences. At the International Financial Conference held at Brussels in 1920 the following resolution was passed:

> "Banks, and especially banks of issue, should be freed from political pressure and should be conducted solely on the lines of prudent finance."

The economic experts responsible for the report of the Committee on Currency and Exchange at that time included such well-known authorities as A. C. Pigou of England, Charles Gide

[23] Since the advent of the Hitler regime in Germany a number of important changes have occurred. The Reichsbank is once more under State control, the head of the Reich appointing the President and Directors of the Bank.

of France, M. Pantaleoni of Italy, G. Bruins of the Netherlands, and Gustav Cassel of Sweden.

At the World Monetary and Economic Conference in 1933, which was participated in by representatives of some sixty-four countries, the following resolution, which again emphasized the necessity of independent central banks, was passed:

> "The Conference considers it essential in order to provide an international gold standard with the necessary mechanism for satisfactory working, that independent central banks, with the requisite powers and freedom to carry out an appropriate currency and credit policy, should be created in such developed countries as have not at present an adequate central banking institution."

Mr. Rhodes referred to the report of the Macmillan Committee on Finance and Industry which stated, *inter alia,* that British practice has been to limit State interference to the minimum.[24]

The Royal Commission on Banking and Currency in Canada in 1933 stated:

> "It has in practice been found that a central bank can give most effective service to the community if it is free from the fear of interference for political ends in operating the delicate mechanism of the national monetary and financial machine."[25]

As additional evidence in support of a privately owned bank, Mr. Rhodes referred to the view expressed a few years earlier by Professor T. E. Gregory of England to the effect that a

[24] The Macmillan Committee on Finance and Industry which was set up in England in 1931 set forth in its report (paragraph 33, page 17) the following: "In the sphere of central banking legislation two tendencies may be observed. The first concerns the degree of elaboration of the constitutional code by which the bank is organized. These are what may be called the British and continental traditions in these matters: The first leaving the bank much more free to develop its constitution in accordance with changing circumstances, and limiting the degree of state interference to a minimum; the second regulating machinery in detail, emphasizing the subordination of the bank to the organs of the state, and admitting some, in certain cases much, state participation in the affairs of the bank itself. Such detailed regulation is explicable in many cases on the ground that the bank has been set up in an environment generally favourable to state paternalism or under circumstances, such as disorganization of the currency, which has made detailed regulation appear advisable. Nevertheless, rational consideration of the problem will show a central bank which is able to adjust itself to new necessities and exigencies without requiring an amendment of its constitution or powers on every occasion when innovation is considered desirable, possesses the inherent advantages which an elastic structure has over a rigid one."

[25] Paragraph 219, p. 65.

State-owned bank may, under political pressure, become an instrument of unsound finance.[26]

Objections to Government Ownership

The Minister of Finance believed government ownership and operation of the proposed bank would be dangerous for a number of reasons. In the first place he was of the opinion that such a bank would be subjected to political pressure and partisan interference in its administration. Occasions would inevitably arise when, for the purpose of controlling a period of inflation, the Bank should apply the brakes and restrict credit. If at the same time, an election should be in the offing, the Government would be placed in an equivocal position. On the one hand, it would have to look to its political future. The Minister was inclined to believe that under such conditions few governments would consider solely the interests of the State and forget party welfare. In the next place Mr. Rhodes felt that a bank controlled by the Government would undoubtedly be subjected to sectional pressure and influence; special consideration and treatment would be asked by pressure groups from different sections of the country. He left it to the judgment of the House what the result would be if a government were supported by a slender majority and a certain group. Another vital objection to nationalization of the central bank lay in the danger of a lack of continuity of policy resulting from frequent changes in government. Another grave objection that the Minister saw was that which would arise out of the fact that the Government would be a borrower from the very bank it owned. Its position as a borrower would be

[26] In the Report of the Select Committee on the Central Bank Bill to the Parliament of Australia in 1930, Professor Gregory wrote as an addendum:

"In discussing the form of a central bank, the first point which necessarily arises is the ownership of the bank. The present reaction against state-owned central banks finds its origin naturally in the difficulties to which central banks were exposed in the war and post-war periods—difficulties to which most banks were subject, but which were naturally more acute when the state is the sole owner, because this means the power of appointment is vested in political hands. That there exists in certain countries a strong political feeling in favour of state-owned banks can not be denied, but the strength of that feeling can be modified if the following points are borne in mind and brought prominently before the public: (a) the inherent danger that a state-owned bank will, under political pressure, be made a mere instrument of unsound finance; (b) the case for a government bank is obviously weakest where there is a fund of banking and general experience upon which the bank can draw for its executive personnel. This applies without doubt to all British Dominions."

incompatible with its function as a regulator of the volume of credit and currency.

While objecting to a Government-owned bank, Mr. Rhodes was also opposed to unrestricted private operation. As he saw it, there were three objections to purely private ownership.

(1) If the central bank were to have the sole right to issue and control legal tender paper currency, it was felt by many that it would be inappropriate to give such a right to an institution not owned by the State.

(2) There was the undesirability of allowing excessive profits to accrue to private shareholders, or indirectly of allowing the profit motive to obtain at all.

(3) The Bank might be dominated by bankers and their interests or by other financial interests.

The Government in submitting its Bill to the House was of the belief it had chosen a middle course, freeing themselves, on the one hand, from the evils of political interference and, on the other, from the danger of control by selfish private interests or management in search of profits.

Safeguards Againt Dangers in Private Ownership

The Minister pointed out the Bill provided for the following safeguards:[27]

1. The shares of the Bank of Canada could not be held directly or indirectly by a bank, or any bank director, officer, or employee.

2. The amount of stock which any individual might hold was limited to fifty shares, representing a total investment of $5,000. This, it was believed, would insure a wide distribution of stock ownership, and result in the impossibility of the stock being controlled by any individual or group of individuals. Power was given to the Minister of Finance to exercise discretion in the matter of distribution of stock. An individual was required to give his proxy to the Minister. In doing so he might indicate to the Minister his desire as to how the proxy should be used.

3. The Governor, the Deputy Governor, and the Assistant Deputy Governor were, in the first instance, to be appointed by the Governor-in-Council, and that thereafter when they were selected by the Board of Directors, their appointment must be approved by the Governor-in-Council.

[27] *Debates, House of Commons, Dominion of Canada, 1934*, p. 1301.

4. Continuity of policy was assured in the provision for rotation. The benefit of the experience of those who had served as directors was assured by their eligibility for office on completion of their term.

5. All by-laws of the Bank must be approved by the Governor-in-Council, and when so approved such by-laws had the same power and effect as if enacted by Parliament.

6. There was a definite limitation of the profits of the Bank. Thus the private profit-seeking motive was entirely eliminated.

In setting up a privately owned central bank subject to the above safeguards, the Government was of the opinion it was creating a quasi-public institution which could be defined best as a public trust.

Parliament Supreme in Case of Conflicts With Bank

During the course of the debate on the ownership and control of the central bank Mr. Rhodes was asked by one member what would happen in case a conflict of view should arise between the management of the Bank, on the one hand, and the Government, on the other. Mr. Rhodes stated, in reply, that the authority of Parliament is always supreme and that it is none the less supreme because of the fact that, in its wisdom, it may delegate a portion of its authority.[28]

In support of his position the Minister quoted from the evidence given by Professor Gregory before the Royal Commission on Banking and Currency to show the real relationship which must prevail between a central bank and the Government.[29]

Co-operative Commonwealth Federation Favours Government Ownership

Members of the Co-operative Commonwealth Federation (C.C.F.) group in the House favoured a central bank in which the stock should be owned by the Government and in which the Governor and directors should be appointed by the Governor-in-Council. In other words, they wanted a nationally owned and controlled bank.

Mr. Coote, a member of the group, said that inasmuch as credit constituted the life blood of industry, its control by a central

[28] Ibid., p. 1302.

[29] This evidence may be found in the *Hearings of the Royal Commission on Banking and Currency in Canada, 1933*, pp. 2990-2999.

bank would give the Bank control over the economic life of the country. The real issue appeared to him to be quite clear—whether the Government or a privately owned institution should have control of the economic activities of the nation. In his opinion, the control of currency and credit could in no sense be defended as a legitimate form of private enterprise. He expressed himself as favouring a central bank owned by the State and controlled by a body of men responsible to the elected representatives of the people.[30] Mr. Coote appears to have regarded a central bank as an engine of social justice and as a means of securing easy credit. He said, *inter alia*, "The setting up of the Bank of Canada as our own bank under national control to enable us to make full use of the nation's credit in creating sufficient purchasing power is the first step in abolishing poverty in the midst of plenty.[31]

Members of the Co-operative Commonwealth Federation were apparently of the opinion that it would be an easier matter to obtain credit from a government-owned and controlled bank than from a privately owned one.

Mr. Woodsworth, leader of the leftist C.C.F. party, stated he was not willing to go quite as far as Mr. Coote in ascribing the main cause of poverty in the midst of plenty to the money question, although he thought that question was undoubtedly of prime importance. He favoured a central bank in which the ultimate control of policy should rest with the Government, but detailed administration should be left to the appointed board. He believed the Government should have the right to appoint and dismiss members of the board; that there should be a Minister of State responsible for answering in Parliament for the affairs of the board, but that parliamentary discussions of financial matters should be confined to questions of policy and not matters of detail.[32]

Fear Bank Would Be a Subsidiary of Bank of England

Fear was expressed by another member of the group, Mr. Garland, that the Bank of Canada would become a subsidiary of the Bank of England, that its policy would be dictated by the

[30] *Debates, House of Commons, Dominion of Canada, 1934*, pp. 1286, 1287.

[31] Ibid.

[32] Ibid., p. 1329.

latter, a privately owned bank. He stated that the Prime Minister, Mr. Bennett, had selected from Great Britain certain eminent but extremely orthodox gentlemen—men like Sir Charles Addis, for whose reputation he had great respect, but for whose orthodoxy in matters of finance he had but the deepest regret and contempt.[33]

He stated that two gentlemen, Messrs. Kershaw and Fisher, had accompanied the Commission during its travels throughout the Dominion of Canada. No publicity had attended their travels. Now it developed that they were two officials of the Bank of England, and it had been suggested that these gentlemen had a great deal to do with the drafting of the very bill and of the report.[34]

Mr. Garland was of the opinion that 6 per cent. dividends were too high. He stated that he knew of no farmers in the West who would approve of a privately owned central bank.[35]

Amendment to Provide for Government Ownership

While the Bill was in Committee, Mr. Ian Mackenzie of Vancouver, a Liberal, moved an amendment to section 17 of the Bill so that the section should read as follows:

> "The Capital shall be divided into shares of fifty dollars each, represented by share certificates, which shall be held by the Minister (Minister of Finance) who shall subscribe for such shares, and payment for the same shall be made out of the Consolidated Revenue Fund."

The object of this amendment was, briefly, to provide that the Bank of Canada should be a publicly owned rather than a privately owned institution.

Earlier, on the second reading of the Bill, Mr. Coote had proposed an amendment to make the Bank a publicly owned institution. This amendment had been ruled out of order.

The Prime Minister Defends Private Ownership of the Bank

The Prime Minister, Mr. Bennett, in refusing to accept Mr. Mackenzie's amendment, stated there were three reasons why

[33] Ibid., p. 1319.
[34] Ibid.
[35] Ibid., p. 1322.

the Government was not prepared to accept it. In the first place, the experience of the world indicated private ownership was preferable to government ownership of the central bank. In the next place, it was essential that the Bank should be free from political control. Lastly, to all intents and purposes the bank would be a publicly owned one since all profits of the Bank, excepting $225,000, would accrue to the people, and the operation of the Bank would be subject to the approval of the Government of the day, as to the personnel of its officers and the laws, including by-laws, under which it would operate.[36]

Mr. Bennett asserted that:

> "It is not correct to describe this bank as a privately owned bank . . . It is true that there will be shareholders who will pay $50 for their shares; they will have the right to vote for the directors in the manner indicated, but where will rest the control of the bank?
>
> "Shall the executive officer who must determine its policies be subject to the direction of the Government? Shall he be forced, as he would be forced in the case of a publicly owned institution, to do what he is told to do by the Government of the day? In a moment of political crisis when it is desirable to do a particular thing for party reasons shall he be subject to that control or shall he be free from that control? He is appointed by the Governor-in-Council for a term of years and he knows his term of office depends, not upon the Government, but upon the extent to which he discharges his duties in a satisfactory manner to the people of the country and the shareholders of the bank."[37]

Two prominent members of the Liberal opposition, Mr. Lapointe and Mr. Euler, criticized the bill on the ground that too much power was being given to an institution privately owned. In their opinion it should be publicly owned. Mr. Bennett differed with them. He said that, at first blush, he, too, had been in favour of a publicly owned bank but a study of the experience and history of central banks and the recommendation of leading authorities, notably Kisch and Elkin, had convinced him that a privately owned bank would be in the best interests of the nation. Further, a recollection of what had transpired in Canada in the past, in the matter of political considerations and appointments to the various commissions had led him to the belief that

[36] Ibid., p. 4151.
[37] Ibid., p. 4154.

government ownership of the bank was not desirable. Mr. Bennett told the House that he had seen so much patronage and government intervention that he was determined to preserve the unchallenged independence of the proposed central bank.[38] This could be achieved only through providing for a privately owned bank subject to government control.

MACKENZIE KING FAVOURS GOVERNMENT CONTROL

Mr. King, the Liberal leader, strongly favoured government control of the Bank. While he regarded the question of ownership a debatable one, he was definitely of the view that the Government should have a large measure of control over the Bank. He feared that in the type of control contemplated by the Government there would develop sooner or later a conflict between financial and fiscal policies, the former in control of private interest, the latter in control of the Government. He felt that in the absence of any directors appointed by the Government, and with all the directors appointed by the shareholders, there might be no means of bringing harmony between the Bank and the Government with respect to a course of procedure that might vitally affect some great national policy. He pointed out that a case might arise where the Bank, being a privately owned institution and privately controlled, and being associated with private banks in other parts of the Empire, might come to have a financial policy to which it would adhere very strongly, while the Government of the day, for national reasons, might have a policy which would require the co-operation of the Bank. That would not be possible unless the Government as well as the shareholders were represented on the Board of Directors of the Bank.[39]

Mr. King stated that there are times when it is necessary and vital that every institution in the land should be subject to the public opinion of the country. He did not believe powers should be given to any institution that would enable it to put itself in a position of opposition to a government that had been entrusted with the responsibility of enforcing particular policies. In Mr. King's opinion the setting up of an institution in the way proposed by the Bill would result in Parliament parting altogether with any control it had over the issue of currency and credit

[38] Ibid., p. 4358.
[39] Ibid., p. 4227.

and handing it over to an institution over which it had little or no control. He contended that regardless of what party might be in office, it was advisable that the Government itself should appoint some of the directors. He suggested the board of directors should be divided, the Government appointing a certain number and the shareholders of the Bank electing the remainder. He suggested this arrangement as a means of avoiding a possible conflict between the Bank and the Government.[40]

A year previously Mr. King had committed the Liberal party to a "national bank." On February 27, 1933, in the House of Commons he enunciated the policy of the Liberal party in the following terms:[41]

> "The Liberal party believes that credit is a public matter, not of interest to bankers only, but of direct concern to the average citizen. It stands for the immediate establishment of a properly constituted national central bank, to perform the functions of discount, and the control of currency issue, considered in terms of public need. A central bank is necessary to determine the supply of currency in relation to the domestic, social, and industrial requirements of the Canadian people, and also to deal with the problems of international commerce and exchange."

Mr. King's statement was ambiguous. The term "national" has a number of connotations. Mr. King did not say whether he meant the Bank should be privately owned and controlled, or publicly owned, or privately owned and publicly controlled, or an admixture of both.

In 1934, when the Bill was under discussion, Mr. King definitely favoured a middle course. He stated he could see wherein the question of public ownership of a central bank was a debatable one, that there was much to be said on both sides.[42] It was not a choice between perfection on the one side and an unmixed evil on the other side. It was a question of which of the alternatives was preferable since each had certain obvious limitations. One objection that he saw to public ownership was that it might raise in the minds of the people of the country expectations which could not be realized. He felt that many would believe that because the State owned the central bank it would be able to meet

[40] Ibid., p. 4231.
[41] *Debates, House of Commons, Dominion of Canada, 1933*, p. 2571.
[42] *Debates, House of Commons, Dominion of Canada, 1934*, p. 4361.

each and every disorder that might arise in the country from any financial cause. Mr. King stated that everyone in the House knew that a state institution would not be able to do anything of the kind any more than a privately owned institution would. He expressed the view that once having set up a publicly owned bank the thought would be occasioned in the minds of many people that a public remedy for all social and financial ills had been discovered. There was also a danger to the State itself in the event of anything happening to a bank owned by the State. There might quickly arise in the public mind confusion between what might be a matter confined in its effects to the Bank, and what might be assumed to concern the very life of the State itself.

Mr. King took strong exception to the Government's plan of establishing a privately owned and controlled central bank. He stated that having decided against the idea of a publicly owned institution, the Government had gone to the other extreme. The middle course Mr. King stated he had in mind would enable the Government to appoint a certain number of directors, a sufficient number to give the Government control of the central bank. The directors appointed by the Government would not own shares but would represent the Government and would sit with the directors elected by the shareholders. One group of directors would watch the operations of the Bank from the viewpoint of the investors. The other group would watch the actions of the Bank from the view of the interests of the public at large. A board of directors chosen in this manner would, in Mr. King's opinion, bring about that unity and continuity in the affairs of the Bank that would redound to the public interest.

While the Bill was in committee of the whole, one of the Liberals, Mr. Ralston, made a strenuous but vain effort to have either five of the directors appointed directly by the Governor-in-Council or to have their appointments approved by the Governor-in-Council. Mr. Ralston stated that if the directors were appointed by the Government they would be more likely to carry out the wishes of the Government than would directors appointed by the private shareholders.[43]

Mr. Bennett, in reply, probably correctly presented matters when he asked:

[43] Ibid., p. 4226.

"What assurance have you that the directors would discharge a public trust any more carefully because they are appointed by the government than if they were elected in the manner I have indicated?"[44]

The main debates in the House on the Bill concerned not ownership of the Bank but control.

The three major parties, it has been noted, differed in their views regarding the ownership and control of the Bank. The C.C.F. group wanted the Bank "publicly or socially owned" and, of course, the officers and directors governmentally appointed. The Liberals, while in favour of private ownership, wanted the Government to have control of the Bank and favoured a sufficient number of governmentally nominated directors to ensure that control. The Conservatives favoured a central bank privately owned, with the directors selected by the shareholders but with the Governor and Deputy Governor appointed by the Government. They had sufficient votes in the House to carry out their policy.

Mr. Mackenzie's amendment was lost.

Qualifications for Governor and Deputy Governor

Considerable discussion took place in the Select Standing Committee on Banking and Currency as to whether the words "Canadian National" should be substituted for the words "British subject" as qualifications for the Governor, the Deputy Governor, and the Assistant Deputy Governor. The Bill provided that in the case of a director of the Bank one must be a British subject ordinarily resident in Canada, while in the case of the Governor, the Deputy Governor, and the Assistant Deputy Governor, one need only be a British subject. The Bill further provided the Governor and Deputy Governor "shall be men of proven banking experience."

The Prime Minister defended the provisions of the Bill in the Committee by stating that there were no Canadians with the necessary experience to operate a central bank. Many members of the Committee had other views. There was the feeling on the part of many members that Canadians should be appointed to the executive positions of the Bank. It was felt that if the Bank was to operate for the benefit of Canada it was essential

[44] Ibid.

that those who managed it should know best what is good for the country; that they should be persons who were acquainted with the domestic and industrial requirements of the nation. There was a strong expression of opinion that the Bank should not be a branch of the Bank of England, or dominated by that bank, or at the mercy of foreign interests.

An amendment was introduced in the House by Mr. Raymond to substitute the words "Canadian National" in place of "British subject".[45]

Mr. Raymond declared that there were in Canada distinguished Canadian bankers thoroughly versed in the economic and banking institutions of the country. Moreover, these men had an intimate knowledge of the nation's needs. He felt, therefore, that it would be not only to the detriment of Canada but an insult to Canadian citizens if officials were brought in from outside to manage the Bank.[46] He expressed the view that Canadians should always preserve autonomy in and keep control of their own economic affairs.

Mr. Bennett stated that the desire which animated those who had prepared the Bill was to provide the country with the best officers possible in the first years of the Bank's operation. The Government was seeking to obtain persons who had the necessary experience in the administration of an organization of this kind. For that reason the selection should not be restricted to Canada, for there was no one in Canada, however skilled he might be in commercial banking, who had ever had the duty of operating a central bank. The Prime Minister stated that there was not one general manager of a Canadian bank who would undertake the position.[47] He said he had asked them in committee and they were of the opinion that there was no one in Canada trained in central bank experience.[48]

The Prime Minister told the House of Commons that not a single general manager of the chartered banks had had any experience in central banking or understood or realized all that was involved in central bank management. Mr. Bennett said that

[45] Ibid., p. 4165.
[46] Ibid.
[47] Ibid., p. 4168.
[48] Sir John Aird, General Manager of the Canadian Bank of Commerce, denied the assertion of the Prime Minister that no Canadian was qualified for the governorship of the Bank of Canada.

in commercial banking Canadian bankers were equal to any in the world. He pointed to the fact that large banks in the United States draw from time to time from the personnel of the chartered banks in Canada because of the high quality, experience and training of the Canadian bankers. When it came to central banking, however, Canada had no one who could undertake the duties imposed upon central bank heads. Mr. Bennett said that whoever became head of the proposed central bank must have some knowledge of central banking functions and management in order to pass on to whatever Canadian might be appointed later the necessary and requisite experience to carry on his duties.

Mr. Mackenzie of Vancouver was particularly insistent that the head of the Bank should be a Canadian familiar with the complexities of life in Canada. He said that no man coming from another land, no matter how well qualified he might be in the technicalities of central banking, could provide the proper and adequate services required of a central bank in Canada as well as a Canadian citizen could. He had no objection to securing technical advisers from the Bank of England or the Bank of France or any other central bank for a short period of a year or two.

The view was expressed by many members that so far as technical experts were concerned the Government should seek the best that could be found but the directing head should be a Canadian. This view was not the expression of narrow nationalism so much as a genuine desire to have a Governor in charge of the Bank who would be thoroughly conversant with the Canadian economy and would safeguard the economic life and interests of the nation. Some believed that it might be necessary at times for the Bank of Canada to resist the influence of the Bank of England. There was a greater likelihood of a Canadian doing so than a governor from the British Isles.

Mr. Raymond's amendment was lost.

Suspensive Vote

A long amendment to the Bill was prepared by Mr. Ralston, which, had it carried, would have incorporated a provision in the Bank of Canada Charter similar to that found in the charters of the central banks of Austria, Czechoslovakia, Denmark,

Esthonia, Germany, Greece, Hungary, Italy, Japan, Poland, Portugal, South Africa, and Jugoslavia.

The amendment provided:

> "The Deputy Minister of Finance, or in case of his absence or incapacity, at any time, such other representative of the Department of Finance as the Minister may name for the time being, shall, by virtue of his office or of such nomination as the case may be, have the right to protest against any act or decision of the board or of the executive committee (except a decision nominating a Commissioner as hereinafter provided for) which he may consider to be contrary to law or against the interests of the State, by filing such protest in writing with the board or executive committee as the case may be, and with the Minister, and any such protest, unless the same is not concurred in by the Minister, and within two days shall have the force of a suspensive veto so that nothing shall be done under the authority of or pursuant to such act or decision until the merits of the protest shall have been decided upon by a Commission of three persons constituted as follows: One person to be named by the Board and one person to be named by the Minister within seven days after such protest, and one person, to be Chairman to be jointly chosen by the Minister and the Bank, and in default of agreement on such mentioned person within seven days after such protest, such chairman shall be the Chief Justice or Acting Chief Justice of the Supreme Court of Canada; the decision of such Commission to be made within seven days after the Commission has been constituted or within such further time as the Minister and the Bank may agree upon, and the decision of the Commission shall have the full force and effect of a decision of the board of directors in respect of which no protest has been filed."

The provision was intended primarily for the purpose of preserving State interests. A situation might be conceived of in which even the Governor might vote to take a certain action which the Deputy Minister might regard as either contrary to the interests of the country or contrary to law, that is, contrary to the constitution of the Bank. The Deputy Minister in such a case could file a suspensive veto or protest with the Board, and unless the suspensive veto was not concurred in by the Minister of Finance within two days, would operate to suspend the action of the Board until the difference was composed between the Government and the directors of the Bank. This would give the Deputy Minister power to assert the interests of the State by

registering a protest which would have the effect of a suspensive veto in any matter regarded as prejudicial to national interests.

The Amendment was negatived.

The original Bill made no provision for the Deputy Minister of Finance as a member of the Board of Directors. An amendment to the Bill providing that the Deputy Minister should be a non-voting member of the Board was accepted by the Government.

Bilingual Notes

A considerable amount of heat was generated in the House over the amendment to the Bank of Canada Bill proposed by Honourable Mr. Lapointe, Liberal, and former Minister of Justice of Canada. Mr. Lapointe introduced an amendment to subsection 4 of Section 24 of the Bill, providing that "the form and material of the notes shall be subject to approval of the Minister (Minister of Finance), provided that said notes shall be printed in both the English and French language.[49] The section read "provided that notes in either the English or the French language shall be available as required." The effect of Mr. Lapointe's amendment was that English and French should appear on the same note. Mr. Lapointe changed his amendment to make it clearer by stating "provided that each said note shall be printed in both the English and the French languages." A similar amendment had been made previously in the Select Standing Committee on Banking and Commerce by the former Minister of the Crown but had been defeated.

The amendment raised a question of very serious moment. It was not the first time that the matter of bilingualism had engaged the attention of the House. It never failed to arouse an acute feeling both in Parliament and in the press.

In stating his reasons for submitting the amendment, Mr. Lapointe referred to the fact that Section 133 of The British North America Act provided that:

> "Either the English or the French language may be used by any person in the debates of the Houses of the Parliament of Canada and of the Houses of the Legislature of Quebec; and both of these languages shall be used in the respective Records and Journals of these Houses; and either of those languages may be used by any person or in any pleading or

[49] Ibid., p. 4236.

process in or issuing from any Court of Canada established under this Act, and in or from all or any of the Courts of Quebec."

Now that the note-issuing function of the chartered banks would be taken over by the Bank of Canada, Mr. Lapointe considered it only fair that the notes should be bilingual. He stated, "Everywhere in the world where a similar situation exists, in order to show the duality of language in such countries both languages, and in certain countries, three languages are used on the notes issued by the banks. In Belgium they have both French and Flemish on the notes. In Switzerland, where there are three official languages, French, German, and Italian, the notes are issued with the three languages appearing thereon." Canada would be the only country, Mr. Lapointe claimed, in which the national currency would be issued in two languages but not on the same notes. He was of the opinion that if French notes circulated in Quebec and English notes in the rest of Canada, Quebec would become more French and the remainder of the country more English.

The Prime Minister, Mr. Bennett, opposed the amendment. He pointed out that in printing Dominion of Canada notes there was no such provision. Moreover, the statutes of Canada were published separately in English and in French. Mr. Bennett regarded the amendment as an attempt to raise a political issue and an effort of the minority to impose its will on the majority.

Mr. King stated the amendment was one which related to the method by which the requirements of the constitution might be carried out to serve the convenience of the public. The Bill before the House required the issuance of two sets of notes, some in French and some in English. What Mr. Lapointe proposed was that the notes should bear on their face the French as well as the English language. In Mr. King's opinion the question was simply one concerning the method which would best serve the convenience of the people of the country and make for harmony. It did not concern the constitution at all.[50]

For convenience Mr. King preferred bilingual notes. He was of the opinion that it would be inconvenient to the banks to have two sets of notes, one in French and one in English. Since Bank of Canada notes would have a wide circulation Mr. King said it

[50] Ibid., p. 4242.

would be possible for a note in French to be handed to someone who could not read French. Difficulties would be raised if bilingual notes were not used. It was pointed out that Canadian postage stamps, excise stamps, money orders, and postal notes issued by the Government bore both the French and English languages. This was done for the purpose of convenience.

There were expressions of heated opinion both in the House of Commons and the press, particularly the French press. The question tended to raise religious and racial passions and had its electoral aspect as well.

A very temperate view of the matter, however, was expressed by Mr. Bourassa, one of the leading French members. He probably expressed the view of most Canadians, that the whole question was really a tempest in a tea-pot; that the average man or woman cared little whether French or English or both appeared on the bank note so long as it could be used in buying goods and services. During the course of the debate Mr. Bourassa said: "The average French Canadian farmer or artisan or business man is prepared to take all the dollars he can earn and make the best use of them, especially at this time, whether they are printed in French or English or Chinese or any other language. I also believe that those staunch supporters of British rights—'this is an English country, nothing but English'—would not spit on a bill printed in French if it helped them to buy a bottle of Scotch whisky."[51]

Mr. Bourassa expressed the opinion that bank notes should express nationality. He reminded Parliament that for a century and a half Canada was a French-speaking country, that Canada had a dual nationality. He favoured the issuing of bilingual notes.

The amendment was defeated.

No Fundamental Changes Made in Bill

The Bank of Canada Bill was under the consideration of Parliament for over four months. It was the subject of debate, amendment, and subamendment. It passed through all sorts of vicissitudes before it reached the stage where it could be referred to the appropriate committee of the House, the Select Standing Committee on Banking and Commerce, a committee consisting of fifty members representing all political parties in the House.

[51] Ibid., p. 4244.

Having reached the committee stage, deliberations occupied not weeks but months. Everyone who even considered himself to be an expert had to be heard; almost every type of monetary crank appeared. One prominent witness was Major C. H. Douglas whose chief contribution was the confusion he created both in the minds of the members of the Committee and some of his own followers. The Bill came back from the Committee into the House where it was again attacked with renewed vigour from all sorts of angles. Many amendments and sub-amendments were again offered. From the House the Bill went to the Senate. Here a number of amendments were offered, but the consideration of the Bill was relatively brief in comparison with the consideration given to the Bill in the Lower Chamber.

The prolonged discussions both in Committee and on the floor of the House resulted in no fundamental changes.

A companion Bill, the Bank Act of 1934, received the same thorough and extended discussion and consideration given to the Bank of Canada Act. This Act was finally assented to on June 28, 1934, and Bank of Canada Act received the Royal assent a few days later on July 3rd.

Agricultural Relief

The Royal Commission made no specific recommendations in its report as to the precise form in which financial aid should be given to agriculture but did recommend that the Dominion Government, in co-operation with the provincial governments, should forthwith institute a special investigation into the whole problem of the provision of short and intermediate credits with a view to the preparation of an adequate and comprehensive scheme for submission to Parliament. No investigation was made, but two statutes were passed in 1934 by the Dominion Parliament, designed to benefit agriculturists.

The Farm Creditors' Arrangement Act was enacted for the purpose of facilitating compromises and arrangements between farmers and their creditors and for the establishment of provincial Boards of Review. Section 7 of the Bankruptcy Act exempts a farmer from its provisions. The Farm Creditors' Arrangement Act was designed to give the farmer the benefit of those provisions without the assignment of assets or without being adjudged a bankrupt. The legislation was based upon the

assumption that without assigning or being adjudicated a bankrupt, a farmer, unable to pay his debts, might avail himself of the general provisions of bankruptcy—that is, he might arrive at an arrangement with his creditors by which they would not be able to proceed against him during the lifetime of the arrangement or while its provisions were being met.

The Farm Loan Amendment Act was an amendment of an earlier statute, the Farm Loan Act which authorized the Dominion Government to advance a sum up to $15,000,000 to the Canadian Farm Loan Board which came into being in 1929. This Board makes loans to farmers unable to pay off their long-term mortgages and to those who lack sufficient capital to carry on agricultural operations. The Act provided for loans not exceeding 50 per cent. of the value of the farms at a rate of 6½ per cent. on a basis of repayment in a period of 23 years or 32 years. The amending Act provided for an increase in advances from the Dominion Treasury up to $40,000,000 plus an additional $30,000,000 to be made available to the Board by means of a Dominion guarantee of the bonds of the Farm Board. Loans were made under appraisements controlled and directed by the provincial authorities under regulations enacted by the federal Board.

In 1935 the Farm Loan Act was amended again. Provincial Boards were abolished and loans were made directly by the Dominion Board. Provision was made for the appointment of representatives of the Dominion Board in each province. Dual control and divided responsibility was thereby avoided. The Act has never operated in Saskatchewan, Ontario, or in Prince Edward Island, since the operation of the Dominion Act is dependent, according to the terms of the Act itself, upon legislation being passed by each province in turn. For one reason or another these three provinces did not take advantage of the federal enactment.

CHAPTER VIII

THE BANK OF CANADA ACT

CHAPTER 43 of the Statutes of 1934, "An Act to incorporate the Bank of Canada", provided for the establishment of a central bank in Canada. This new central bank bears the name of one of the earliest banks to receive a charter in North America. In 1807 and 1808 merchants of Montreal and Quebec sought without success a charter from the Legislature of Lower Canada for a bank to be known as the Bank of Canada. In 1810, merchants of Kingston sought a charter for a bank of the same name. It was not until 1818, the year after a charter was granted to the Montreal Bank, now the Bank of Montreal, that a Montreal group secured a charter for the Bank of Canada. The Bank had a capital of £300,000 and, in addition to the Montreal office, an agency was started immediately in Kingston. This bank did not succeed, however. The Bank of Montreal took over its assets and the first Bank of Canada wound up with a large loss to its shareholders, but none to its customers.

Again, in 1858, the Legislative Council of Canada granted permission for the incorporation of a Bank of Canada with a capital of $3,000,000 which was not forthcoming from public subscriptions. The charter was purchased in 1866 and the name was changed to the Canadian Bank of Commerce.

The new Bank of Canada is the third of that name to be chartered in Canada.

FUNCTIONS OF THE BANK OF CANADA

The chief functions of the Bank of Canada are suggested in the preamble to the Act, namely, "to regulate credit and currency in the best interests of the economic life of the nation, to control and protect the external value of the national monetary unit and to mitigate by its influence fluctuations in the general level of production, trade, prices and employment, so far as may

be possible within the scope of monetary action, and generally to promote the economic welfare of the Dominion."

Much of the language of the preamble is strikingly similar to that found in paragraphs 206 and 236 of the *Report of the Royal Commission.* The Commission had sounded a warning note in its report.

> "It is easily possible to expect either too much or too little of central bank action . . . A central bank cannot be expected to influence directly the price of a particular commodity. It is not even desirable that a central bank should be specifically charged with any responsibility for the general price level of a country. There are too many factors, of varying nature, which combine to influence that level, and a central bank, working as it does purely in the monetary sphere, can not be expected to have complete control, though it may well have a measure of influence."

The absence in the preamble of this note of warning, as to the degree to which such an institution could fulfil all the expectations the public might attach to it, has led Mr. A. W. Rogers, Secretary of the Canadian Bankers' Association, to observe:[1]

> "It may be said, therefore, by its broad interpretation of some words of the Royal Commission and the omission of any adequate warning note, Parliament has provided a basis for great expectations by the public mind which may embarrass not only the Governor of the Bank of Canada but the Government itself."

Instruments of Credit Control

Central banks employ various devices for exerting an influence upon the supply of credit. In order to carry out the purposes for which it was established, the Bank of Canada has been given three statutory instruments of control. These are:

(1) the discount rate
(2) open market operations
(3) foreign exchange operations.

Rediscounting

Rediscounting at the central bank of approved commercial paper or the grant of loans to it on approved short-term securities is the recognized means by which a commercial bank

[1] *Journal of the Canadian Bankers' Association,* October, 1934, p. 25.

can strengthen its cash position at the shortest possible notice. In theory, at least, variations in the discount rate by the central bank affect the cost of borrowing by the commercial banks and in turn the cost of borrowing by the customers of the latter banks. In brief, it is assumed that through changes in the rediscount rate a central bank can aid in the stabilization of prices in so far at least as credit in the form of bank loans affects general prices.

The Bank of Canada has been given fairly wide powers relative to rediscounting. Section 21 of the Bank of Canada Act provides that the Bank may buy, sell, or rediscount bills of exchange and promissory notes endorsed by a chartered bank drawn or issued in connection with the production or marketing of goods, wares, and merchandise as defined by the Bank Act, and having a maturity not exceeding ninety days, excluding days of grace, from the date of acquisition by the Bank.[2] The Bank may also buy and sell or discount limited amounts of bills of exchange and promissory notes endorsed by a chartered bank, drawn or issued in connection with the production or marketing of products of agriculture, the forest, the quarry and mine, or the sea, lakes, and rivers as defined by the Bank Act,[3] and having a maturity not exceeding one hundred and eighty days excluding days of grace, from the date of acquisition by the Bank.[4] The Bank is empowered by the Act to make regulations limiting to a percentage of its total assets the amount of such paper having a maturity in excess of ninety days which it may take.

In addition to the power to rediscount commercial paper endorsed by the banks, the Bank is authorized to make loans or advances for periods not exceeding six months to chartered banks or banks incorporated under the Quebec Savings Bank Act, upon the pledge of any of the securities in which the Bank is allowed to invest, or of bills of exchange or promissory notes which it may purchase, sell or rediscount.[5] Canadian municipal securities or securities issued by a school corporation or parish trustees, or securities issued pursuant to the statutes of a province which provides for payment thereof and the interest thereon by the

[2] Subsection (g).
[3] The persons to whom and the security upon which chartered banks may make loans are set forth in Section 88 of the Bank Act of 1934.
[4] Subsection (h).
[5] Section 21 (i).

province may also be pledged. Gold or silver coin or bullion or documents of title thereto are likewise pledgeable. No limit is placed upon the amount of such loans and advances to the chartered banks.

The Bank may make loans or advances for periods not exceeding six months to the Dominion Government or the government of any province on the pledge or hypothecation of readily marketable securities issued or guaranteed by the Dominion of Canada or any province.[6] In the case of loans to the Dominion Government the loans shall not exceed one-third of the estimated revenue for the fiscal year and in the case of loans to the provincial governments, the loans shall not exceed one-fourth of the estimated revenue for the year.[7]

Clearly the way is paved for the development of a short-term money market in Canada which will provide facilities for more economical short-term financial operations of government bodies.

In the purchase of commercial and agricultural paper the Bank is not a competitor of the chartered banks. It will have to obtain its holdings of commercial paper from the chartered banks. How far the chartered banks will rediscount such paper remains to be seen. They may retain the commercial paper and borrow on the security of government obligations.

Open Market Operations

The Bank is empowered to engage in open market operations.[8] For the purpose of carrying out these operations the Bank is authorized to buy and sell in the open market from or to any person, either in or outside of Canada, securities, cable transfers, bankers' acceptances, and bills of exchange from or to any person in Canada or elsewhere with or without the endorsement of a chartered bank.[9] These cable transfers and bankers' acceptances must have maturities not exceeding ninety days. The securities must be of the same classes as those in which the Bank may invest, with the exception of long-term United Kingdom and United States obligations. The quantity of long-term Dominion and provincial issues which may be purchased under this provision of the Act may not, including investment holdings of the

[6] Section 21 (j).
[7] Section 21 (k).
[8] Section 21 (1).
[9] Ibid.

same kind, exceed $15,000,000.[10] There is no limitation of the amount of short-term securities of the kinds in which it may invest, which the Bank may acquire in open market operations.

Open market operations, through buying and selling of the securities and commercial paper described above, may be expected to form one of the effective means the Bank may use to influence the volume of credit and thereby general business activity and the price level. Since the short-term money market in Canada is of a limited scope, it is probable that open market operations of the Bank will, for some time to come, be largely in government securities. Mr. Rogers, Secretary of the Canadian Bankers' Association, stated that, "at all events it is probable that Dominion and provincial short-term issues will be the chief securities which the Bank will buy and sell under this power." [11] Of recent years the Dominion Government has relied on short-term financing to an increasing extent.

Foreign Exchange

The Bank is authorized to effect transfers of funds by telegram, letter, or other method of communication, and buy and sell transfers effected by such means, trade acceptances, bankers' acceptances, bankers' drafts, and bills of exchange drawn in or on places outside of Canada and having a maturity not exceeding ninety days excluding days of grace, or not exceeding ninety days after sight excluding days of grace, from the date of acquisition by the Bank.[12]

These powers in respect to foreign exchange are quite broad. The Bank is not required to deal through the chartered banks. In the field of foreign exchange the Bank may compete with the chartered banks, and in time may exercise a dominating influence thereon with a view to maintaining the foreign exchange value of the Canadian dollar. This will be an important as well as a

[10] This was subsequently amended by the Bank of Canada Act Amendment Act, 1938. The quantity of securities issued or guaranteed by the Dominion of Canada or any province not maturing within two years which the Bank may acquire is limited to fifty per cent. of the Bank's outstanding note issue and deposit liabilities. The Bank is limited in its holdings of such securities in another way. The Bank shall not hold at any time securities not maturing within ten years of a par value in excess of five times the amount of the paid-up capital and rest fund of the Bank.

[11] *Journal of the Canadian Bankers' Association*, October, 1934, p. 35.

[12] Section 21 (b). This subsection was amended by the Bank of Canada Act Amendment Act, 1936, by striking out "or not exceeding ninety days after sight excluding days of grace."

difficult function in view of the relatively large foreign investments in Canada.

It is not assumed that the Bank will be able to control the effects of a major international financial collapse such as occurred during the depression, but it is expected that it will prevent such minor departures from the gold parity as occurred in Canada in the years 1929 and 1931 before the sharp break in foreign exchange in September of the latter year, when Canadian exchange was at a discount of from 1 to 3 per cent. without suspension of the gold standard.

The Royal Commission pointed out in paragraph 230 of its Report that the holding of gold and foreign exchange by the central bank should and could become a factor of the first importance in carrying out the national policy in regard to the external value of the currency; that its function is to impart or counteract a trend as circumstances require.

Fiscal Agent of Governments

The Bank of Canada is directed to act as fiscal agent of the Government of Canada without charge and, by agreement, may also act as banker or fiscal agent of the government of any province.[13] The Bank, if and when required by the Minister of Finance so to do, shall act as agent for the Government of Canada in the payment of interest and generally in respect of the management of the public debt of Canada.[14] The Bank may make no charge for cashing any cheque drawn on the Receiver-General or on his account or for cashing any other instrument issued as authority for the payment of money out of the Consolidated Revenue Fund or upon any cheque drawn in favour of the Government of Canada or any department of the Government and tendered for deposit in the Consolidated Revenue Fund.[15]

There is obviously a need for some responsible authority which will provide expert and disinterested advice, particularly

[13] Section 23 (1).
[14] Section 23 (2).
[15] A slight change was made by the Bank of Canada Act Amendment Act of 1936. Subsection (3) now reads "The Bank shall not make any charge for cashing or negotiating any cheque drawn on the Receiver-General or on his account, or for cashing or negotiating any other instrument issued as authority for the payment of money out of the Consolidated Revenue Fund, or upon any cheque drawn in favour of the Government of Canada or any department thereof and tendered for deposit in the Consolidated Revenue Fund."

to provincial governments, regarding the domestic as well as the foreign market for bonds, and offer facilities for some possible co-ordination of external borrowing operations. There is here, obviously, a fertile field for the reaping of tangible benefits hitherto undeveloped through lack of appropriate machinery.

The functions of the Bank of Canada are to be regulatory and supplementary, and in no way to compete with the chartered banks. In defining the powers of the Bank, the Act provides ample scope for the exercise of all legitimate central banking functions while still imposing certain restrictions and limitations, particularly with regard to investments.

INVESTMENTS

The Bank is authorized to deal in short-term securities, upon which there is no limit to its holdings. In this category it may buy and sell or rediscount short-term securities issued or guaranteed by the Dominion of Canada or any province, having a maturity not exceeding two years from the date of acquisition by the Bank,[16] and United Kingdom, British Dominions, United States of America, and French issues maturing not over six months after the Bank has acquired them.[17] This provision of the Act is intended to assure a large degree of liquidity in the Bank's portfolio. This is in line with the "short-term banking" policy followed by the chartered banks. No doubt greater use of treasury bills on the provinces will be encouraged in an effort to build up a short-term money market in Canada.

Subject to strict limitations as to quantity and quality the Bank may purchase long-term securities. It may buy and sell securities issued or guaranteed by the Dominion of Canada or any province, having a maturity exceeding two years from the date of acquisition by the Bank, but the Bank shall at no time hold such securities (exclusive of the securities transferred to the Bank by the Department of Finance at the time it began business) of a par value in excess of three times the amount of the paid-up capital of the Bank.[18] The maximum holdings of these securities would be, therefore, $15,000,000. Long-term securities of the United Kingdom and the United States may not

[16] Bank of Canada Act, Section 21 (c).
[17] Ibid., Section 21 (e).
[18] Ibid., Section 21 (d).

be held in excess of one-half of the amount of the paid-up capital of the Bank, that is, not in excess of $2,500,000.[19]

The Bank may buy and sell or rediscount bills of exchange and promissory notes endorsed by a chartered bank drawn or issued in connection with the production or marketing of goods, wares and merchandise as defined in the Bank Act, and having a maturity not exceeding ninety days, excluding days of grace, from the date of acquisition by the Bank.[20] The Bank may also buy and sell or discount limited amounts of bills of exchange and promissory notes endorsed by a chartered bank, drawn or issued in connection with the production or marketing of products of agriculture, the forest, the quarry and mines, or the sea, lakes and rivers as defined by the Bank Act, and having a maturity not exceeding one hundred and eighty days, excluding days of grace, from the date of the acquisition by the Bank.[21] The Bank is empowered by the Act to make regulations limiting to a percentage of its total assets the amount of such paper having a maturity in excess of ninety days which it may take.

Coin and Bullion

The Bank may buy and sell gold, silver, nickel, and bronze coins and gold and silver bullion.[22] The Act provides for the establishment of the gold bullion standard. It states, "the Bank shall sell gold to any person who makes demand therefor at the head office of the Bank and tenders the purchase price in legal tender, but only in the form of bars containing approximately

[19] The Bank of Canada Act, 1934, Section 21, subsection 1 (a).

Subsections (d) and (f) of Section 21 of the Bank of Canada Act were amended by the Bank of Canada Act Amendment Act of 1938 to read as follows:

"(d) buy and sell securities issued or guaranteed by the Dominion of Canada or any province, having a maturity not exceeding two years from the date of acquisition by the Bank, but the Bank shall at no time hold securities not maturing within two years having a par value in excess of fifty per cent. of its outstanding note issue and deposit liabilities, nor shall the Bank at any time hold securities not maturing within ten years of par value in excess of five times the amount of the paid-up capital and rest fund of the Bank.

"(f) buy and sell securities issued by the United Kingdom or the United States of America having a maturity exceeding six months from the date of acquisition by the Bank, but the Bank shall at no time hold such securities of par value in excess of one-half of the amount of the paid-up capital of the Bank."

[20] Ibid., Section 21 (g).

[21] Ibid., Section 21 (h).

[22] Ibid., Section 21 (a).

four hundred ounces of fine gold." [23] The Act further provides, "the Governor-in-Council, from time to time and for such period as he may deem desirable, may suspend the operation of the next preceding subsection and remove such suspension." [24]

Provisions were made for the Bank, on the commencement of business, to take over the gold held by the Dominion against note issue (approximately $70,000,000) and all the gold coin or bullion owned and held in Canada by the chartered banks (approximately $60,000,000).[25] The Governor-in-Council may from time to time after the Bank has begun business, require every chartered bank and every other person to transfer to the Bank all gold coin or bullion owned and held in Canada. Thus the Bank may become the sole purchaser of gold in Canada.

The Act provides that whenever gold is sold by, transferred to, held as reserve by, or deposited with the Bank the value of the gold shall be computed on the basis established by the Currency Act at the date of the relevant transaction.[26] The statutory price of gold when the Bank took over the gold from the Dominion Government and the chartered banks was $20.67 per fine ounce.

Any profits resulting from the sale by the Bank of gold coin and bullion transferred to the Bank, or from an increase in the value of such gold resulting from any change in the monetary standard of Canada, must be paid by the Bank to the Receiver-General for the Consolidated Revenue Fund.[27]

Considerable controversy which will be discussed later arose from a provision of the Act which stated that:

> "The aforesaid provisions of this section (those dealing with valuation of gold transferred to the Bank) shall not apply in the case of gold transferred under subsection 1 of section 28, if the Governor-in-Council is satisfied that the said gold was at the time of the transfer being held by a chartered bank against liabilities elsewhere than in Canada, and in such case the profit shall belong to the chartered bank."

[23] Ibid., Section 25 (1).
[24] Ibid., Section 25 (2). Canada has been off the gold standard since 1928. The suspension of the standard in existence when the Bank was established was continued.
[25] Ibid., Section 25 (3).
[26] Ibid., Section 29.
[27] Ibid., Section 30.

The Act provided that the silver held by the Minister for redemption of Dominion notes should be handed over to the Bank and should be valued at the market price of the fine silver content thereof.

NOTE ISSUE

The Act specifically provides that:

> "On and after the day on which the Bank is authorized to commence business the Bank shall, except as provided in the Bank Act, have the sole right to issue notes payable to the bearer on demand and intended for circulation in Canada and may, subject to the provisions of section twenty-six of this Act, issue such notes to any amount. Such notes shall be legal tender, and shall be the first charge upon the assets of the Bank."[28]

The Bank Act of 1934 provides in Section 61 that the maximum circulation of chartered banks shall be limited to their paid-up capital from the day the Bank of Canada begins operations (March 11, 1935), then reduced by five per cent. each year beginning January 1, 1936, for a period of five years and then by ten per cent. each year for a further period of five years until the limit of twenty-five per cent. of the paid-up capital is reached by January, 1945. The Act thus provides for a gradual retirement of the issues of the chartered banks until their outstanding issues are no greater than twenty-five per cent. of their paid-up capital.

Under the provisions outlined the Bank of Canada will gradually assume an increasing share of the note issue but will not have the sole right to issue notes, as some writers have assumed, unless a further change is made in the Bank Act.[29]

As noted before, the Bank of Canada assumed the liability for the Dominion notes outstanding, and has replaced them with its own notes in denominations of $1, $2, $5, $10, $20, $25, $50, $100, $500 and $1,000.[30]

Provision was made that the bank notes should be available as required in either the English or the French language.[31] The

[28] Ibid., Section 24 (1).

[29] Writing in the *American Economic Review* of March, 1935, p. 80, Mr. Dixon states "The Bank of Canada will gradually assume the sole right of note issue." This is, obviously, a mistake.

[30] *The Canada Year Book, 1936*, p. 902.

[31] Bank of Canada Act, Section 24 (4). This provision was changed in 1936 and the notes made bilingual.

language provision was the subject of bitter debate in the House when this section of the Bill was under discussion.

There appears to be no legal restriction on the note issue authority of the Bank except such as is provided by the gold reserve requirements.

Reserves

Section 26 of the Act provides that the Bank must at all times maintain as security against its outstanding notes and deposit liabilities, a reserve consisting of gold coin and bullion, in the unrestricted ownership of the Bank, equal to an amount not less than twenty-five per cent. of its notes and deposit liabilities. The Bank may maintain an additional reserve consisting of silver bullion, of balances held abroad, certain short-term obligations of the United States and the United Kingdom, and short-term foreign bills of exchange.

With regard to silver it is provided that the silver held by the Government must be turned over to the Bank at the market price, and the Bank shall, during the years 1935, 1936, and 1937, purchase under the terms of the London Silver Agreement of 1933, 1,671,802 fine ounces of mined Canadian silver.[32]

The Act defines foreign exchange which the Bank may hold as additional reserve to the minimum gold reserve of twenty-five per cent. to mean:[33]

> (1) Balances with the Bank of England, the Bank for International Settlements, the Federal Reserve Bank of New York, and a central bank in any country whose currency by law and in fact is convertible on demand at a fixed price into exportable gold;
>
> (2) Treasury bills or other obligations of the United Kingdom, or the United States of America having a maturity not exceeding three months from the date of acquisition by the Bank;
>
> (3) Bills of exchange having a maturity not exceeding ninety days excluding days of grace, or not exceeding ninety days after sight excluding days of grace from the date of acquisition by the Bank payable in London or New York or in a country whose currency by law and in fact is convertible on demand at a fixed price into exportable gold, less any liabilities of the Bank payable in the currency of the United Kingdom, the United States of America or any country, whose

[32] Ibid., Section 26, subsections 2 (a) and (4).
[33] Bank of Canada Act, 1934, Section 26, subsection 2 (b).

currency is by law and in fact convertible on demand at a fixed price into exportable gold.[34]

The holdings of foreign exchange are clearly not a part of the statutory 25 per cent. reserve. The Act went further than the recommendation of the Royal Commission which suggested:

> "The Bank should maintain a proportion of 25% in gold and foreign exchange against its outstanding note issue and sight liabilities."[35]

At the request in writing of the Board, the Governor-in-Council may suspend the operation of Section 26 of the Act in so far as it requires the Bank to maintain a reserve of gold equal to an amount not less than twenty-five per cent. of its notes and deposit liabilities. Such suspension is limited to a period not exceeding sixty days, but on the further request in writing of the Board may be extended from time to time for further periods not exceeding sixty days each, provided no such suspension shall continue longer than one year without the sanction of Parliament.[36] This provides a safety valve.

Reserves of the Chartered Banks

Each chartered bank is required under Section 27 to "maintain a reserve of not less than five per centum of its deposit liabilities within Canada and such reserve shall consist of a

[34] The Bank of Canada Act Amendment Act, 1936, redefined foreign exchange which the Bank may hold. Paragraph (b) subsection 2 of Section 26 of the Act now provides:

(b) foreign exchange, which shall mean:—

(1) balances in pounds sterling, United States of America dollars and currencies which by law and in fact are convertible on demand at a fixed price into exportable gold, held in the Bank of England, the Federal Reserve Bank of New York, the Bank for International Settlements or a central bank in any country the currency of which is convertible as hereinbefore described;

(2) treasury bills or other obligations of the United Kingdom or the United States of America having a maturity not exceeding three months from the date of acquisition by the Bank;

(3) bills of exchange having a maturity not exceeding ninety days, excluding days of grace, from the date of acquisition by the Bank, payable in pounds sterling, United States of America dollars or in a currency which by law and in fact is convertible on demand at a fixed price into exportable gold, less any liabilities of the Bank payable in the currency of the United Kingdom, the United States of America, or any country whose currency is by law and in fact convertible on demand at a fixed price into exportable gold."

[35] *Report of the Royal Commission on Banking and Currency in Canada*, 1933, Section 13, page 100.

[36] Bank of Canada Act, 1934, Section 26 (3).

deposit with the Bank and of notes of the Bank held by such Bank." [37] The daily average amount of deposit liabilities within Canada for each chartered bank is the basis of determining the amount of reserve to be maintained by such bank during the month next following the month in which such return was made.[38] If any bank knowingly allows its reserves to fall below this amount, it must pay a penalty to the Bank of Canada at the rate of 10 per cent. per annum of the amount of the deficiency for each day on which there is a deficiency in the amount of the reserve maintained by the chartered bank.[39] The deposit made by the chartered banks with the Bank of Canada as reserves against their respective deposit liabilities is insured by the Government against loss in case of failure of the Bank.[40]

Every bank incorporated under the Quebec Savings Banks Act is required to maintain against its deposit liabilities such reserves in the form of notes of the Bank or deposits with the Bank or a chartered bank as may be deemed to be sufficient by the Bank.[41]

The Royal Commission recommended a reserve of five per cent. consisting of a deposit only, and the original draft of the Bill contained this provision. The reserve requirement proposed in respect of the Canadian banks was much more stringent than that imposed upon the commercial banks in New Zealand or in India. Moreover, the English banks are under no compulsion to keep any deposits whatever with the Bank of England, as a result of which they have kept their reserves partly in the form of such deposits and partly in Bank of England notes, a much more elastic and useful practice than the one proposed in Canada. It was also apparent that in addition, with the curtailment of the note issue of the chartered banks, these banks would have to keep substantial amounts of Bank of Canada notes in the tills of their branches. It seemed obvious that the banks would probably maintain substantial balances with the Bank. After considerable discussion Parliament amended the Bill so that the five per cent. reserve "shall consist of

[37] Ibid., Section 27 (1).
[38] Ibid., Section 27 (3).
[39] *Ibid.*, Section 27 (4).
[40] Ibid., Section 27 (6).
[41] Ibid., Section 27 (7).

a deposit with the Bank and of notes of the Bank held by such bank."[42]

This amendment improves the workability of the Act. It means that each chartered bank must maintain in its tills Bank of Canada notes and on deposit with the Bank of Canada a sum which together shall be at least five per cent. of its total deposit liabilities. This provision gives more elasticity to the note issue and more freedom to the chartered banks with respect to their reserves, thus preserving two characteristics of Canadian banking practice. Heretofore, the chartered banks endeavoured to maintain a cash reserve of approximately ten per cent. of their deposit liabilities, although not legally required to maintain any such reserve. The new reserve provisions allow the banks to maintain a smaller cash reserve than they have heretofore maintained in actual practice. The chartered banks will probably continue to maintain reserves substantially greater than the newly prescribed minimum and maintain deposits with the Bank suitable for the settlement of inter-bank transactions.

It will be noted that Canada has not followed the practice obtaining in both the United States and New Zealand in distinguishing between time and demand deposits and requiring a different percentage of reserves for each. The Canadian Act, too, reflects the recent tendency favouring reduced legal requirements for reserves. The preparatory commission of experts for the World Economic Conference recommended a reduction in such requirements, and some plans considered by the Conference favoured an upper limit of 25 per cent. as the required reserve for central banks.

Prohibited Business

Certain types of business are specifically prohibited. The Bank may not engage in or have any direct interest in any commercial or industrial undertaking.[43] A similar provision in the Bank Act is designed to confine the chartered banks to commercial banking. The Bank is barred from purchasing or loaning upon the security of its own stock or that of any other

[42] Ibid., Section 27 (1). As amended by the Bank of Canada Act Amendment Act, 1938, the following is the requirement: "Every chartered bank shall maintain a reserve of not less than five per centum of such of its deposits as are payable in Canadian dollars, and such reserves shall consist of a deposit with the Bank and of notes of the Bank held by such bank."

[43] Bank of Canada Act, Section 22 (a).

bank, except the Bank for International Settlements.[44] In the Bank Act is found a similar provision—commercial banks may not deal in or loan against the stock of any bank, including the Bank of Canada.

The Bank is forbidden to make loans or advances upon the security of any real or immovable property; provided that in the event of any claims of the Bank being in the opinion of the Bank endangered, the Bank may secure itself on any real property of the debtor or any other person liable and may acquire such property which shall, however, be resold as soon as practicable thereafter.[45] This provision has been modelled after a similar provision of the Bank Act.

The Bank may make no loans or advances without security nor may it accept deposits for a fixed term nor, as stated before, pay interest on any moneys deposited with the Bank. This is a common feature of central bank legislation. In this way central banks can secure working capital without cost.

Renewals of maturing bills of exchange, promissory notes, or other similar documents purchased or discounted or pledged to the Bank are forbidden excepting in so far as the Board may make regulations authorizing in special circumstances not more than one renewal of any such bill of exchange, promissory note, or other document.[46]

MANAGEMENT

It was provided that the Bank shall be under the management of a Board of Directors composed of a Governor, a Deputy Governor and seven directors.[47] An Assistant Deputy Governor is permissible under the Act, but not compulsory. The Act specifically states that the Assistant Deputy Governor shall not be a member of the Board. The permissive feature of the Act has been invoked and an Assistant Deputy Governor has been

[44] Ibid., Section 22 (b).
[45] Ibid., Section 22 (c).
[46] Ibid., Section 22 (f).
[47] The Bank of Canada Act Amendment Act, 1936, changed this provision to, "The Bank shall be under the management of a Board of Directors composed of a Governor, a Deputy Governor and directors elected or appointed in accordance with the provisions of this Act."

This provision was again changed by the Bank of Canada Act Amendment Act of 1938. The amended Act now states "The Bank shall be under the management of a Board of Directors composed of a Governor, a Deputy Governor and eleven directors appointed in accordance with the provisions of this Act."

appointed. The Deputy Minister of Finance is an *ex officio* member of the Board without the right to vote. In case of his absence or incapacity at any time, the Minister of Finance may nominate, for the time being, any other official of the Department of Finance.[48]

The Governor

The Governor and the Deputy Governor must be "men of proven financial experience". The Act provided that the first Governor, his deputy, and assistant deputy should be appointed by the Governor-in-Council for a term of seven years; thereafter they are to be appointed by the directors with the approval of the Governor-in-Council. These officers and the directors are eligible for reappointment at the expiration of their terms of office.

Persons Disqualified for Appointments

Under the Act the following are disqualified from appointment as Governor or Deputy Governor of the Bank: [49]

(a) A person who is not a British subject.

(b) A person who is a member of either House of Parliament or of a Provincial Legislature; or

(c) who is employed in any capacity in the public service of Canada or of any province of Canada or holds any office or position for which any salary or other remuneration is payable out of public funds; or

(d) is a director, officer, or employee of any other bank or financial institution or has any interest as a shareholder in any bank or other financial institution; or

(e) has reached the age of seventy-five years.

Powers of the Governor

The Governor is the chief executive officer of the Bank and has the direction and control of the Bank. He is clothed with

[48] Professor Dowrie in his book, *Money and Banking*, is of the opinion the Canadian Parliament fell into an error in making the Deputy Minister of Finance an *ex officio* member of the Board without a vote. He points out that the experience of the United States over a period of twenty years led Congress to drop both *ex officio* members from the Board of Governors. Professor Dowrie himself has fallen into an error and confused the term Minister with Deputy Minister. In any event the experience of Canada may be different. The writer believes it is a good thing for the Deputy Minister to be an *ex officio* member. He is a permanent Civil Servant and not a politician.

[49] Bank of Canada Act, Section 6 (2).

authority to act in connection with the conduct of the business of the Bank in all matters which are not by the Act or By-Laws of the Bank specifically reserved to be done by the Board or by the Executive Committee or by a meeting of the shareholders.[50] In the absence or incapacity of the Governor, the Deputy Governor may exercise all the powers and functions of the Governor. In the absence or incapacity of both the Governor and the Deputy Governor, the Board of Directors are required to authorize either the Assistant Deputy Governor or one of the members of the Board to act as Governor for the time being. The authority of such persons to act as Governor is limited to a period not exceeding a month without the approval of the Governor-in-Council.

Section 14 of the Act gives the Governor a large measure of control and places a heavy burden of executive responsibility upon him. This section provides "No action or decision of the Board of Directors, or of the Executive Committee, shall have any effect unless the same is concurred in by the Governor or in his absence or incapacity, by the Deputy Governor." [51]

DIRECTORS[52]

The Act provided that provisional directors consisting of the Deputy Minister of Finance and several other permanent officials

[50] Bank of Canada Act, Section 7 (1). The Bank of Canada Act Amendment Act of 1938 amended this section by deleting the words "or by a meeting of the shareholders" and substituting therefor "or by the Executive Committee".

[51] This section was amended by the Bank of Canada Act Amendment Act of 1936 and now reads: "14 (1) The Governor, or in the event of his absence or incapacity the Deputy Governor only, shall have power to veto any action or decision of the Board of Directors or of the Executive Committee, and if this veto power be exercised, the Governor or Deputy Governor, as the case may be, shall within seven days inform the Minister in writing of the circumstances and the Minister shall submit the veto to the Governor-in-Council who may confirm or disallow the veto.

(2) Any director or member of the Executive Committee may inform the Minister in writing of his view of the action or decision in question, which view shall also be transmitted to the Governor-in-Council".

[52] Under the Bank of Canada Act Amendment Act of 1936 under the terms of which the Bank was partially nationalized, provision was made for the appointment of six directors by the Government, each having two votes until 1940. Directors holding office at the date of the amendment were to hold office until the expiration of their several terms. Provision was made for private directors who would ultimately be three in number.

Under the Bank of Canada Act Amendment Act of 1938, which completely nationalized the Bank, provision was made for eleven directors appointed by the Government, in addition to the Governor and the Deputy Governor who are members of the Board.

of the Civil Service were to act until the first general meeting of the shareholders.[53] At that meeting directors were to be elected for varying terms, the terms to run as follows: One until the third annual general meeting, two until the fourth annual general meeting, two until the fifth annual general meeting and two until the sixth annual general meeting, respectively.[54] The by-laws determined the length of term of each director elected. The two receiving the most votes were to be elected for the longest term. The terms of the other directors were determined by the number of votes they received.

Each director must be the registered owner of ten shares of the capital stock. The directors are to be selected from diversified occupations. The by-laws provide that two directors must be chiefly occupied in primary industry, two in commerce or manufacturing, and three in occupations other than these. No person shall be eligible to be a director who is a director, officer or employee of a chartered bank.[55] Any person nominated for election as a director who is a shareholder of a chartered bank is required, if elected, to divest himself of ownership of his shares within three months of the date of his election. Thereafter during his term of office he must not have any interest, directly or indirectly, as a shareholder in a chartered bank.

The following persons are disqualified from holding office as directors of the Bank: [56]

(a) One who is not a British subject ordinarily resident in Canada;

(b) One who is employed in any capacity in the public service of Canada or of any province of Canada or holds any office or position for which any salary or other remuneration is payable out of public funds;[57] or

(c) has reached the age of seventy-five years.

If any director, in the opinion of the Board, becomes permanently incapacitated, he may be removed from office by resolution of the Board approved by the Governor-in-Council.

[53] Ibid., Section 9 (1).
[54] Ibid., Section 9 (2).
[55] Ibid., Section 10 (2).
[56] Ibid., Section 10 (3).
[57] The Bank of Canada Act Amendment Act of 1938 added "provided, however, that a director may perform temporary services for the Government of Canada or any province for which he may be reimbursed actual living and travelling expenses."

The by-laws require the Board of Directors to meet not less than four times a year, or more frequently if the Board so determines. The Board also meets when called together by the Governor. The members of the Board select a Chairman of the Board from among their number. Three directors and the Governor or his deputy constitute a quorum. The presiding officer, who is the Governor or the Deputy Governor in the absence of the Chairman, has a second or casting vote in the event of a tied vote. Any two directors may, by notice in writing, call a directors' meeting. At such meeting five directors constitute a quorum. In all directors' meetings a majority of votes is decisive.

Executive Committee

An Executive Committee of four is provided for under the Act. This Committee includes the Governor, Deputy Governor, a director selected by the Board, and the Deputy Minister of Finance, or, in case of his absence or incapacity at any time, such other officer of the Department of Finance as the Minister may nominate for the time being.[58] The Deputy Minister has no vote. When the Board is not in session the Committee has all its powers, but every decision of the Committee must be submitted to the Board at its next meeting.

Excepting when the Board is in session the Executive Committee has power to determine the minimum rates at which the Bank is prepared to discount or rediscount or to make advances.[59] These rates must be made public by the Bank at all times.

The by-laws require weekly meetings of the Executive Committee and authorize the Governor to call special meetings. Two members constitute a quorum.

Capital and Shares[60]

The Act provided that the Bank should have a capital of $5,000,000 divided into 100,000 shares with a par value of $50. Provision was made for increasing the capital by a resolution

[58] Bank of Canada Act, Section 13 (1) and (2).
[59] Ibid., Section 13 (4).
[60] Owing to the partial nationalization of the Bank of Canada in 1936 and the complete nationalization of the Bank in 1938 changes were made in the capitalization of the Bank and in the ownership of the shares. Changes were also made in Section 31 which deals with the Rest Fund. These changes will be described in Chapter X.

passed by the Board of Directors and ratified at a meeting of the shareholders, subject to the final approval of Parliament. The Minister of Finance was directed to offer the shares for public subscription, allotting them to persons eligible under the Act to hold shares in such manner as he might in his discretion determine, subject to the qualification that no shareholder might hold more than fifty and that they should be held only by British subjects ordinarily resident in Canada.[61] Chartered banks were prohibited from holding shares either directly or indirectly. The same prohibition was extended to directors, officers, clerks, and employees of such banks. In the event of any of the shares not being subscribed for by the public within a reasonable time the Minister was authorized to subscribe for such shares and pay for them out of the Consolidated Revenue Fund.[62] The Act required $12.50 per share to be paid at the time the application was filed and the balance within twelve months.[63] The liability of each shareholder was limited to the amount unpaid on the shares held.

Dividends, which were cumulative, were limited to four and one-half per centum per annum. Under the by-laws dividends might be paid half-yearly on the amount paid upon the stock.[64] In view of the fact that the Bank was in the nature of a quasi-governmental institution the rate appeared attractive.

Provision was made for the gradual creation of a rest fund by the allocation of surplus profits, one-third of which shall be applied for such purpose until the reserve equals the paid-up capital, and thereafter one-tenth until the reserve is twice the paid-up capital, so that an eventual rest fund of $10,000,000 will be established.[65] Surpluses over and above the amount to be set aside for the building up of a rest fund go to the Government. Thus in the early years of the Bank surplus profits are to be apportioned between the rest fund and the Dominion Government. When the rest fund reaches an amount equal to twice the paid-up capital, all surplus profits will then be paid to the

[61] Ibid., Section 17.

[62] Inasmuch as the capital was over-subscribed this provision was not invoked.

[63] Shares were offered to the public September 17, 1934, $12.50 payable on application and balance on January 2, 1935.

[64] Bank of Canada Act, Section 31.

[65] Ibid., Section 31. This section was amended in 1936 and again in 1938. The amendments will be dealt with in Chapter X.

Dominion. Thus, as far as possible, the profit motive has been eliminated.

Head Office and Agencies

The Act provided for the establishment of the head office of the Bank at Ottawa, the capital of the Dominion. The Bank may establish branches and agencies and appoint agents in Canada, and may also, with the approval of the Governor-in-Council establish branches and appoint agents elsewhere than in Canada. To date nine agencies have been established, all located in Canada at the following points: Calgary, Charlottetown, Halifax, Montreal, Regina, Saint John, Toronto, Vancouver, and Halifax.[66] Each province thus has an agency.

Meetings

Provision is made by the Act for the annual meeting of the shareholders on the last Tuesday of February in each year at the head office of the Bank.[67]

A special meeting of the shareholders may be called at any time by the Board on its own initiative or upon request in writing signed by not less than one hundred shareholders, holding not less than one thousand shares.

Voting[68]

Every shareholder is entitled to one vote for each share registered in his name for at least three months before the date of meeting. No person, other than the Minister, shall vote for more than fifty shares. Voting by ballot for the election of directors is required.[69] No person shall vote by proxy except that any shareholder may give to the Minister, in writing, instructions as to the manner in which he desires to vote on any business of the meeting. The Minister is then required to inform the scrutineers appointed at the meeting of the instructions so received and the scrutineers shall record the vote of such shareholder in accordance with the instructions so given.

[66] *Report of Bank of Canada*, February 3, 1937, p. 3.

[67] Bank of Canada Act, Section 36 (1 & 2). Owing to the nationalization of the Bank in 1938, this section was repealed.

[68] Since the nationalization of the Bank in 1938 private shareholders have been eliminated.

[69] Ibid., Section 36.

AUDIT

The Act provides the Government shall appoint two auditors, members of an incorporated institute of accountants, to act until the first annual meeting. Thereafter the auditors shall be appointed by the shareholders.[70] The Minister of Finance may from time to time require the auditors to report to him on the adequacy of the procedure adopted by the Bank for the protection of its creditors or shareholders and as to the sufficiency of their own procedure in auditing the affairs of the Bank. The Minister of Finance may, at his discretion, enlarge or extend the scope of the audit, or direct that any other procedure be established or that any other examination be made by the auditors or by the Inspector-General of Banks as the public interest may require.

RETURNS

Each week, as soon as practicable after the close of business, on Wednesday, the Bank is required to make up and to transmit to the Minister on a prescribed form a statement of its assets and liabilities as at the close of business on that day.[71] Publication of a copy of every such statement is required in the next succeeding issue of the *Canada Gazette*. On or before the seventh day of each month the Bank is required to make up and transmit to the Minister a statement of its assets and liabilities on the last day of the preceding month. Within six weeks after the close of each fiscal year, which is the calendar year, the Bank is required to transmit to the Minister of Finance a statement of its accounts for the fiscal year signed by the Governor, the Deputy Governor, and the chief accountant of the Bank and certified by the auditors, in the form prescribed by the by-laws of the Bank.[72]

A copy of the accounts so signed and certified shall be forthwith published in the *Canada Gazette,* and if Parliament is then

[70] Bank of Canada Act, Section 32 (2). Owing to the partial nationalization of the Bank in 1936 this section was repealed. Auditors are now appointed each year by the Governor-in-Council on recommendation by the Minister.

[71] Ibid., Section 33 (1).

[72] Ibid., Section 34 (2). This section was amended in 1936 providing for the signature of either the Governor, the Deputy Governor or the Assistant Deputy Governor and the Chief Accountant of the Bank. It was again amended in 1938 providing for the signature of the Governor or the Deputy Governor or the Assistant Deputy Governor and Chief Accountant or Acting Chief Accountant of the Bank and certified by the auditors.

sitting, shall within fourteen days after the receipt thereof by the Minister be laid before Parliament. If Parliament is not in session then it must be laid before Parliament within fourteen days after the commencement of the next ensuing session thereof.[73]

The Bank is required within sixty days after the end of each fiscal year to transmit to the Minister a list of the names, addresses, and descriptions of the shareholders of the Bank at the end of the year, and of the numbers of shares held by each shareholder. This list is then required to be laid before Parliament.[74]

PENALTIES

Penalties are provided by the Act for holding office in the Bank when ineligible, for verifying false statements, accounts, or lists or transmitting any false statement or for any contravention of the Act by any officer of the Bank or any officer of a chartered bank or any other person.

REPEAL OF THE FINANCE ACT AND DOMINION NOTES ACT

The establishment of the Bank of Canada necessitated the repeal of certain existing legislation.

Prior to the taking over of the Dominion note issue by the Bank of Canada when it opened on March 11, 1935, Dominion notes were issued under three statutory authorities: (1) The Dominion Notes Act (Statutes of 1934, C. 34) which required a gold reserve of 25 per cent. to be held against the first $120,000,000 of notes issued and full coverage against any issue in excess of that amount; (2) the Finance Act (Revised Statutes of Canada, 1927, C. 70) part II of which authorized the Minister of Finance to advance to any chartered bank or savings bank of Quebec, Dominion notes to any amount on pledge of approved securities deposited with the Minister; and (3) Chapter 4 of the Statutes of 1915, authorizing the Government to issue Dominion notes to the amount of $26,000,000 without gold coverage, but partly covered by the deposit of $16,000,000 of railway securities guaranteed by the Dominion Government.

On June 21, 1934, bills were passed providing for the repeal of the Finance Act and the 1915 statute, such repeal to become

[73] Bank of Canada Act, 1934, Section 34 (3).
[74] This section was repealed in 1938 when the Bank was nationalized.

effective when the Bank of Canada began operations. On June 26, 1934, an amendment to the Dominion Notes Act provided for the repeal of that Act when the Bank of Canada began operations.

In its broad outlines, the Bank of Canada resembles the Bank of England, the Bank of France, and the Reichsbank in that it is a single institution. It does not resemble the Federal Reserve System of the United States. The Bank of England served as the model of the framers of the Bank of Canada, but the builders created a distinctly Canadian institution. The Act of 1934 created a private corporation with an indeterminate charter holding a public trust. Private ownership was considered desirable by Parliament in order that the Bank should be free from political interference. The limited number of shares which anyone might hold was an attempt to avoid the danger of a controlling interest. The inclusion of the Deputy Minister without voting privilege on the Board of Directors was to provide a necessary link between the Bank and the Department of Finance and at the same time to avoid the possibility of political pressure.

Parliament has provided the Bank with ample machinery for a central banking business. It has unusually wide open-market powers and should be able to exert a substantial degree of control over credit in Canada.

CHAPTER IX

ORGANIZATION OF THE BANK OF CANADA

THE period which elapsed between the enactment of the statute on July 3, 1934, providing for the Bank of Canada and the actual establishment of the Bank as a going institution on March 11, 1935, was utilized in providing the proper personnel and necessary equipment for the management and operation of the Bank.

APPOINTMENT OF GOVERNOR AND DEPUTY GOVERNOR

Mr. Graham Towers,[1] a Canadian, a graduate with honours in Economics of McGill University, was selected by the Prime Minister, Mr. Bennett, as the first Governor of the Bank of Canada at a salary of $30,000 a year for a period of seven years. Mr. Towers, believed to be the world's youngest Governor, who was thirty-seven years of age at the time of his appointment, had had fourteen years of banking experience with the Royal Bank of Canada. He had joined the Royal Bank as economist; then after visiting and familiarizing himself with the branches of the Royal Bank in the British West Indies, he was sent to Cuba, where he became accountant for the Havana Branch in 1922, later acting as Assistant Inspector of Cuban Branches with headquarters at Havana. Subsequently, acting as Inspector in the Foreign Department he inspected the principal branches of the Bank in Central and South America, later inspecting the Bank's branches in London, Paris, and Barcelona. In 1929 he was appointed Chief Inspector, occupying himself principally with Canadian affairs of the Bank. In December, 1933, Mr. Towers was appointed Assistant General Manager of the Bank, which position he relinquished at the time of his appointment as Governor of the Bank of Canada.

Mr. Towers' appointment was highly pleasing to Canadians, particularly in view of the fact that Mr. Bennett had stated in

[1] The basis for the material on Mr. Towers is found in the *Journal of The Canadian Bankers' Association*, October, 1934.

the debates on the Bill that there was no one in Canada qualified for the appointment.

The Bank of England lent its Secretary, Mr. J. H. C. Osborne, to the Bank of Canada. Mr. Osborne was appointed Deputy Governor for a period of five years. It was arranged, however, that Mr. Osborne might return to England before the expiry of his term as Deputy Governor, if he could be conveniently released.[2]

Canada has had the benefit of Mr. Osborne's wide experience as a central banker during the period of organization and in the earlier stages of the operations of the Bank of Canada. Canada is greatly indebted to Governor Montagu Norman and the Court of Directors of the Bank of England for making available his services.

Allotment of Shares[3]

The subscription list, offering Bank of Canada stock at fifty dollars a share, was opened to the public on September 17th, 1934. Within forty-eight hours after the announcement of the offering the stock was over-subscribed, necessitating allotting the stock. Approximately 13,000 subscriptions for approximately 230,000 shares were received. Only 100,000 shares under the Act were available for sale. A large number of subscriptions were for the maximum number.

Allotments were made on the following basis:

Subscriptions of 7 shares or less, allotment in full; 8 to 10 shares, allotment of 7; 11 and 12 share subscriptions, 8; 13 and 14 share subscriptions, 9; 15 to 25 inclusive, 10; 26 to 30 inclusive, 11; 31 to 35 inclusive, 12; 36 to 40 inclusive, 13; 41 to 45 inclusive, 14; 46 to 50 share subscriptions, 15 shares.

The following table supplies in convenient form, by provinces, available information relative to the application for shares of the stock of the Bank of Canada.

[2] At a meeting of the Board of Directors held on September 12th, 1938, Mr. Osborne informed the Board that personal considerations required his return to England, and submitted his resignation to take effect on September 14th. The Board of Directors accepted the resignation and appointed Mr. Donald Gordon, who had been Secretary of the Bank since February, 1935, to the office of Deputy Governor for a period of seven years, commencing September 15th, 1938.

[3] The data used were taken from files of newspaper clippings kept by the *Financial Post*, Toronto, Canada.

TABLE OF APPLICATION FOR BANK OF CANADA SHARES
(Available 100,000 shares of $50 each)

PROVINCE	APPLICANTS	SHARES APPLIED FOR	SHARES PER APPLICANT
Ontario	5,315	108,348	20.4
Quebec	3,252	60,073	18.5
Manitoba	757	13,021	17.2
British Columbia	717	14,327	20.0
Saskatchewan	659	7,806	11.8
Nova Scotia	582	12,197	21.0
Alberta	419	6,590	15.7
New Brunswick	336	7,086	21.1
Prince Edward Island	62	1,415	22.8
Northwest Territories	1	20	20.0

TABLE OF ALLOTMENT OF BANK OF CANADA SHARES[4]

PROVINCE	NUMBER OF SHARES	NUMBER OF SHAREHOLDERS	AVERAGE NUMBER OF SHARES HELD
Prince Edward Island	601	64	9.4
Nova Scotia	5,109	580	8.8
New Brunswick	2,944	330	8.9
Quebec	25,962	3,340	7.8
Ontario	45,707	5,330	8.6
Manitoba	5,931	770	7.7
Saskatchewan	4,181	640	6.5
Alberta	3,116	410	7.6
British Columbia	6,385	730	8.7
Yukon	64	6	10.7
	100,000	12,200	8.2

Residents of Ontario and Quebec were allotted over 71 per cent. of the stock; 36.9 per cent. of the allotment of shares went to women.

No apparent reason existed why a shareholder should not increase his holdings over and above the original allotment up to a maximum allowed by the Act through purchases in the open market. Ultimately there might be fewer shareholders.

SHARES WIDELY HELD

As allotted, the shares were widely held by people in all walks of life. Many persons held but one share. Many of Canada's

[4] *Canada Gazette*, October 23, 1934.

most prominent citizens, however, made no application for stock. This was particularly true of Canada's foremost corporation executives since many of them are directors of the chartered banks. This constituted, it appears, one of the weaknesses of the Act. It deprived the Bank of Canada of the possibility of securing some of the ablest men of the county. While there was nothing, apparently, to prevent the Government, under the Amendment of 1936, from appointing some of these men as representatives, they must rid themselves of any interests in the Bank's stock.

Limited Number of Corporations Holding Bank of Canada Shares

The by-laws stated that only corporations controlled by British subjects ordinarily resident in Canada might own stock. This qualification definitely limited the number of corporations which might hold stock in the central bank. Some of the most important corporations of Canada were thus excluded. These included the Canadian Pacific Railway, International Nickel, Anglo-Canadian Pulp, Aluminum Company of Canada, Imperial Oil, Canadian General Electric, Hudson Bay Company, Imperial Tobacco Company of Canada, Goodyear Tire, General Motors Corporation, Ford Motor Company of Canada, Gatineau Power, and many other companies.

The shares of the Bank of Canada were traded on a fully paid basis on the Montreal Stock Exchange after December 31, 1934.

Provisional Directorate

Until the Board of Directors was elected by the shareholders, the Bank operated under a provisional directorate of Civil Servants under the Chairmanship of the Deputy Minister, Dr. W. C. Clarke.

The method of nomination and election of directors was prescribed in the by-laws.

Provisions of By-Laws relating to the Election of Directors

The by-laws provided that in the case of the nomination and election of Directors:

1. Not less than ten weeks before the General Meeting of shareholders at which directors were to be elected, a nomination paper in a prescribed form was required to be sent by post to every shareholder.
2. Every nomination of a director was required to be signed by one or more shareholders and delivered to the Bank not less than seven weeks before the General Meeting at which directors were to be elected.
3. A meeting of the Board was required to be held at least six weeks prior to the General Meeting at which directors were to be elected for the purpose of determining what persons were validly nominated.

The by-laws further provided that in the case of the First General Meeting of the shareholders instructions should be printed on the ballots requiring the shareholders to select directors from diversified occupations in the following manner: two directors whose chief occupation was a primary industry, two directors whose chief occupation was in commerce or manufacturing, and three directors whose occupation was other than in primary industry, manufacturing, or commerce. The by-laws provided that the two directors receiving the largest number of votes should hold office for five years, the next two for four years, the next two for a period of three years and the one receiving the smallest vote for a period of two years. Thereafter all directors were to be elected for a period of five years and were to be eligible for re-election.

The by-laws relating to the selection of directors were vague in that they provided no definition as to the meaning of the term primary industry. For example, would the President of a copper company, if he devoted all his time to the corporation, qualify as a primary producer? Apparently he would.

Method of Electing Directors Unsatisfactory

One of the weaknesses in the set-up of the Bank of Canada was the method of selecting directors.

The Act placed on the shareholders an exceedingly difficult, if not impossible task of selecting seven directors from an unorganized group of over 12,000 shareholders scattered throughout Canada. Moreover, these shareholders were directed to select directors from diversified occupations, and while the Act did not so state it was essential in the national interest that

they should also be reasonably representative of the various geographic sections of the country as well as the two chief racial groups. The election arrangements were so haphazard that the Government let it be known that it would welcome the sponsorship of candidates by trade and vocational associations. As a result the Canadian Chamber of Commerce, an organized business group, intervened in the election and submitted a slate of nominees bearing its recommendation. The entire slate of the Chamber of Commerce was elected. Fortunately every economic area of Canada was represented on the list submitted by the Chamber of Commerce. In the face of a difficult situation the organization did the country a real service.

One director was elected from the Maritime Provinces, two from Quebec, one a French Canadian, two from Ontario, one from the Prairie Provinces, and one from British Columbia.

First General Meeting of Shareholders

Notice of the first General Meeting of the shareholders was sent out December 14, 1934, calling for a meeting of the shareholders on Wednesday, January 23, 1935, at the Chateau Laurier, Ottawa. The chief business of the meeting was the determination of what persons had been validly elected directors of the Bank, and the amount of the directors' fees.

Directors Elected

The following were duly declared elected for the terms indicated.

Director	Occupation	Residence	Term
Joseph Beaubien	Mayor	Outremont, Quebec	3 years
William Duncan Black	Manufacturer	Hamilton, Ontario	4 "
Thomas Bradshaw	Insurance Executive	Toronto, Ontario	5 "
Robert James Magor	Manufacturer	Montreal, Quebec	3 "
William Kirk McKean	Lumberman	Halifax, Nova Scotia	4 "
William C. Woodward	Accountant	Vancouver, B.C.	2 "
Robert Allen Wright	Farmer	Drinkwater, Sask.	5 "

Directors' Fees

Directors' fees were fixed at one hundred and fifty dollars and expenses per man per meeting.

Head Office

The Head Office of the Bank was established in the Victoria Building, opposite the Parliament Buildings in Ottawa.

By-Laws

By-laws of the Bank of Canada were passed by the Board of Directors of the Bank of Canada at a meeting held on March 5th, 1935. These by-laws were substituted for the by-laws previously made by the Governor-in-Council. The by-laws as finally adopted by the Board were published in the "Extra" of the *Canada Gazette* issued on March 11, 1935.

Notes

The Governor-in-Council pursuant to subsection 3 of Section 24 of the Bank of Canada Act, on the recommendation of the Minister of Finance, under the authority above cited, ordered that the following shall be the denomination of the notes of the Bank of Canada: $1, $2, $5, $10, $20, $50, $100, $500, $1,000.

Provisions were made for the issuance of a note of the denomination of $25 to be issued in commemoration of the twenty-fifth anniversary of the accession to the Throne of his Gracious Majesty King George V.[5]

These notes are more colourful and artistic and considerably smaller in size than the old Dominion notes which they replaced. The chartered banks issued new notes, reducing the size to conform to the dimensions of the notes of the central bank. These notes are 6 x 2⅞ inches, about ¼ of an inch shorter and 3/16 of an inch wider than the Federal Reserve Notes issued in the United States. Bilingual notes were not issued by the Bank of Canada, the notes being printed in either English or in French.

Controversy on the Surrender of Gold by the Chartered Banks

Considerable controversy arose over Sections 29 and 30 of the Bank of Canada Act which relate to the valuation of gold and the transference of the gold held by the chartered banks to the new central bank. Section 28 required every chartered bank to transfer to the Bank of Canada on the day it should be authorized to commence business, all gold coin or bullion owned and held in Canada. Section 29 provided that the value of such gold should be computed on the basis established by the Currency Act at the date of the relevant transaction. In the absence of any amendment to the Currency Act it appeared that the banks would

[5] *Canada Gazette*, March 11, 1935.

receive for their gold the standard price of $20.67 per fine ounce, although the Canadian Government was purchasing freshly mined gold at $35 an ounce.

Under Section 20 of the Act profits arising from the sale of gold or from any revaluation of gold were to go to the Government of Canada. A proviso was added to the effect that the profit on gold held by a chartered bank against its foreign liabilities should belong to that bank, when the Governor-in-Council was satisfied that the gold was so held.

The banks naturally protested strenuously against this proposal to expropriate their gold without adequate compensation based on the world price of that commodity. Through their acting president, Mr. S. H. Logan, the Canadian Bankers' Association submitted a brief to the Select Standing Committee on Banking and Commerce of the House of Commons on May 31, 1934, commenting on the provisions of the Bill requiring surrender to the Bank of Canada of the gold held in Canada by the chartered banks.[6]

Mr. Logan in presenting the representations of the bankers asked the Committee to consider the part played by gold in the Canadian banking structure during the pre-war days and to contrast that situation with the one which exists at the present time.

The bankers stated that before 1914 gold holdings in Canada by the chartered banks were an important factor in strengthening them against any domestic emergency. There was little demand for gold coins by the public and the amount in general circulation was comparatively small, but it had become traditional for Canadians to judge the strength and stability of the individual bank by the amount of gold which it held. A much more vital matter, however, from the banker's point of view was that if his supply of Dominion notes became depleted he could secure from the Minister of Finance the additional notes required to re-establish these essential cash reserves only in exchange for his gold.

Apart, of course, from the domestic situation, the banker's gold, whether held at home or abroad, was, under gold standard conditions, a form of international currency, good everywhere,

[6] *Minutes of the Proceedings of the Select Standing Committee on Banking and Commerce,* 1934, p. 897.

and available to meet a banking emergency in any part of the world where he had undertaken transactions.

The brief pointed out that when war broke out and the Finance Act was passed the situation in Canada was fundamentally changed. It was no longer necessary for a bank to purchase Dominion notes with its gold, for the supplies requisite to maintain its Canadian cash reserves could be borrowed from the Minister of Finance against approved security. Gold holdings by a bank in the Dominion to protect its domestic position became, therefore, entirely unnecessary, except for their psychological effect on the public mind. They remained, however (as the only form of international currency), just as important as before to safeguard a bank in the foreign transactions which it undertook, for, though a general prohibition was in force against gold export without official authority, it was clear that such authority would not be withheld if the circumstances warranted a relaxation of the regulations.

It was explained that the commitments of Canadian banks abroad are by no means confined to those banks which have established branches in other countries, nor can they be measured solely by the amount of the deposit and other liabilities of such foreign branches. While liabilities of this nature are in some cases substantial they are well safeguarded by local reserves adequate to cope with any minor disturbances, and these reserves in turn can be reinforced from the general reserves (including gold holdings) carried by the banks in Canada and in the great financial centres.

General reserves, in addition to their value for reinforcing local foreign branch reserves, are also very necessary in connection with the purchase or sale by a bank of foreign bills arising from the export and import trades, from the ebb and flow of international transactions in securities, and from other normal capital movements.

The Committee was told that when a bank purchases an item drawn in any foreign currency it hedges the transaction at once by a sale of an equal amount in the same currency. The time it will take to despatch the bill purchased to the country upon which it is drawn and the approximate date, therefore, upon which the bank will come into actual possession of the foreign currency in question is carefully calculated. The date upon which the bank

agrees to deliver the amount of that currency which it sells as a hedge is set to coincide as closely as possible with that upon which it will present and receive payment for the bill it has purchased. Some leeway in the exact coincidence of these dates is given through the balances maintained by the bank with its correspondent in the country concerned, but for obvious reasons balances sufficient to guard against every possible emergency cannot be carried in each country with which the bank may at some time be called upon to put through transactions.

The Association pointed out that emergencies may arise when the shipment of goods covered by the bill which the bank has purchased may go astray or some import embargo or quota regulation may come into force without notice which delays or prevents their arrival, and the drawee may refuse to pay the item until the goods are delivered. The bank in consequence does not receive the sum in the foreign currency at the time expected, yet it is under contract to deliver promptly on the date agreed the equal amount in that currency which it has sold as a hedge. The bank cannot ask for an extension of time; it must meet its obligations without hesitation or delay on the day they fall due or it is branded as in default.

To provide the foreign currency required under such circumstances the bank as a first step will attempt to buy the necessary amount of that currency in the Canadian market or in London or New York. If it can find no sellers, if it is unable to fill its requirements because of some exchange quota restriction, or if it is offered the currency only at an exorbitant premium which will involve it in heavy loss, the bank will then ship its gold.

Exactly the same process would be followed, Mr. Logan explained, if a general panic arose in any foreign country where a Canadian bank was established and it became necessary in consequence to reinforce the bank's local cash reserves at that point.

Mr. Logan stated it should be realized by Parliament that the gold holdings of a bank, whether carried in Canada or elsewhere, are really an insurance fund against the payment of excessive exchange rates. The fund is used only to control the cost of the transfer of funds to other countries when the need is urgent for the bank's protection. These gold holdings have never been

used for speculative operations but were accumulated and have been maintained as a true emergency reserve against legitimate banking transactions.

Turning to the provisions of the Bill it was explained that upon the transfer of the gold of the chartered banks to the Bank of Canada at its statutory price, the banks would receive in exchange Bank of Canada paper dollars, or their equivalent in the form of a deposit in that Bank. This would be excellent money in so far as Canadian operations of the banks were concerned, but these dollars would have no stable value in any other country. Perhaps at the time of the transfer pounds sterling could be bought in Canada at $5 each to protect the banks' sterling commitments. It is quite conceivable, however, that at some later date the banks might have to pay $6 or more for the pound. The same situation might arise with any other currency which was required in an emergency. It might be necessary to pay a premium of 10, 20, or 30 per cent. to secure the necessary amount. The banks would be exposed, therefore, by the surrender of their gold to the risk of very substantial exchange losses, because they would be deprived of the means by which they could protect themselves.

The bankers claimed that since the War all the gold owned by the banks could honestly be said to have been held solely against liabilities outside Canada. While the banks recognized the liabilities were purely contingent, they might be required to cover them at any time.

Mr. Logan stated that he felt that it was grossly inequitable for the Government to say to one class of the community—the gold mines—"we will pay you the market price for your gold less certain deductions" and to another class—the banks—"we will pay you only four-sevenths of the market value of your gold because it happens to be in the form of coin." He pointed out that the world markets made no such distinction and the banks' gold was as much the property of their shareholders as the gold dug from a mine was the property of the shareholders of the mining company.

In presenting the case for the Canadian chartered banks, Mr. Logan stated that an impression appeared to exist in the country that if Canada commandeered from the banks their gold without payment of the existing premium she would be merely following a precedent established in several other countries.

He explained that such was not the case and told the Committee that in Australia the gold sovereign, the Australian pound and the pound sterling were at an approximate parity when the Commonwealth Bank took over two-thirds of the gold held by the commercial banks. Those banks received, therefore, substantially the ruling price for the gold they surrendered and retained the balance of their holdings to do with as they saw fit.

Referring to the United States, Mr. Logan stated that gold was taken from the commercial banks under conditions somewhat similar to those which had prevailed in Australia. When the commercial banks in the United States were required in the spring of 1933 to surrender to the Federal Reserve Banks the gold which they held, there was no premium in the world markets on gold over the United States dollar. Moreover, the proportion of total gold in the United States held by the commercial banks was small in comparison with the vast sums in gold already in possession of the Federal Reserve Banks. This gold had been acquired by these banks over a long period. When the revaluation of gold in the United States was made in 1934 most of the profit which accrued to the United States Government was derived, therefore, from gold which was and had been for some years the property of the Government, and was held by the Federal Reserve Banks as agents of the Government.

Mr. Logan felt that the action taken by New Zealand was more nearly comparable to that proposed in Canada but even there the statutory requirements as to gold holdings by the banks were not parallel to Canadian legal requirements.

The chartered banks protested strongly against the forced transfer of gold from the chartered banks at a figure far below that at which it was valued in the world markets, instead of at a price reflecting the ruling premium. They contended that if the Government considered this gold was necessary for the successful operation of the Bank of Canada the Government should buy it at its fair market value, as was being done in the case of gold from the mines.

The bankers in their brief to the Committee expressed the view that the great majority of Canadians believed in private property and the sanctity of the rights of property holders. While the Government might by statutory enactment compel the banks to surrender their gold without proper compensation it

would not appeal to the common man as a fair and equitable arrangement. Moreover, such a public disregard for property rights could not but have an unfavourable reaction upon the observance and performance of ordinary obligations between individuals.

The brief of the Canadian Bankers' Association may be briefly summarized. It attempted to establish six main points:

1. That "since the war all the gold owned by the banks may honestly be said to be held solely against the liabilities outside of Canada."
2. That such gold was "really an insurance fund against the payment of excessive exchange rates."
3. That under the terms of the Bank of Canada Bill it was doubtful if the banks would receive any profit on any of the gold transferred to the Bank of Canada because of (a) the impossibility of determining the amount held against foreign liabilities; (b) the fact that the premium on gold might disappear before final settlement was made.
4. That it was inequitable to deprive banks of the premium on gold while allowing the gold mines to obtain the world price for their current product.
5. That the practice of other countries provided no precedent for the action contemplated by Canada.
6. That the proposed action constituted an unjust infringement of the rights of private property and would be unfavourably regarded by the majority of the people of Canada.

The Government's reply was made by the Deputy Minister of Finance, who, in conclusion, defended the proposal by the following four major arguments:

"1. The gold now held by the chartered banks against their domestic liabilities was acquired by them as a counterpart to the essentially national function of issuing currency. The chartered banks have been given by the Parliament of this country an important franchise; that franchise gave them, first, the right to issue notes to circulate as currency which is usually regarded as a prerogative of the State alone, and, secondly, the right to circulate their own credit by means of cheques drawn against deposits and to carry on all the ordinary operations of commercial banking. It is universally recognized that the exercise of these privileges involves the obligations of maintaining cash reserves (in the form of gold and other legal tender) against the liabilities assumed. In most countries the banking laws stipulate a definite minimum percentage of gold (or of gold and gold exchange or other

legal tender) that must be held against either notes or deposits outstanding, or against both note and deposit liabilities. In Canada Parliament has seen fit to leave the exact proportion of cash reserves to be carried to the good judgment of the banks themselves and in doing so has accepted an argument which has been strongly pressed by our bankers throughout our entire banking history.

"It should be clear, therefore, that the gold which the banks hold was acquired by them in order to ensure their ability to discharge their obligations to the public. It was not bought as an ordinary investment and no speculative profit could legitimately have been anticipated. The argument therefore that the Government's decision to take over the banks' gold reserves at the statutory price which was paid for it involves confiscation of the property rights and suggests that such confiscation might be extended to other bank assets is entirely beside the point.

"2. The national aspect of the banks' gold holdings was recognized and emphasized by the prohibition of the export of such gold without a license imposed by the Order-in-Council of October, 1931. This order is still in effect and as a result the banks are still unable to export their gold and secure a profit thereon, without a license from the Minister of Finance.

"3. The profit on the gold now held by the banks is a fortuitous one. It does not arise out of the operations of commercial banking. It is the result of a national and international situation from which the banks have no reason to expect any profit. In this connection it is not sufficient to say that it is the result of the currency action and financial policy of other countries, especially England's departure from the gold standard and the revaluation of gold by the United States. If Canada had not seen fit to break away from the gold standard by the prohibition of gold export and the suspension of specie payments, in other words, if Canada had been willing and able to stay at the old parity, there would today be no premium on gold in terms of Canadian currency. The premium that now exists results from Canadian monetary policy applied in the face of a serious World situation.

"The premium on gold in comparison with the mint par value is the measure of the depreciation in the value of our currency. This depreciation has been at the expense of the people and not at the expense of the banks. It follows that any profit on gold reserves arising out of monetary policy should accrue to the State, representing the people as a whole.

"4. The functions for which the banks were formerly responsible of issuing part of the note currency of the country and of maintaining part of our national gold reserves are in future to be assumed by the State through the medium of the

quasi-public institution, the Bank of Canada. In order not to affect unduly the profits of the banks, the transfer of their note-issuing powers to the central bank is to be spread over a period of time, but the centralization of the country's gold reserves is to be accomplished immediately. Such centralization is a *sine qua non* of the effective working of a central bank. If it is true that a no-man's-land of responsibility has existed in the past in the handling of our national gold reserves, that uncertainty must, forever, be ended. The responsibility must be placed squarely upon the shoulders of a single institution and that institution must have the prerogatives that go with that responsibility."

In reply to the Deputy Minister of Finance, Mr. Logan stated that neither before the War nor at any time since had the holder of a bank note or any depositor the right to demand payment in gold of the bank's obligation on its notes or its indebtedness to its depositors. The prohibition of export of gold, therefore, had no application whatever to the holding of gold by the banks.

He referred to the fact that the most prominent financial journal in London, the *Economist,* condemned the course proposed to be taken by New Zealand in respect of the gold held by the commercial banks in excess of that part of their gold holdings required by statute to be held against their note issues, and stated that the full market price should be paid for such gold.

In reply to the statement of the Deputy Minister of Finance that many other countries had adopted the course proposed to be followed by Canada in taking over the gold from the commercial banks at nominal par and not at market value Mr. Logan stated this view was evidently based upon the argument of The Honourable Mr. Coates, who stated that action similar to that proposed by his Government had been taken by certain other countries. While it was probably true that in the cases named by him these governments took the profits upon the gold held by their central banks, it was not stated such governments took the profit in like manner on gold acquired from the commercial banks.

Mr. Logan pointed out in proof of his contentions that in France when the gold holdings were transferred from the commercial banks to the Bank of France in 1928, the commercial banks received the full premium of about 400 per cent. Similarly in Belgium, the commercial banks received in 1926 the full premium of about 500 per cent. upon the transfer of their gold to the National Bank of Belgium. In Italy in 1926, when the

banks of Naples and Sicily surrendered their note-issuing privilege to the Bank of Italy, and transferred to it their statutory reserves of gold and foreign exchange, they were paid in full the ruling gold premium of about 400 per cent.

The fact that the three leading countries named, upon investigation are found to have done the exact opposite of what Mr. Coates said and implied that they did, should dispose of the whole fabric of argument based upon the New Zealand case and upon Mr. Coates' allegations.

The presentation of these views evoked some sympathetic statements from members of the Committee including supporters of the Government and of the Opposition. An amendment proposed by one of the latter, that the value of the gold be computed on the basis "of the current market value at the date of the relevant transactions" was, however, lost. The sections were then adopted.

There was no discussion in the House of Commons or in the Senate upon the failure to provide for compensation to the banks for their gold upon the basis of its market value.

The controversy had not been settled by the date when the Bank of Canada was authorized to commence business March 11, 1935. On that day the banks transferred their gold to the Bank of Canada, the value, at $20.67 per fine ounce, being about $37.5 millions. Had the gold not been so transferred on that day the provisions of subsection 2 of Section 28 would have enabled the Governor-in-Council to pass a special order directing the banks to turn over their gold, failing which severe penalties might have been imposed. In the United States the corresponding statute expressly provided that the penalty for failing to surrender gold to the Government was to be a sum twice the value of the gold withheld. The chartered banks chose to comply with the statute and to continue to negotiate for the best terms possible.

There was considerable interest in the probable action of the Government under the proviso to Section 30 of the Act. The banks were in a position to argue strongly that all of their gold was held against their foreign liabilities. In the monthly return of the chartered banks for February 28, 1935, gold and other coin held in Canada was $39,463,300 and abroad was $11,650,470, while foreign liabilities, comprising roughly deposits abroad and amounts due to banks and banking correspondents abroad,

amounted to about $355 millions, apart from the contingent liabilities against which the gold was held.

In discussing this proviso in the House of Commons on the 25th of June, 1934, the Prime Minister said, in part:

> "The honourable member for Vancouver Centre has directed attention to the difficulty that will arise in making a division under this clause of profits resulting from the sale by the Bank of gold coin and bullion transferred to it pursuant to the provisions of clauses 25 and 28. I do not for a minute minimize the difficulty, but to state in this bill an exact figure would be unfair to this Bank as it would be unfair to the chartered banks . . . I appreciate that this places upon the Governor-in-Council a substantial responsibility, but it is one that must be taken with respect to many of these matters. I should say, speaking antecedent to the occasion arising, it must be the subject matter of discussion, agreement, and arrangement based upon such expert knowledge applied to the facts as will enable a reasonable disposition to be made of the matter in the light of the monetary value attaching to the external liabilities in terms of gold. That is all that can reasonably be said about the matter."

An Order-in-Council dated April 29, 1935, dealing with this matter was tabled in the House of Commons.[7] After referring to the amounts of gold transferred by the respective banks to the Bank of Canada, totalling over $37 millions, the Order quoted from the proviso respecting the payment to the banks of the profit on that part of the gold which the Governor-in-Council was satisfied was held against liabilities outside of Canada. The Order then proceeded as follows:

> " . . . It is therefore necessary for the Governor-in-Council to reach a decision as to the proportion of the total amount of gold coin and bullion transferred to the Bank of Canada by the chartered banks which was at the time of the transfer being held against liabilities elsewhere than in Canada.
>
> "The chartered banks have made representations to the effect that all, or substantially all, of their gold was at the time of the transfer held against liabilities elsewhere than in Canada. In general, they point out that with the monetary instability which has prevailed and the continued threat of wide exchange fluctuations, manifold risks and the possibility of losses are ever present in conducting foreign business; that if any major crisis occurred abroad the liquid assets which

[7] P.C. 1110, submitted by the Prime Minister, Mr. Bennett, in the House of Commons, *Debates, House of Commons, Dominion of Canada, 1935*, pp. 3730, 3731.

they held elsewhere than in Canada against foreign liabilities were likely to be immobilized, particularly as the foreign branches of Canadian banks have no right of rediscount with any central bank in any foreign country; and that all their gold had always been regarded and treated as a mobile reserve, free for transfer abroad either for the general protection of the bank's foreign liabilities or for use in the event of any specific emergency which rendered it expedient to ship gold.

"In the opinion of the Minister of Finance, having in mind the traditional requirements of prudent banking and the necessity of maintaining adequate cash reserves against domestic liabilities, the general contention of the banks that all their gold owned and held in Canada was at the time of the transfer being held against liabilities elsewhere than in Canada cannot be successfully maintained. Moreover, a careful examination of the data showing domestic and foreign liabilities as well as cash, quick and liquid assets both in Canada and elsewhere of the various chartered banks discloses no precise basis on which the gold held in Canada may be allocated against domestic and foreign liabilities respectively. Nevertheless, it is apparent that in view of the greater risks arising out of foreign liabilities, the inability of our Canadian banks to rediscount liquid assets with foreign central banks and the necessity of relying upon gold as the only satisfactory mobile reserve, a substantial proportion of the gold owned and held by the chartered banks in Canada can reasonably be regarded as being held at the time of transfer against liabilities elsewhere in Canada.

"AND WHEREAS, detailed examination of the available information in regard to the domestic and foreign liabilities and reserves of the various chartered banks has been made;

"THEREFORE, in view of the foregoing, His Excellency the Governor-General-in-Council, on the recommendation of the Minister of Finance, is pleased to decide and doth hereby decide and order that forty per cent. of the gold owned and held in Canada by the various chartered banks and transferred by them to the Bank of Canada, as set out above, be regarded, for the purposes of Section 30 of the Bank of Canada Act, as being held at the time of transfer against liabilities elsewhere than in Canada."

Gold Holdings Transferred by Chartered Banks

The chartered banks transferred to the Bank of Canada gold owned and held by them in Canada in the following amounts:[8]

[8] Report submitted by the Prime Minister, Mr. Bennett, in the *Debates, House of Commons, Dominion of Canada, 1935*, p. 3731.

Barclay's Bank (Canada)	$ 10,482.23
The Canadian Bank of Commerce	13,182,326.17
The Dominion Bank	804,495.53
The Imperial Bank of Canada	218,220.98
Bank of Montreal	13,043,245.93
Banque Canadienne National	419,002.56
The Bank of Nova Scotia	6,546,338.19
La Banque Provinciale du Canada	40,350.86
The Royal Bank of Canada	2,382,087.24
The Bank of Toronto	833,854.17

The Governor of the Bank of Canada reported at the First Annual General Meeting of the shareholders of the Bank of Canada that $37,128,916 in gold valued at $20.67 per ounce was received from the chartered banks. He stated that as a result of the determination of the Governor-in-Council that 40 per cent. of the gold held by the chartered banks was deemed to have been held against liabilities elsewhere than in Canada, the chartered banks received $10,475,114 profit on the basis of the valuation of gold at $35 per ounce on 40 per cent. of their holdings.

The Exchange Fund

In 1935 Parliament enacted the Exchange Fund Act which went into effect on July 5 of that year. This Act required the Bank of Canada to revalue the gold it held at the current market price. The Bank was then required to credit the profit on its gold holdings to a special account, the Exchange Fund, which is held in the name of the Minister of Finance. The Act creating the fund authorizes the Minister to utilize the funds in that account "for the purpose of endeavouring to control the external value of the Canadian monetary unit or of checking undue fluctuations in its exchange value".

After revaluing the $106,584,355 in gold which the Bank of Canada received from the Dominion Government and the chartered banks and after allowing $10,475,114 profit to the chartered banks, as determined by the Governor-in-Council, the Bank of Canada credited $63,006,382 to the Exchange Fund in 1935. Future profits or losses on gold held by the Bank will be credited or debited to that account.

So far the Exchange Fund has not been used in any attempt to influence the external value of the Canadian dollar. Whether

it will ever be used is another matter. When the establishment of the Fund was being debated in Parliament considerable scepticism was exhibited by many members as to what the Fund could possibly accomplish in view of the size of such funds maintained by Great Britain and the United States. Many felt that Canada had too few "chips" to sit in at the game with the other nations. The Fund may be regarded as a potential weapon which may or may not be used. Its effectiveness will depend on the skill with which it is used. In view of the volume of Canada's foreign trade it is probably much too small to be of any great value at present.

CHAPTER X

BANK OF CANADA ACT AMENDMENT ACTS, 1936 AND 1938

DURING the course of the debates in the House and the discussion in the Select Standing Committee on Banking and Commerce in 1934, the Liberals had stood for a greater measure of control by Parliament over the Bank of Canada. As they were not in the majority their views had not prevailed. Again in 1935 they pressed for more control. The Liberal leader, Mr. King, spoke with great emphasis as to the importance of allowing the Government to have some control over the Bank.

GOVERNMENT CONTROL AN ELECTION ISSUE IN 1935

The demand for more governmental control over the Bank was made one of the election issues in the Dominion elections in the fall of 1935. One of the important planks in the platform of the Liberal party called for a "Nationalized Central Bank". The Liberals defeated the Conservatives by a record majority and late in the next session of Parliament in 1936, on June 1, Mr. Dunning, the Minister of Finance, to implement the party pledge, moved that the House go into Committee to consider the following resolution:[1]

> "That it is expedient to bring in a measure to amend the Bank of Canada Act so as to increase the stock of the Bank, to provide that certain shares thereof shall be purchased by the Minister of Finance out of the Consolidated Revenue Fund in order to assure ownership of a majority of the shares by the Government, to increase the number of directors, and to provide for election and appointment of directors in such manner as to assure voting control of the board of directors appointed by the Government."

PROPOSED AMENDMENTS

The resolution sought authority to introduce a bill to implement the announcement from the Throne that Parliament would

[1] *Debates, House of Commons, Dominion of Canada, 1936*, p. 3531.

be asked to make such changes in the ownership and control of the Bank of Canada as might be necessary to give the Government a predominant interest in the ownership as well as the effective control of the Bank.

The Government proposed to make two important and significant changes in the constitution of the Bank of Canada. These changes were:[2] first, the issue of an additional $5,100,000 of capital stock of the Bank, to be purchased by the Minister of Finance and held by him on behalf of the Dominion of Canada. This was to insure a predominance of public ownership in the shares of the Bank. Second, the appointment by the Government of additional directors with sufficient voting power to give the Government a majority control of the board of directors both immediately and permanently. The Government proposed to make other changes of lesser importance. Most of these were consequent upon changes in the capital stock and in the directorate. Certain amendments were contemplated to clear up ambiguities in the Bank of Canada Act and to provide for changes which experience had shown to be desirable. The Minister called special attention to another proposed amendment providing that Bank of Canada notes should be bilingual in the future.

The proposed Bill would enable the Government to appoint four additional directors, each of whom would have two votes. This would give the public a majority of the Board of Directors. The directorate would be altered gradually without disturbing the terms of the present directors who had been given varying terms. After 1940 the directorate would consist of three representatives appointed by the shareholders, four appointed by the Government and two government-appointed officers of the Bank, namely, the Governor and the Deputy Governor. No change was contemplated relative to the Deputy Minister of Finance who holds a watching seat on the directorate. The authority of the Governor to veto decisions of the Board of Directors would be retained, but the federal government would have power to disallow such vetoes.

By the terms of the Bill, Mr. Dunning stated, the relative voting strength on the Board in each of the immediate succeeding years would be,[3]

[2] Ibid., p. 3532.
[3] Ibid., p. 3541.

	GOVERNMENT	PRIVATE SHAREHOLDERS
1936-1937	10	7
1937-1938	10	7
1938-1939	10	6
1939-1940	10	4
1940-1941 and thereafter	6	3

It will be noted the figures of the Government included up to 1940 four directors with dual votes plus the votes of the Governor and the Deputy Governor.

REASONS FOR AMENDMENTS

The factors which Mr. Dunning stated had led the Government to propose amendments to the constitution of the Bank providing for a dominant interest by the public in ownership and also voting control of the Bank may be summarized as follows:

(1) The primary function of a central bank is to regulate the volume of currency and credit in use, and this is so vital a national function that it should not be left to the control of private interests. The issue of currency has always been a prerogative of the Crown.

(2) It is inappropriate for a Government to leave to a privately controlled institution the stabilization functions contemplated by the preamble of the Act. The preamble of the Act contemplated that the Bank of Canada shall, by appropriate mechanisms—chiefly open market operations and manipulation of the rediscount rate—set influences at work which will tend at times to expand credit and at other times to contract credit, with a view to securing a greater degree of stability in the level of production, trade and employment. This Mr. Dunning considered too vital a function to leave in the hands of a privately controlled institution.

(3) Too much importance had been attached to the fact that central banks like the Bank of England and the Bank of France are privately owned. This fact may be explained by historical circumstances which are no longer relevant.

Mr. Dunning stated he considered the matter of public ownership much less important than that of governmental control.

DEBATES ON THE RESOLUTION PROPOSING AMENDMENTS

Two days of debate took place on the resolution before the Bill was introduced and given its first reading. The debate was along party lines. Three points of view were expressed.

(1) That represented by Mr. G. G. McGeer, Vancouver, wanted the central bank with all its functions nationalized.

(2) A more moderate view, proposed by the Minister of Finance, Mr. Dunning, of nothing more than voting control of the Bank by government majority stock ownership, and the power that goes with it of appointing the Governor and of electing the majority of the directors.

(3) The view that the Bank should remain a private institution under control of the shareholders who elect their own directors.

The C.C.F. supported the first view, the Liberals the middle view, and the Conservatives who had been in power when the Bank Act of 1934 was passed supported the third view.

At times the debate was extremely warm. The Conservatives accused the Liberals of being in favour of absolute public ownership while in opposition and during the election campaign and then in favour of a compromise when in power. The fact is that Mr. King, the Liberal leader and Prime Minister, appears never to have definitely stated the Bank was to be wholly owned by the State. He used the term "national central bank" on a number of occasions. His opponents apparently assumed that a national central bank is a wholly governmentally owned central bank. Two views may be expressed. Either Mr. King had never in his own mind intended to establish a completely State-owned central bank, or if he did he subsequently modified his views when in office, a right which every leader has. The more nearly correct view would seem to be that Mr. King never intended to set up a wholly nationally owned bank. In 1934 he stated that the matter of public ownership was a debatable subject but, in his opinion, public control was not.

In any event, both the Conservatives and the C. C. F. group considered the Liberal proposal a weak, anaemic measure, providing for a half nationally owned and half privately owned bank. The proposal was regarded by opposition groups as "neither meat nor fish, flesh nor fowl". It was, however, a means by which the Government liquidated its campaign promises.

It must be remembered that for a long time both the Liberals and Conservatives were sceptical with regard to the necessity of a central bank and went so far as to denounce anything of that nature. Later, when they had come around to view a

central bank as a necessity, at least politically, there was a good deal of difference of opinion as to the ownership and control of the Bank. Mr. Bennett admitted he had changed his mind when it came to the matter of establishing a Bank. He had originally favoured a publicly owned bank.

When the Bill was up in 1934, the Liberals were by no means certain of their position. They did not unite to criticize the measure. Some Liberals came out strongly for an absolutely publicly owned and publicly controlled bank. In 1935 Mr. Euler stated:[4]

> "We on this side of the House were last year almost entirely in favour of a publicly owned central bank, though we may not be inclined, at least now—I am speaking for myself—to go as far as the nationalization of the chartered banks of Canada."

If this is true, then it may be asked why did not the Liberals advocate a publicly owned bank in 1936? Several Conservatives chided the Liberals for not bringing in a measure to give effect to a fully publicly owned and controlled central bank. They asserted the Liberals campaigned for such and the public believed that they would establish a publicly owned and publicly controlled bank.

There is no doubt many Liberals did campaign for a publicly owned central bank. However, in fairness to Mr. King, there seems to be no evidence on record that he did. His views were qualified and carefully phrased.

The fact that the Liberal party compromised on the ownership may be due to the increasing conservativeness and the practical experience of the Minister of Finance, Mr. Dunning, as well as the cautiousness of Mr. King. The Prime Minister over and over again stated that the question of government ownership was not, in his opinion, the important thing, that the essential thing was control rather than ownership.

During the course of the debate one of the members, Mr. Tucker, stated that since the Bank of Canada had been established it had not been operating to raise price levels; therefore, it was time the Government took over the control.[5] Others also made similar complaints.

One of the Western members, Mr. Johnson, stated that if the Bank of Canada was to be a publicly owned bank operated in the

[4] Ibid., 1935, p. 453.
[5] Ibid., 1936, p. 3576.

interests of the people, then interest should be cut out entirely.[6] Later the same member, an advocate of social credit, stated:[7] "Another principle of a national owned bank would be that money should be issued on the real wealth of the people, instead of allowing a privately organized company such as the chartered banks or the central bank, to issue money on its own behalf". A publicly controlled or national central bank would, in his opinion, "ensure the lastingness of political freedom. It would make possible attainment of a just annual living wage for the worker and production at a profit for the farmer. That could be easily done with a properly nationalized bank. Confiscation of the honestly acquired property and savings of the people would be prevented. . . ."[8]

In short, some members seemingly believed a publicly owned central bank would be an instrument for bringing about the millennium.

In the opinion of the only woman member of the House, Miss Macphail, "the business of the central bank is to create currency and credit".[9]

Mr. Woodsworth, leader of the Co-operative Commonwealth Federation, introduced an amendment to the resolution proposed by Mr. Dunning. The effect of the amendment was to provide for complete government ownership and control of the Bank.

The amendment was ruled out of order.

The method of nationalizing the Bank is rather typical of Mr. King. Anxious to comply with a widespread demand for a Bank controlled by Parliament, yet determined to withstand the demands of the social credit extremists and other inflationists, the Prime Minister provided a compromise which, while it did not suit the radical monetary reformers, made some concession to the current trend of public opinion. No drastic changes in the policy of the Bank were forecast as a result of the subsequent appointments of the Government.

In 1934 a long and bitter debate was held in the House relative to the subject of bilingual notes. The Government was opposed to bilingual notes so the Bank of Canada Act provided for some notes of the Bank to be printed in English and some in French.

[6] Ibid., p. 3549.
[7] Ibid., p. 3550.
[8] Ibid.
[9] Ibid., p. 3870.

This necessitated agencies of the Bank of Canada keeping a supply of both kinds of notes on hand to meet demands of paying institutions and individual customers who could specify whether they wanted notes bearing the French language or notes bearing the English language on their face.

In 1936 the Liberal Government proposed an amendment to the Act providing for bilingual notes. The Government pointed out that both English and French were official languages in Canada and all official documents carried both languages. It was more economical to have bilingual notes since only one plate was required. Moreover, there would be no need to keep stocks of both throughout Bank of Canada agencies. It would lessen the labour of receiving tellers in sorting and segregating them before they were returned to the Bank of Canada and would lessen the total receipts and reissue of notes. The existence of two sets of notes involved a double set of books with respect to currency issues.

Again a prolonged and bitter debate taking up a whole day in the House of Commons followed the introduction of the proposal. Racial prejudices were aroused by certain members of the Conservative party. The debate fills pages and pages of *Hansard*. A great deal of excitement and controversy was aroused in regard to the languages which should appear on the Bank's notes. More smoke clouds were raised on this subject than on any other issue connected with the Bank.

To most people it probably matters little what appears on the notes as long as they are accepted in payment of purchases. It is not likely anyone may be found who will turn down a note simply because he doesn't care about the language it bears. The debate on the subject appeared very much like the blowing up of a political tempest. There was a tense atmosphere and much acrimony. As Mr. Woodsworth observed next day, there were other aspects of legislation concerning the Bank which were of far greater importance to the people of the country.

Changes Made By the Bank of Canada Act Amendment Act, 1936

The Amended Bank of Canada Act was assented to June 23, 1936. The main changes that were made in the Act of 1934 concern (1) changes as to capital and ownership, (2) changes as

to Directors, (3) changes as to the veto power of the Governor and (4) changes in investments of the Bank, (5) note issue, (6) rest fund, (7) inspection, (8) audit. In some sections the language was improved and clarified.

Capital

The Amendment of 1936 authorized an increase in the capital of the Bank of Canada from $5,000,000 to $10,100,000 by providing for the creation of 102,000 Class "B" shares with a par value of $50 to be issued to the Minister of Finance and held by him on behalf of the Dominion of Canada and to be paid for out of the Consolidated Revenue Fund. The 100,000 shares of the Bank held by the public were designated Class "A" shares. Provision was made that the Class "B" shares issued to the Minister should carry the same rights and obligations as the Class "A" shares of the Bank except that the registered holder thereof should not be entitled to vote at the election of directors. The liability of each shareholder was limited to the amount unpaid on the shares held by such stockholder. The amended Act provided that Class "A" shares may be held only by or for the beneficial ownership of British subjects ordinarily resident in Canada, or corporations organized under the laws of the Dominion of Canada or of any province and controlled by British subjects ordinarily resident in Canada. Not more than fifty shares may be held by or for the benefit of any one person other than the Minister of Finance. A trustee, however, may hold shares in trust for other persons in excess of fifty shares so long as the shares held in trust for any one such other person do not exceed fifty shares, but the trustee holding shares in trust under the provisions of the Act in excess of fifty shares is not entitled to vote with respect to any such shares in excess of fifty.

Directors

Under the changes made in the Act in 1936, the Minister of Finance, as the holder of the Class "B" shares, on the approval of the Governor-in-Council, was directed to appoint six directors, two to serve until 1940, two until 1941, and two until 1942. As their terms expired provision was made for filling their places by appointees who should serve for a period of three years. The amendment provided that directors holding office at the date the

amendment came into force should continue as directors until the expiration of their several terms of office. Registered holders of Class "A" shares of the Bank were directed to elect one director at the annual meeting in 1940, to hold office for a term of two years and two directors in 1941 to hold office for terms of two years and three years respectively. Thereafter, it was provided that the private shareholders should be represented by three directors, each of whom should hold office for a term of three years, one to be elected at the annual general meeting in 1942 and one at each successive annual general meeting.

In the case of vacancies occurring among the directors of Class "A" shareholders, the Board was empowered to appoint a qualified person to hold office until the next Annual General Meeting, when the shareholders were required to elect a person to fill the vacancy for the remainder of the term. It was provided, however, that no director in office at the date of the coming into force of this subsection should be so replaced if there were three or more directors elected by the shareholders in office. In the event of a vacancy among the directors appointed by the registered holder of the Class "B" shares of the Bank, the registered holder of the shares was directed, with the approval of the Governor-in-Council, to appoint a qualified person to hold office for the remainder of the term.

In the transaction of the business of the Bank, each director was given one vote, with the proviso, however, that prior to the Annual General Meeting in 1940 each of the directors appointed by the registered holder of the Class "B" shares should have two votes.

The directors shall, on expiration of their terms of office, be eligible for re-election or reappointment.

In recognition of the fact there would be an increased number of directors, subsection one of Section 5 of the Act was repealed, and there was substituted therefor a provision stating the Bank shall be under the management of a Board of Directors composed of a Governor, a Deputy Governor, and directors elected or appointed in accordance with the provisions of the Act. There may also be an Assistant Deputy Governor who shall not as such be a member of the Board.

Section 12 of the Bank of Canada Act, 1934, provided for the selection of the chairman of the Board of Directors by the

members of the Board from their own number. This section was repealed in 1936 and the Act now provides the Governor shall be the chairman of the Board of Directors.

Governor's Veto

Under Section 14 of the Bank of Canada Act the Governor of the Bank had an absolute veto. No action or decision of the Board of Directors, or of the Executive Committee was effective unless it was concurred in by the Governor, or, in his absence or incapacity, by the Deputy Governor. This section was repealed in 1936 and the Governor was given a suspensive veto only. The Governor, or in the event of his absence or incapacity, the Deputy Governor only was given power to veto any act or decision of the Board of Governors or Executive Committee. But if this power is exercised, the Minister of Finance must be notified of the circumstances in writing by the Governor, or the Deputy Governor, as the case may be, within seven days. The Minister is then required to submit the veto to the Governor-in-Council who may affirm or disallow the veto. Any director or member of the Executive Committee may inform the Minister in writing of his view of the action or decision in question and the Minister must submit this view also to the Governor-in-Council. The effect of the changes is to limit the power of the Governor since the ultimate decision or action rests with the Governor-in-Council (Cabinet).

The tenure of office of the Governor, Deputy Governor, and Assistant Governor was left the same. Each is appointed for a period of seven years, subject to good behaviour. At the expiration of their terms of office they are eligible for reappointment.

Investments

Subsection (b) of Section 21 relating to the authority of the Bank to deal in exchange was amended slightly. Under the original Act the Bank was authorized to effect transfers of funds by telegram, letter, or other methods of communication, and to buy and sell transfers effected by such means, trade acceptances, bankers' acceptances, bankers' drafts, and bills of exchange drawn in or on places outside of Canada and having a maturity not exceeding ninety days excluding days of grace, or not

exceeding ninety days after sight, excluding days of grace, from the date of acquisition by the Bank. The substance of the section was left the same under the amendment in 1936, but greater clarity was obtained by omitting the phrase "or not exceeding ninety days after sight excluding days of grace."

Considerable change was made in subsections (d) and (f) of Section 21 of the Act. These subsections deal with the long-term investments which the Bank is empowered to make.

Under the Act of 1934 the Bank of Canada was authorized to buy and sell securities issued or guaranteed by the Dominion of Canada or any province having a maturity exceeding two years from the date of acquisition by the Bank, subject to the limitation that the Bank should at no time hold such securities (exclusive of the securities of the Dominion of Canada transferred to the Bank by the Minister of Finance on the day on which the Bank was authorized to commence business) of a par value in excess of three times the amount of the paid-up capital of the Bank. The Amendment of 1936 made two important changes in the amount of such securities which the Bank may hold. In the first place, the Bank may not hold Dominion or provincial direct or guaranteed obligations in an amount having a par value in excess of 50 per cent. of its outstanding note and deposit liabilities. In the second place, the Bank may not at any time hold such securities maturing more than ten years from the date of acquisition of a par value in excess of three times the amount of the paid-up capital and rest fund of the Bank.

Securities issued by the United Kingdom or the United States of America, having a maturity in excess of six months from the date of acquisition by the Bank, may be held to an amount in which the par value of such securities is not in excess of twenty-five per cent. of the paid-up capital of the Bank. Previously the Bank could purchase such securities up to one-half of the amount of the paid-up capital of the Bank. However, since the capital of the Bank was increased slightly more than one hundred per cent. there was really no significant change in the amount of the long-term securities of the United Kingdom and the United States which the Bank may hold.

The same change was made in subsection (g) of Section 21 as was made in subsection (b). The following term "or not exceeding ninety days after sight excluding days of grace" was omitted.

Subsection (p) of Section 21 of the original Act provided the Bank may "do anything ancillary to all or any of the above purposes."

This subsection was amended to read the Bank may "do any other banking business incidental to or consequential upon the provisions of this Act and not prohibited by this Act."

SCHEDULE "C" CHANGED

Schedule "C" of the Bank of Canada Act sets forth the form in which the assets and liabilities of the Bank shall be stated. The original act made provision for no fewer than four divisions under bills discounted:

(a) Commercial Bills,
(b) Agricultural Bills, etc.,
(c) Dominion Government Treasury Bills,
(d) Provincial Government Treasury Bills.

In 1936 a change was made in the statement and the subdivisions were dropped. The Bank's statement of assets and liabilities simply shows "Bills Discounted".

The Act of 1934 provided for "advances" to:

(a) Dominion Government,
(b) Provincial Governments,
(c) Chartered Banks.

Savings banks were added in 1936 and the statement now shows advances to "Chartered and Savings Banks".

The original Act made provision for five subdivisions under "Investments". These were:

(a) Dominion Government short-term securities,
(b) Provincial Government short-term securities,
(c) Other Dominion Government securities,
(d) Other Provincial Government securities,
(e) United Kingdom, other British Dominions or U. S. A. securities of a maturity exceeding three months.

A change was made in 1936. The statement now shows three subdivisions:

(a) Dominion and Provincial Government short-term securities,
(b) Other Dominion and Provincial Government securities,
(c) Other securities.

The statement makes no separation between Dominion and Provincial Government securities. There is no method by which one can ascertain the extent to which the Bank holds securities of each of the several provinces or holds securities of the provinces as a whole.

Mr. R. B. Bennett, former Prime Minister, suggested the change was made because of certain reasons.[10] The Province of Ontario was refused a loan and the Premier of the province made strong statements about it. One province managed to secure three million dollars from the Bank of Canada, payable in three months. It could not be paid when due, and the only way the Bank could continue to hold it was by converting it into an investment. It was no longer a short-term security but an investment security. About that time schedule "C" was changed. No longer did it appear that there was an advance to a province of three millions of dollars.

Note Issue

The Act of 1934 had provided, among other things, that notes in either the English or the French language should be available as required. Under the amendment of 1936 each note is now required to be printed in both the English and the French languages.

Reserves

No change was made in 1936 relative to the gold reserves which the Bank of Canada must hold against notes and deposit liabilities. A change, however, was made in the foreign exchange which the Bank may hold in addition to the required gold reserves. Under the Act of 1934 foreign exchange was defined as meaning:

(1) balances with the Bank of England, the Bank for International Settlements, the Federal Reserve Bank of New York and a central bank in any country whose currency by law and in fact is convertible on demand at a fixed price into exportable gold;

(2) Treasury bills or other obligations of the United Kingdom or the United States of America having a maturity not exceeding three months from the date of acquisition by the Bank;

[10] *Debates, House of Commons, Dominion of Canada, 1938* (unrevised) p. 1451.

(3) bills of exchange having a maturity not exceeding ninety days excluding days of grace, or not exceeding ninety days after sight, excluding days of grace from the date of acquisition by the Bank payable in London or New York or in a country whose currency by law and in fact is convertible on demand at a fixed price into exportable gold, less any liabilities of the Bank payable in the currency of the United Kingdom, the United States of America, or any country, whose currency is by law and in fact convertible on demand at a fixed price into exportable gold.

Foreign exchange which may be held by the Bank was redefined to mean:

(1) balances in pounds sterling, United States of America dollars and currencies which by law and in fact are convertible on demand at a fixed price into exportable gold, held in the Bank of England, the Federal Reserve Bank of New York, the Bank for International Settlements or a central bank in any country the currency of which is convertible as hereinbefore described;

(2) Treasury bills or other obligations of the United Kingdom or the United States of America having a maturity not exceeding three months from the date of acquisition by the Bank;

(3) bills of exchange having a maturity not exceeding ninety days, excluding days of grace, from the date of acquisition by the Bank, payable in pounds sterling, United States of America dollars or in a currency which by law and in fact is convertible on demand at a fixed price into exportable gold, less any liabilities of the Bank payable in the currency of the United Kingdom, the United States of America, or any country whose currency is by law and in fact convertible on demand at a fixed price into exportable gold.

Inspection

Prior to the amending Act of 1936 the Bank of Canada had power to authorize the Inspector-General of Banks or one of its own officers to make an inspection of the books, accounts and

documents of the chartered banks. Under the changes made in the Bank of Canada Act in 1936 inspection was made mandatory instead of permissive and was placed solely in the hands of the Inspector-General of Banks. He is required to make annually such inspection of the books, accounts and documents of each chartered bank as he may deem necessary for the purpose of satisfying himself that the return required to be made by each chartered bank to the Bank of Canada is correct. He is then required to certify to the Bank whether in his opinion the said return is correct.

Rest Fund

Certain changes were made in 1936 in the amount which should be transferred to the reserve or rest fund of the Bank from the surplus available from the operations of the Bank during each financial year. When the rest fund was established it was provided that one-third of such surplus should be allocated to that fund and the balance should be paid to the Receiver-General to be placed to the credit of the Consolidated Revenue Fund as long as the rest fund was less than the paid-up capital of the Bank. It was further provided that one-tenth should go to the rest fund and nine-tenths to the Consolidated Revenue Fund of the Government as long as the rest fund of the Bank was less than twice the paid-up capital and not less than the capital, and all of the surplus to the Consolidated Revenue Fund when the rest fund was not less than twice the paid-up capital to the Bank. The amended Act provided that if the rest fund of the Bank is less than one-half of the paid-up capital, one-third of such surplus shall be allocated to the rest fund and the residue shall be paid to the Receiver-General and placed to the credit of the Consolidated Revenue Fund; if the rest fund is less than the paid-up capital but is not less than one-half of the paid-up capital, one-tenth of such surplus shall be allocated to the rest fund and the residue to the Consolidated Revenue Fund; if the rest fund is not less than the paid-up capital, the whole of the surplus shall be paid to the credit of the Consolidated Revenue Fund.

The effect of the amendment would have been to restrict the rapidity of the growth of the rest fund and its size. It would also have increased the amount of the profits in the early years of the Bank which would accrue to the Consolidated Revenue

Fund of the Government. The new provision was much less conservative than the requirement of the Act of 1934 but in all probability was quite adequate.

AUDIT

The Act of 1934 had left the appointment of auditors after the first annual meeting to the shareholders who were required to appoint two auditors. To qualify as an auditor a person had to be one who was eligible to be appointed as an auditor of a chartered bank. No person was eligible for appointment if he or any member of his firm had been auditor for two successive years during the three years next preceding.[11]

The Amendment of 1936 provides the appointment of auditors shall be by the Governor-in-Council, on recommendation of the Minister of Finance.[12] The qualifications for auditorship are the same as originally provided.

GOVERNMENT APPOINTMENT TO BANK BOARD

Final steps in the partial nationalization of the Bank of Canada were taken on September 11, 1936, when the Government acquired 102,000 Class "B" shares and appointed six additional directors to represent these holdings, thus assuring governmental control.[13]

In selecting the public representatives on the Board of Directors the Government was enabled to give representation to those provinces not already represented by the seven directors then serving. Those named were: Robert McQueen, Winnipeg, Head of the Department of Economics, University of Manitoba; Auguste C. Picard, Quebec, Vice-President of the Rock City Tobacco Company, Limited; George G. Coote, Nanton, Alberta, farmer, and from 1921-35 a member of the House of Commons, and financial critic for the United Farmers group; Lieut.-Col. Claude Brown, London, Ontario, Director of the Huron and Erie Mortgage Corporation and Canada Trust Company; J. Leroy Holman, Summerside, P.E.I., Vice-President of the R. T. Holman Co., a mercantile establishment; Fred. Magee, Fort Elgin, N.B., President and General Manager of Fred. Magee, Limited, and a former member of the New Brunswick Government.

[11] Bank of Canada Act, 1934, Section 32 (2).
[12] Bank of Canada Act Amendment Act, 1936, Section 32 (1).
[13] Canadian Press Despatch, *The Globe*, Toronto, September 11, 1936.

Two of the above appointments merit particular interest. One is that of Mr. Coote, a farmer from Alberta. During the fifteen years Mr. Coote sat in the House of Commons, a member of the United Farmers of Alberta group, he was an ardent advocate of monetary reform and staunchly supported the demand for a central bank. In recent years he has been an active supporter of "reflation". His appointment lends a touch of unorthodoxy to the Board and contradicts, to some extent, the suspicion in some quarters that Government directors would be appointed purely for political ends.

The appointment of Professor McQueen of the Department of Economics, University of Manitoba, gives representation on the Board to the modern academic approach to the problems of monetary finance.

Public ownership of the Bank was not accomplished. The Bank was left half public and half private with the exception that the Government owned fifty-one per cent. of the capital stock, which gave it control in voting power and the selection of directors. The change did not place the Bank in the category of a publicly owned institution. The Bank had no need for the extra $5,100,000 increase in capitalization.

The amendment did not change the essential character of the Bank. Section 13 of the Bank Act was not amended or varied. This section governs and controls the operation of the Bank. It confers upon the Governor, the Deputy Governor, and that member of the Board of Directors selected by the directors, designated as the executive committee, powers completely to control the organization in the absence of action being taken by the Board. The executive committee is authorized to deal with any matter within the competence of the Board, but every decision of the committee must be submitted to the Board at its next meeting.

Bank of Canada Act Amendment Act, 1938

Partial nationalization of the Bank of Canada in 1936 was but the first step toward complete nationalization of the Bank.

On May 27, 1938, Prime Minister Mackenzie King announced in the House of Commons that complete nationalization of the Bank of Canada would be undertaken in that session of Parliament.

On June 10th, 1938, Mr. Dunning, Minister of Finance, moved that the House go into Committee at the next sitting to consider the proposed resolution:

> "That it is expedient to provide a measure to amend the Bank of Canada Act *inter alia* to provide for the redemption by the Bank of Canada of the 100,000 Class "A" shares of the Bank of Canada of the par value of $50 each at the price of $59.20 and accrued dividends; to reduce the capital of the Bank of Canada from $10,100,000 to $5,000,000 divided into 100,000 shares of $50 each; and to authorize the Minister of Finance for the purpose of such redemption and reduction of capital to surrender to the Bank of Canada 102,000 Class "B" shares of the Bank of Canada of the par value of $50 each; of which 2,000 shares shall be cancelled and 100,000 shares of $50 each be issued by the Bank of Canada to the Minister of Finance and to pay to the Bank of Canada the additional amount necessary to pay the difference between the purchase price of the shares to be redeemed and their par value."[14]

This resolution preceded the introduction of a bill authorizing the Government to acquire by way of purchase all of the outstanding privately owned shares of the Bank of Canada and to convert the Bank thereby into a wholly government owned as well as government controlled institution.

Reasons for the Complete Nationalization of the Bank

The Minister of Finance stated, in introducing the Bill, that during the preceding year or so there had been a good deal of political controversy throughout the country with respect to monetary policy generally and also with respect to the constitution of the Bank of Canada which is the chief instrument through which Parliament exercises its control over monetary policy.[15] Mr. Dunning said the Government was of the opinion, after watching developments, that it was highly undesirable and very much against the national interest that there should be continued political bickering concerning the constitution of the Bank itself. For that reason it was felt that, in addition to maintaining the control which the Government already had through the authority to appoint a substantial majority of the Board of Directors, the Government should acquire the whole of the ownership of the shares of the Bank. Mr. Dunning reminded the House that this

[14] *Debates, House of Commons, Dominion of Canada, 1938* (unrevised) p. 4016.

[15] Ibid., p. 4385.

had been suggested on more than one occasion by members of all political parties. The Government hoped, therefore, to dispose once and for all of political discussion relating to the ownership of the Bank.

The Minister stated that it was not the intention of the Government by the introduction of this measure to make the Bank of Canada merely a department of the Government or that the Bank of Canada should become in any way a political arm of the Government. In his opinion that would be fatal to the successful operation of the control of monetary policy.

It would appear to be difficult, if not impossible, to reconcile the view of Mr. Dunning as expressed at the time he introduced the Bill amending the Act in 1938 with the speeches made by the Minister at the time the Act was amended in 1936. In 1936 Mr. Dunning felt the only method by which the Bank could be properly controlled was to give the Government the authority to appoint the majority of the directors. The Minister of Finance pointed out, however, that his own personal views had not changed. He said, "personally I hold the view that what was done here two years ago represents the best form of control of a national bank. I say that still." [16]

Although Mr. Dunning expressed his own personal preference he said he believed it was more desirable that his fellow-countrymen should be satisfied with the constitution of the central bank than it was that his own particular ideas should prevail as to the manner in which national control should be made effective.

In contrast to the remarks of the Minister of Finance relative to the political controversy which had prevailed throughout the country with respect to the control of the Bank, Mr. Bennett, the former Prime Minister and leader of the Conservative party, during whose premiership the Bank of Canada had been established, stated there had been less discussion in the preceding eighteen months than at any other time in the history of the Bank. The former Minister of Finance stated there had been in reality practically no controversy over the control of the Bank, the public having accepted the view that the Government already had control of the Bank through ownership of the majority of the shares of the Bank.

[16] Ibid., p. 4389.

Mr. King, the Prime Minister, did not explain what motives impelled the Government to acquire complete ownership of the Bank instead of majority ownership and control but they will be interpreted generally as political. Social Credit, one of the fundamental tenets of which is government control of credit, has been gaining ground in the West, and some of the Government's own Western members have consistently advocated it.

During the session of Parliament in 1938 the Co-operative Commonwealth Federation and Social Credit representatives in the House spent days arguing about money and central banking. They charged again and again that the Bank of Canada was not under government control as it should be. Mr. Dunning, Minister of Finance, took great pains to make it clear to the dissidents that with its fifty-one per cent. stock ownership and majority control of the directorate the Bank was securely under government control. But many failed to see or refused to accept the explanation.

Mr. Blackmore, member from Lethbridge, Alberta, leader of the Social Credit group in the House of Commons, during the 1938 session of the House moved a vote of want of confidence in the Government. He stated that it had failed adequately to use the resources of the country to battle poverty. He believed the Government should begin to issue currency and credit in terms of public need. A number of members wished to operate through the medium of what has been described loosely as "fountain pen money".

With the Social Credit and the Co-operative Commonwealth Federation parties actively campaigning against the Liberals in a provincial election in the Province of Saskatchewan, it is believed that the federal Liberal leader, Mr. King, thought the time opportune for a step which might be interpreted as giving the Government more control over the Bank than it formerly exercised, although, in fact, it will not actually do so.

After a relatively short debate the Bill was passed and the amended Act was assented to on July 1st, 1938.

Changes Made by the Amended Bank of Canada Act, 1938

Other than certain changes in the text of the Bank of Canada Act made necessary by reason of the elimination of the private shareholders the main changes relate to (1) the Board of

Directors, (2) the capital of the Bank, (3) investments, (4) reserves to be maintained by the chartered banks, (5) rest fund.

Board of Directors

The Amended Act provides that the Bank shall be under the management of a Board of Directors composed of a Governor, a Deputy Governor and eleven directors. On the first of March in each year the Minister of Finance, with the approval of the Governor-in-Council, is required to appoint for a term of three years each a sufficient number of directors to provide that there shall be eleven directors.[17] Directors holding office at the date of passage of the amended Act shall hold office up to and including the last day of February in the year of the expiration of the term of office for which he was elected or appointed.[18] In the event of a vacancy among the directors the Minister shall, with the approval of the Governor-in-Council, appoint a qualified person to hold office for the rest of the term.[19] In the transaction of the business of the Bank each director shall have one vote.[20] Directors are eligible for reappointment on expiration of their terms of office.[21]

Capital of the Bank

The Amended Act provides that the capital of the Bank shall be five million dollars but may be increased from time to time pursuant to a resolution passed by the Board of Directors and approved by the Governor-in-Council and by the Parliament of Canada.[22] The capital is divided into one hundred thousand shares of the par value of fifty dollars each.[23] The Act provides that these shares shall be issued to the Minister to be held by him on behalf of the Dominion of Canada.[24]

The Minister of Finance was required at the date the Act came into force to exchange one hundred thousand Class "B" shares of the Bank then held by him for one hundred thousand shares of the capital stock authorized to be issued by the amended

[17] Section 5 (1).
[18] Section 9 (1).
[19] Section 9 (2).
[20] Section 9 (3).
[21] Section 9 (4).
[22] Section 17 (1).
[23] Section 17 (2).
[24] Ibid.

Act.[25] The one hundred thousand Class "B" shares so exchanged were then required to be cancelled.[26]

On the day the newly amended Act came into force the Bank was required to pay to each holder of Class "A" shares of the Bank the sum of $59.20 for each Class "A" share registered in his name at the close of business on the fifteenth day of July, 1938, together with the amount of dividend accrued to the date of the coming into force of the amended Act.[27] All Class "A" shares of the Bank were deemed to be cancelled as of the date the amended Act became effective.[28] The Minister of Finance on the same day was required to reimburse the Bank the amount by which payments made by the Bank, excluding any amount paid by way of dividend, exceeded the par value of such shares.[29] It was provided that such reimbursement should be effected by surrendering to the Bank for cancellation two thousand of the Class "B" shares held by the Minister having the aggregate par value of one hundred thousand dollars, and by paying to the Bank out of any unappropriated moneys in the Consolidated Revenue Fund the sum of eight hundred and twenty thousand dollars.[30]

On the day of the coming into effect of the amendment the Bank was required to pay to the Minister of Finance on behalf of the Dominion of Canada the amount of dividends accrued up to that date upon the one hundred and two thousand Class "B" shares of the Bank held by the Minister as of that date.[31]

Investments

Changes were made in the long-term securities which the Bank of Canada may hold. The Bank may buy and sell Dominion or provincial direct or guaranteed obligations, having a maturity exceeding two years from the date of acquisition by the Bank, but it is prohibited from holding at any time securities not maturing within two years having a par value in excess of fifty per cent. of its outstanding note issue and deposit liabilities. Moreover, it may not hold at any time such securities not

[25] Section 17a (1).
[26] Ibid.
[27] Section 17a (2).
[28] Ibid.
[29] Section 17a (3).
[30] Ibid.
[31] Section 17a (4).

maturing within ten years of a par value in excess of five times the amount of its paid-up capital and rest fund. Securities issued by the United Kingdom and the United States of America having a maturity exceeding six months from the date of acquisition may be bought and sold by the Bank, but the Bank is forbidden to hold at any time such securities of a par value in excess of one-half of the amount of the paid-up capital of the Bank.

In view of the decrease in the capital of the Bank by slightly more than fifty per cent. the amount of securities of the British and American Governments having a maturity in excess of six months from the date of acquisition which the Bank may hold has not been materially changed. The same thing may be said relative to the amount of securities issued or guaranteed by the Dominion of Canada or any province, not maturing within ten years, which the Bank may hold.

Reserves

The Amended Act requires each chartered bank to maintain a reserve of not less than five per cent. of such of its deposit liabilities as are payable in Canadian dollars. It is provided that this reserve shall consist of a deposit with the Bank of Canada and of notes of the Bank of Canada held by each bank. Under the Act of 1934 the chartered banks were required to maintain a reserve of not less than five per cent. of their deposit liabilities in Canada.

In harmony with the change in reserve requirements each chartered bank is now required to make a return to the Bank of Canada showing the amount of its deposit liabilities payable in Canadian dollars instead of the amount of its deposit liabilities within Canada.

The Act now provides that in calculating the reserve requirements, the daily average amount of the deposit liabilities of each chartered bank as are payable in Canadian dollars shall be the basis of determining the amount of the reserve to be maintained by such bank during the month next following the month in which such return is made.

Rest Fund

The Bank of Canada Act Amendment Act of 1938 repealed Section 31 of the Bank of Canada Act as amended in 1936 and

substituted therefor the original provisions relating to the rest fund as enacted in 1934.

The Act now provides that after proper provision has been made for doubtful debts, depreciation in assets, pension funds, and all such other matters as are properly provided for by banks, and after deducting an amount equal to four and one-half per cent. of the paid-up capital for dividends, the Board of Directors of the Bank shall dispose of the surplus available from the operations of the Bank during each financial year as follows:

(1) If the rest fund of the Bank is less than the paid-up capital, one-third of such surplus shall be allocated to the rest fund and the residue shall be paid to the Receiver-General and placed to the credit of the Consolidated Revenue Fund;

(2) If the rest fund is not less than the paid-up capital but is less than twice the paid-up capital, one-tenth of such surplus shall be allocated to the rest fund and the residue shall be paid to the Receiver-General and placed to the credit of the Consolidated Revenue Fund;

(3) If the rest fund is not less than twice the paid-up capital, the whole of such surplus shall be paid to the Receiver-General and placed to the credit of the Consolidated Revenue Fund.

Report of the Governor

Section 34 of the Bank of Canada Act was amended so as to make provision for a summary or report by the Governor to the Minister of Finance within six weeks after the end of each fiscal year which coincides with the calendar year.

Price Paid for Bank of Canada Stock

Government ownership of the Bank of Canada was completely effected on August 15, 1938, when the Treasury Department of the Dominion Government bought in the 100,000 shares in the hands of the public at a price of $59.20. This stock was originally issued at a price of $50 a share. All holders of Bank of Canada Class "A" stock received $59.20 for each share registered at the close of business July 15 together with interest accrued to August 15.

In a statement made in debate in the House of Commons, Mr. R. B. Bennett stated that as far as he could find, the highest

price ever paid for Bank of Canada shares in the market for less than board lots was $60 and the lowest was $53.[32]

In arriving at the price $59.20, paid to the private holders of Bank of Canada stock, Mr. Dunning stated that the instructions he had given for arriving at a price were to take all the actual sales both in Montreal and Toronto and average the prices paid between January 1, 1938, and the date the Prime Minister had made the announcement relative to the complete nationalization of the Bank on May 27.

Changes in Ownership of Bank of Canada, 1935-1938

The ownership of the Bank of Canada has rapidly changed since it started operations in March, 1935. Under the original set-up, as established by the Conservative Government of R. B. Bennett in 1935, the shares of the Bank were held by private individuals, each individual being limited to fifteen shares. The original capitalization was $5,000,000 divided into 100,000 shares of $50 each. Dividends were limited to 4½ per cent. In the general election campaign in the autumn of 1935 the Liberals advocated public ownership and control. Following their election, they set out in the session of 1936 to implement their election promise. This was done by issuing $5,100,000 more stock, which was bought by the Minister of Finance on behalf of the Dominion of Canada, and also by the appointment of six additional directors with sufficient voting power to give the Government an immediate and decisive control of the Board of Directors. The Bank was in this way partially nationalized.

The Co-operative Commonwealth leader, Mr. Woodsworth, moved an amendment in the debate on partial nationalization calling for complete government ownership and control of the Bank. He was supported by a few Liberal members. The amendment was voted down at the time but its principle has now been accepted by Parliament.

So far as the public is concerned, or the banking system of Canada, nationalization will have no immediate effect since the Government had already a majority control of the directorate of the Bank. Until the recently amended Act came into force a minority of the Board of Directors was elected by the private

[32] *Debates, House of Commons, Dominion of Canada, 1938* (unrevised) p. 4386.

shareholders, but under the new system the Government will replace them as their terms expire. There will be no change in the policies of the Bank or in the Governorship.

The Act nationalizing the Bank provides for a Board of Directors consisting of the Governor of the Bank, the Deputy Governor and eleven appointed members—thirteen in all. In addition to the members of the Board as constituted, the Deputy Minister of Finance is by virtue of his office a member of the Board. This Board appears to be much too large and unwieldy, especially for a country like Canada.

The amended Bank of Canada Act has removed from the Canadian scene a unique and highly successful experiment in the field of public-private enterprise.

Central Bank Relationship with the Government

Complete ownership of the Bank of Canada is regarded in the business community of Canada with mixed feelings. It is felt the Government has added nothing to its control of money and credit and is losing the benefit of having an independent, non-political group of shareholders privileged to elect a minority of directors.

There are a considerable number of Canadians who are of the opinion the Government should have delayed in making amendments to the Bank of Canada Act until such time as the Bank has had time to demonstrate its strength and weaknesses. Within a period of a little more than three years since its establishment the Bank has gone through the gamut of a privately owned institution, a partially nationalized one, and finally a nationally owned institution.

There is no reason why the Bank of Canada should not have continued along the lines originally laid down in 1934 by Mr. Bennett, or even along the modified plan introduced in 1936 by Mr. King. The sudden change to complete public ownership suggests the influence of political considerations—something to be deplored in an institution of this type. As stated earlier, Mr. Dunning, the Minister of Finance, broadly indicated that the complete nationalization bill which he sponsored was not to his liking, but appeared to be the most desirable action under the existing situation. While recognizing that dangers of partisanship exist, Mr. Dunning stated such dangers can be obviated only

by high-minded men in the seat of government refusing to permit that to be done. It would be necessary, he said, to build up a tradition of non-interference, a tradition which would enable the management of the Bank properly to repudiate such interference, and to successfully appeal to Parliament against it. The Government hopes to build up a tradition around the Bank of Canada somewhat similar to that of the British Civil Service, which, although dominated by the Government, is seldom interfered with.

Those who have been following the Government's course do not believe that while Mr. Dunning remains Minister of Finance the change presages any ventures into the realm of fiscal unorthodoxy. They do not expect, for instance, that Mr. Towers, the Governor of the Bank, will be requested, as some Liberal members and others have advocated, to issue new currency to the full amount of Canada's gold reserves and with this to finance a huge scheme of public works.

It probably makes little difference how the Bank of Canada is owned. The relationship between the Bank and the Government must necessarily be close. While it is imperative that the national government should be in a position to decide the aims of monetary policy because of its effects upon economic life, it is essential that the actual execution of the policies decided upon should be in the hands of a monetary authority free from fiscal exigencies and above the mêlée of political bargaining.

CHAPTER XI

OPERATIONS OF THE BANK OF CANADA, 1935-1938

UNDER authority of subsection 1 of Section 20 of the Bank of Canada Act, 1934, and under the Orders-in-Council dated March 6, 1935, the Minister of Finance, by certificate, authorized the Bank of Canada to commence business on the 11th day of March, 1935. On that day Canada's new central bank opened its doors. On the same day Orders-in-Council came into force repealing the Finance Act and the Dominion Notes Act and continuing the gold suspension.

Following the requirements of the Act, the chartered banks transferred to the Bank of Canada gold to the value of $37,128,916, mostly in coin.[1] The old central gold reserves at Montreal, a feature of the banking system since 1913, were discontinued. The Dominion Government transferred to the new central bank its gold holdings amounting to $69,455,439. The Bank thus commenced operations with gold holdings amounting to $106,584,355,[2] calculated on the basis of the statutory price of $20.67 an ounce.

When the Bank commenced operations it assumed responsibility for the redemption of all Dominion notes issued and outstanding. To cover that liability which then amounted to $185,455,439, the Dominion Government transferred to the Bank the following assets: [3]

(a) Gold valued at	$ 69,455,439
(b) Silver valued at	986,363
(c) Dominion of Canada 3% bonds maturing 1940 at a par value of	115,013,637
Total	$185,455,439

[1] *Report* of the Governor, Bank of Canada, First Annual General Meeting of the Shareholders, February 25, 1936, p. 6.
[2] Ibid.
[3] Ibid.

THE BANK OF CANADA BECOMES CLEARING AGENT FOR THE CHARTERED BANKS

On March 11, 1935, the Bank of Canada and its agents took over the functions of the Royal Trust Company as clearing agent of the chartered banks. The debit or credit balances in the five chief centres of Canada, Montreal, Ottawa, Toronto, Winnipeg, and Vancouver, settlement points for the clearing houses in their respective zones, are daily communicated by the clearing house manager and confirmed by the representative bank, to the local agent of the Bank of Canada (to the Bank of Canada itself in the case of Ottawa) for transmission to the Bank of Canada at Ottawa by telephone or telegraph. On receipt of the daily advice the Bank of Canada makes the appropriate credit or debit entry in the account kept for each of the chartered banks.

CHANGES IN THE BANK'S BALANCE SHEET, 1935

During the ten months in which the Bank of Canada was in operation in 1935 considerable changes took place in the balance sheet of the Bank. These changes reflect the growth and operations of the Bank during that period of time. Of primary importance was the increase in the gold reserve resulting from the revaluation of gold by legislation passed July 5, 1935. A profit of $73,500,000 resulted from this operation, of which $10,475,114 was credited to the accounts of the chartered banks and the balance, namely $63,006,382,[4] was set aside as an exchange fund. A portion of this fund was used to take over some of the short-term and long-term Dominion securities held by the Bank, while the rest was placed to the credit of the Dominion Government and placed on deposit with the Bank. The fund is managed by the Bank of Canada and entries are passed through the account weekly, representing adjustments in the actual value of the gold held by the Bank. The purpose of this is to make sure that any profit or loss on these holdings is for the account of the Government and not the Bank.

In the ten months' period of operation notes of the Bank increased slightly, from $97,805,665 to $99,667,229. Because of the write up of the Bank's gold holdings, the ratio of net reserves

[4] *Report*, Governor of the Bank of Canada. First Annual General Meeting of the Shareholders, February 25, 1936, p. 7.

to notes and deposit liabilities increased. Of the notes in circulation, $40,497,965 were in the hands of the chartered banks and $59,179,264 were in the hands of the public.

Deposits of both the chartered banks and the Dominion Government increased. Deposits of the chartered banks—$181,636,033—represents the major portion of their cash reserves against deposit liabilities in Canada. Adding to the deposit figure, $40,497,965 in Bank of Canada notes, which the banks held in their tills, the total cash reserves at December 31st, 1935, were $222,133,998, equal to approximately 10 per cent. of the chartered banks' deposit liabilities in Canada—double that required by the Bank of Canada Act.

The fact that the note issue of the Bank of Canada is so much smaller than the old Dominion note issue is due to the fact that cash reserves are now being maintained in the form of deposits with the Bank of Canada, as well as notes of the Bank of Canada. The combined total of Bank of Canada notes and chartered banks' deposits with the Bank of Canada is the figure which should be used when making a comparison with the cash statistics antedating the opening of the Bank.

Comparative Balance Sheet of the Bank of Canada, 1935

The following table shows the balance sheet of the Bank as of December 31, 1935, and, for comparative purposes, the first balance sheet issued on March 13, 1935.[5]

Liabilities	March 13, 1935	December 31, 1935
Capital, paid up	$ 4,990,640	$ 5,000,000
Rest Fund		173,092
Notes in Circulation	97,805,665	99,677,229
Deposits:		
Dominion Government	4,212,200	18,262,844
Chartered Banks	151,927,628	181,636,034
Other Banks	277,922	766,255
Dividends, Unpaid		113,000
Other liabilities	99,702	2,026,698
Total liabilities	$259,314,757	$307,655,152

[5] The statistics used were taken from the published Balance Sheets of the Bank of Canada and the *Report* of the Governor of the Bank of Canada at the First Annual General Meeting of the Shareholders, February 25, 1936.

ASSETS	March 13, 1935	December 31, 1935
Reserve		
Gold coin and bullion	$106,584,356	$180,509,343
Silver bullion	986,363	1,638,366
In sterling funds	192,250	219,235
In U.S.A. funds	202,625	4,003,866
In other gold standard funds		9,215
Subsidiary coin	297,335	128,778
Advances to Dominion Government		3,465,813
Investments:		
Dominion Government short-term securities	34,846,294	30,873,169
Other Dominion Government securities	115,013,637	83,409,676
Bank premises		111,911
Other assets	1,191,897	3,285,780
Total Assets	259,314,757	307,655,152

PROFITS OF THE BANK

PROFIT AND LOSS ACCOUNT

Bank of Canada

31st December, 1935

Profits from 11th March, 1935, to 31st December, 1935, after making provision for Contingencies and Reserves		$764,228.31
Appropriated as follows:		
Dividend No. 1—Payable 2nd July. 1935, at 4½% per annum on $12.50 from 21st September, 1934, to 2nd January, 1935, and on $50.00 from 2nd January, 1935, to 30th June, 1935.	$126,000.00	
Dividend No. 2—Payable 2nd January, 1936, at 4½% per annum on $50.00 from 1st July, 1935, to 31st December, 1935,	113,000.00	
	239.000.00	

Contribution to the Civil Service Superannuation and Retirement Funds	5,951,82	244,951.82
		$519,276.49
Transferred to Rest Fund	$173,092.16	
For credit to Receiver-General of Canada—account Consolidated Revenue Fund	346,184.33	
		$519,276.49

The above report of the Bank of Canada for the period March 11 to December 31, 1935, shows profits amounting to $764,228.31, after making provision for contingencies and reserves. This was equivalent to a little over 15 per cent. on the Bank's capital. This was an excellent showing, inasmuch as the cost of replacing the old Dominion note issue with the new small-sized Bank of Canada legals was an unusual expense item. Moreover, the Bank did not initiate open market operations during the year and did not furnish any banking service to the provincial governments.

The decline in silver prices also had a very material effect on profits. On March 11th, the Bank took over from the Dominion Government, at the price then prevailing, 1,671,802 ounces of silver, which the Government had acquired in accordance with the terms of the London Silver Agreement. Between March 11th and the end of the year, the Bank acquired an additional 1,671,802 ounces, the action of the Bank in both cases being governed by the terms of the Bank of Canada Act and the instructions received from the Minister of Finance. The market price of silver on December 31st was materially below the quotation of March 11th, and also below the average price between the latter date and the end of the year. The resultant depreciation in the value of the Bank's holdings was $489,368, all of which was charged to Profit and Loss Account.

Dividend Payments

Dividend payments shown in the first statement were also higher than usual because stockholders received credit for the

25 per cent. made in the fall of 1934 to secure bank shares, and 4½ per cent. was paid for the full calendar year 1935, while the Bank was actually in operation less than ten months. Stockholders were paid the stipulated dividend of 4½ per cent. on the $12.50 paid in for the period from September 21, 1934, to January 2, 1935, and on the full $50 from January 2 to December 31, 1935. This required $239,000, which with a contribution of $5,952 to the Civil Service Superannuation and Retirement Funds, left a balance in the profit account of $519,276, of which one-third was set up as a "rest fund" and the remainder was credited to the Consolidated Revenue Fund of the Dominion Government.

Since its inception the central bank has issued weekly statements much on the lines of other such institutions. The first was made public on March 14th, after three days of activity. Monthly statements are issued also.

Material Increase in Note Circulation in 1936

During the course of the year 1936 a material change took place in the note issue of the Bank. It increased from $99,677,229 on December 31st, 1935, to $135,735,457 on December 31st, 1936, an increase of $36,058,229. The active note circulation—the amount of Bank of Canada notes in the hands of the public—increased $28,773,502, while chartered bank notes decreased $9,779,577. The average daily circulation for the year 1936 as compared with 1935, showed an increase of about 7.2 per cent. This the Governor pointed out was mainly due to the enlarged volume of the country's business, coupled with a rise in the level of prices.

Security Holdings Increase

During the year the security holdings of the Bank increased $46,032,570. This addition to the portfolio of the Bank more than offset the increase of the Bank's active note circulation. The increase of $46 millions was offset to the extent of $34 millions by the increase in the capital of the Bank and the enlargement of the Bank's active note circulation, leaving some $12½ millions as an addition to the chartered banks' cash. The issued and paid-up capital of the Bank was increased by $5,100,000 as a result of the Act amending the Bank of Canada Act.

Changes in Balance Sheet of Bank, 1936

The following table shows the changes in the Balance Sheet of the Bank in 1936.[6]

	Changes producing a decrease in Chartered Banks' Cash	Changes producing an increase in Chartered Banks' Cash
	(Figures shown in millions of dollars)	
Increase in Sterling and U.S.A. funds		4.9
Decrease in advances to Dominion Government	3.5	
Increase in investments		46.0
Increase in Capital and Rest Fund	5.7	
Increase in notes in active circulation	28.8	
Increase in Dominion Government balances	1.7	
Increase in other banks' balances	1.3	
Other changes		2.7
	41.0	53.6
	Deduct	41.0
Increase in chartered banks' cash reserves (notes of and deposits with the Bank of Canada)		12.6

Profits Increased Materially

In 1935, after providing for contingencies and reserves, the Bank had available for distribution some $764,000 on operations covering a period of about nine months and a half. Had the Bank been in operation for a whole year on the same basis as the nine months and a half, it is estimated its 1935 earnings would have been about $965,000. In 1936, the profits of the Bank improved considerably and amounted to $2,008,124.28, after making provision for contingencies and reserves.

The improvement in the profits of the Bank during the second year of operation was due to a number of factors. The Bank had to incur during its first year various expenses many of which would normally be non-recurrent. The expense of note issue was

[6] *Report* of the Governor of the Bank of Canada at the Second Annual General Meeting of the Shareholders, February 23, 1937.

much less the second year. Then the loss on the purchases of silver required by the Act diminished in 1936. The increase in profits was due more, however, to a rise in the earnings of the Bank mainly because of the increased holdings of securities.[7]

During the course of the year 1936, the Bank paid out in dividends to the private stockholders $224,000 and to the Government as a stockholder from the 11th of September, 1936, to the 31st of December, 1936, $70,793.15. Contributions to Civil Service Superannuation and Retirement Funds amounted to $1,460.58. There was transferred to the Rest Fund the sum of $570,723.52. This fund, at the close of 1936, amounted to $743,715.68. The Bank placed in the Consolidated Revenue Fund to the credit of the Receiver-General of Canada $1,141,247.03. In less than two years of operation the Bank has contributed to the Government Treasury in profits $1,487,431.36.

Deposits Increased Slightly

Deposits of the chartered banks showed a slight increase during the year, increasing from $181,636,033.98 at the close of 1935 to $186,973,784.87 at the close of 1936. Dominion Government deposits also showed a slight increase. Dominion Government deposits were $18,262,843.88 at the close of 1935. On December 31, 1936, Dominion Government deposits amounted to $19,917,328.85.

Foreign Exchange Funds

During the course of the year a slight decline took place in gold holdings. At the close of the year 1935, gold coin and bullion amounted to $180,509,342.65 while at the end of 1936 the amount was $179,376,815.89. Silver bullion increased $618,-664.95. The balance sheet of the Bank showed sterling funds and United States of America funds separately in 1935. In 1936 the two were lumped together. The amount of these funds held by the Bank at the close of the year 1936 was more than double the same at the close of 1935. At the close of the latter year these funds amounted to $4,223,101.54 while at the close of 1936 they amounted to $9,125,400.74. The balance sheet of the Bank at the close of 1935 contained an item "Funds of other countries on the Gold Standard". The amount of funds so held was very small—$9,215.29. The balance sheet for 1936 disclosed no such items.

[7] Ibid.

Value of Bank's Premises Increase

The Bank's statement for 1936 showed a considerable increase in the value of bank premises. During the year the Bank gave a good deal of consideration to the premises occupied by its Agencies. The Bank's Agency in Toronto was remodelled. At Regina preparations were made by the Bank to erect new premises. Premises were purchased from the Dominion Government. At other points the Agencies were located in rented quarters.

On March 27, 1937, work was commenced on the construction of a new Head Office in Ottawa. The foundation stone of the Bank of Canada building was laid by the Prime Minister on August 10th. The new building, consisting of five stories above the ground and two below, was ready for occupancy in the spring of 1938. The transfer of all Head Office Departments was accomplished during the last week of April of that year.

An analysis of the ownership of the shares of the Bank of Canada as of December 31, 1936, reveals the fact that the holdings of the central bank's shares were becoming concentrated into fewer hands as time went on. This tendency, however, was not rapid. The initial subscribers, 12,200 in number, averaged 8.2 shares each in 1934 whereas the number of shareholders on December 31, 1936, had declined to 10,423 and the average holding had risen to 9.6 shares. The Bank of Canada Act permitted a maximum holding of 50 shares.

Statistical Summary

In January, 1937, the Bank of Canada began the publication of a monthly *Statistical Summary*, which is intended to help students of finance and economics by selecting essential data from statistics scattered through other publications, adding other new material and presenting the whole without comment in a convenient form illustrated by graphs. The *Summary* is not designed to compete with existing publications, but to supplement them. The Bank distributes the *Summary* free to certain libraries and other institutions but charges a nominal sum to the general public to cover a part of the cost of the issue. In the preparation of these statements the Statistical Department of the Bank has done a good piece of work. This is a well-worthwhile movement on the part of the Bank.

BANK OF CANADA

STATEMENT OF ASSETS AND LIABILITIES
AS AT 31ST DECEMBER, 1936

Liabilities

Capital:		
Authorized, Issued and Paid-Up—		
100,000 Class "A" shares, par value $50 each	$ 5,000,000.00	
102,000 Class "B" shares, par value $50 each	5,100,000.00	$ 10,100,000.00
Rest Fund		743,715.68
Notes in Circulation		135,735,457.87
Deposits:		
Dominion Government	19,917,328.85	
Chartered Banks	186,973,784.87	
Other Banks	2,059,627.27	208,950,740.99
Dividend Declared— Payable 2nd January, 1937		182,793.15
Other Liabilities		1,273,197.48
		$356,985,905.17

Assets

Reserve—at market value		
Gold Coin and Bullion	$179,376,815.89	
Silver Bullion	2,257,130.91	
Sterling and U.S.A. Dollars	9,125,400.74	$190,759,247.54
Subsidiary Coin		143,116.49
Investments—at not exceeding market values:		
Dominion and Provincial Government short-term securities	61,299,024.59	
Other Dominion and Provincial Government Securities	99,016,389.96	160,315,414.55
Bank Premises (Land, Buildings and Equipment) — at cost less amounts written off		350,718.63
Other Assets		5,417,407.96
		$356,985,905.17

BANK OF CANADA

PROFIT AND LOSS ACCOUNT
31ST DECEMBER, 1936

Profits for year ending 31st December, 1936, after making provision for Contingencies and Reserves		$ 2,008,124.28
Appropriated as follows: Dividend No. 3 payable 2nd July, 1936, at 4½% per annum on $5,000,000 for six months at 30th June, 1936	$ 112,000.00	
Dividend No. 4 payable 2nd January, 1937, at 4½% per annum on $5,000,000 for six months to 31st December, 1936, and on $5,100,000 from 11th September, 1936, to 31st December, 1936	182,793.15	
	294,793.15	
Contribution to Civil Service Superannuation and Retirement Funds	1,460.58	296,253.75
Balance		$1,711,870.55
Transferred to Rest Fund	$ 570,623.52	
For credit of Receiver-General of Canada, account Consolidated Revenue Fund	1,141,247.03	1,711,870.55

Rest Fund

Balance as at 31st December, 1935	$ 173,092.16
Amount transferred at 31st December, 1936, as above	570,623.52
Balance at at 31st December, 1936	$ 743,715.68

Assets of the Bank of Canada Increase in 1937

During the year 1937 the assets of the Bank of Canada increased from $356,985,905 as of December 31, 1936, to $390,430,215 as of December 31, 1937. The principal changes which occurred in the assets during the period were: an increase in the amount of sterling and United States dollars held by the Bank from $9,125,400 to $14,884,810; a decrease in subsidiary coin from $143,116 to $42,989; and an increase in the value of bank premises from $350,178 to $1,167,562. This represents an increase of over 60 per cent. in the holdings of sterling and United States dollars, a decline of approximately 70 per cent. in subsidiary coin and an increase of well over 300 per cent. in the value of bank premises. Little change was shown in the gold holdings of the Bank which stood at $179,763,762 on December 31st. A considerable increase was recorded in Dominion and provincial short-term securities held by the Bank amounting to $82,343,729 on December 31, 1937, as against $61,299,024 on December 31, 1936. During the year the Bank's investments increased on balance by $25.8 millions, $21 millions of which was in the short-term category. The change in the amount of the Bank's investments is of the same order of magnitude as that in active circulation.

On June 16, 1937, an item, "other assets", made its first appearance in the balance sheet of the Bank of Canada. At that time it amounted to $4,995,887 but by December 31, 1937, it had increased to $12,212,437. The "other securities" of the Bank are understood to comprise short-term securities of the United Kingdom and the United States. The purpose of these securities appears to be to offset any temporary fluctuations in the exchange value of the Canadian dollar. In effect, it is a fund slightly less liquid than reserves held in the form of foreign currencies.

On the basis of foreign exchange held in the form of sterling and United States dollars, and "other securities", it would appear that the central bank on December 31, 1937, had approximately $27 millions of liquid assets abroad. The precise purpose of the expansion of outside assets has not been revealed, but it appears that the central bank has made preparation to take care of such a contingency as a brief or sudden withdrawal of funds from Canada, without using the gold reserve.

Decrease in Net Assets of Chartered Banks Abroad

It is possible that the central bank's expansion of its assets abroad is related to changes in the past few years in connection with the operations outside Canada by the chartered banks. Formerly the chartered banks had more assets abroad than they had liabilities. The return of the chartered banks as of April 30, 1937, showed that liabilities abroad were $26.6 millions more than the assets outside Canada. Thus the central bank's liquid reserves outside Canada are more than sufficient to counterbalance the position of the chartered banks.

In recent years the chartered banks have reversed their former net balances abroad. This is shown by the following table:

Net Assets of Chartered Banks Abroad
(In millions of dollars)[8]

April 30th					
1932	+	$106.4	1935	+	$ 28.1
1933	+	84.1	1936	—	22.2
1934	+	62.2	1937	—	26.6

It appears that the increase in the Bank of Canada's assets abroad is not connected with the Dominion Government's exchange fund of some $63 millions, created in July, 1935, by the increase to $35 in the price of gold. Although the central bank's acquisition of foreign reserves is not related to the exchange fund, the foreign cash and securities put the Bank in a position to support the Canadian dollar against an undesired temporary fall.

Note Issue of Bank of Canada Increases in 1937

The principal changes occurring in the liability items of the balance sheet of the Bank of Canada in 1937 were: an increase in note circulation from $135,735,457 to $165,330,405; a decrease in Dominion Government deposits from $19,917,328 to $12,292,-382; and an increase in the deposits of the chartered banks from $186,973,784 to $196,039,736. The increase in note issue was largely due to the seasonal and cyclical changes in business requirements and to the gradual retirement of the notes of the chartered banks, as required by law. The amount of Bank of Canada notes in circulation as of December 31, 1937, showed an increase of $29,594,448 on the year. The active circulation, that is, the amount of the Bank's notes in the hands of the public,

[8] *Financial Post*, Toronto, June 26th, 1937.

increased by some $23,558,000, while the notes of the chartered banks decreased by $7,472,000.[9] Thus the net active circulation rose by about $16 millions. Using daily averages the increase was 10 per cent. as compared with 7.2 per cent. between 1935-1936.[10]

Profit and Loss Account

In 1936, after providing for contingencies and reserves, the Bank of Canada had available for distribution $2,008,124. At the close of 1937 the comparable figure was $2,268,596, an increase of approximately $260,000 over 1936. Over the year the investments of the Bank showed a gain of about $36 millions more than in 1936, but from the viewpoint of earnings, this factor was partially offset by a lowering of the average yield of the Bank's holdings of Treasury bills.

In 1935 the Bank had a loss on its silver purchases of $489,000. In 1936 its loss on silver was some $135,000. In the year 1937, due to the fact that silver prices had been relatively stable, its loss was only $13,847.[11] The Bank values its silver according to the prevailing market price.

After paying dividends at the rate of 4½ per cent. on its capitalization of $10,100,000 the Bank transferred $604,698.79 to the Rest Fund and the balance, $1,209,397.57, to the credit of the Receiver-General of Canada for the account of the Consolidated Revenue Fund.[12] As at 31st December, 1937, the Rest Fund had a balance of $1,348,414.47.[13]

Bank Rate

The Bank rate remained unchanged throughout the year at 2½ per cent.

Treasury Bills

The amount of Dominion Government Treasury bills outstanding at the end of December, 1937, was $150 millions, unchanged from the figures of December 31, 1936. The weighted average tender rate during the year was .715 per cent. for bills of three months' currency.[14]

[9] *Report* of the Governor of the Bank of Canada, Third Annual Meeting of Shareholders, February 22, 1938, p. 5.
[10] Ibid.
[11] Ibid., p. 6.
[12] Ibid., p. 18.
[13] Ibid.
[14] Ibid., p. 9.

The Bank's holdings of Treasury bills varied widely during the course of the year 1937. An indication of the extent of these fluctuations is given by the Bank's weekly and monthly statements under the heading of "Dominion and Provincial Government short-term securities", the bulk of which at the present time consists of Dominion Government Treasury bills. Investments in this category rose from $63.3 millions at the end of September to $82.5 millions as at October 31st, and $94.8 millions at November 30th. By December 31st there was a reduction to $82.3 millions.[15] From these figures it will be observed that considerably over half of the outstanding Treasury bills were held by the Bank of Canada at the close of the year.

The Governor of the Bank of Canada in stating the reasons for the increase in short-term security holdings during the closing months of each year, said: [16]

> "For one thing, it has been our policy to provide additional cash to off-set the seasonal increase in the amount of notes in the hands of the public; and we have implemented this policy by the purchase of securities. The second reason is connected with the fact that this is the time of year when the chartered banks desire to build up their cash reserves. When year end movements of this character are taking place, the short-term investments of the Bank of Canada tend to rise, since the market for Treasury bills and other short-term securities would not be capable of absorbing the holdings which the chartered banks may desire to part with temporarily, unless support were given by the central bank. In the absence of such support, considerable and quite unnecessary dislocation in the capital market would result."

Canadian Dollars in 1937

During the year 1937 fluctuations of the Canadian dollar against both the United States dollar and sterling were narrower even than in 1936. The entire range of fluctuation against the former was 37/64 per cent. as compared with 1¼ per cent. in the preceding year.[17] Against the pound sterling, the range of fluctuation was approximately 3 1/16 per cent. compared with 4 per cent. in 1936.[18]

[15] Ibid.
[16] Ibid., pp. 9, 10.
[17] Ibid., p. 12.
[18] Ibid.

BANK OF CANADA

STATEMENT OF ASSETS AND LIABILITIES
AS AT 31ST DECEMBER, 1937

Liabilities

Capital:		
Authorized, Issued and Paid-Up—		
100,000 Class "A" shares, par value $50 each	$ 5,000,000.00	
102,000 Class "B" shares, par value $50 each	5,100,000.00	$ 10,100,000.00
Rest Fund		1,348,414.47
Notes in Circulation		165,330,405.40
Deposits:		
Dominion Government	12,292,382.09	
Chartered Banks	196,039,736.76	
Other Banks	3,456,934.69	211,789,053.54
Dividend Declared: Payable 3rd January, 1938		228,260.00
Other Liabilities		1,634,082.57
		$390,430,215.98

Assets

Reserve—at market value		
Gold Coin and Bullion	$179,763,762.29	
Silver Bullion	2,992,623.24	
Sterling and U. S. A. Dollars	14,884,810.21	
Other Currencies of countries on a gold standard	382.08	$197,641,577.82
Subsidiary Coin		42,989.19
Investments—at not exceeding market value:		
Dominion and Provincial Government short-term Securities	82,343,729.14	
Other Dominion and Provincial Government Securities	91,564,709.67	
Other Securities	12,212,437.28	186,120,876.09
Bank Premises (Land, Buildings and Equipment) — at cost less amounts written off		1,167,562.71
Other Assets		5,457,210.17
		$390,430,215.98

Investigation of Fiscal Problems of Western Provinces

The Bank of Canada rendered a distinct service to the country by making an investigation of the financial burdens and fiscal problems of the Western provinces. After consideration of a number of alternative proposals for dealing with the problems of Manitoba and Saskatchewan the recommendation was made that a Royal Commission should be appointed by the Dominion Government to investigate the financial basis of Confederation. The proposals, as outlined in a letter from Mr. Graham Towers, Governor of the Bank of Canada, to Premier John Bracken of the Province of Manitoba were as follows:

1. Refunding of the outstanding debt by the issuance of new securities guaranteed as to principal and interest by the Dominion Government.
2. Refunding of the outstanding debt by the issuance of new securities guaranteed only as to interest for a temporary period by the Dominion Government.
3. Refunding of high coupon bonds by the issuance of new securities guaranteed by the Dominion Government, the provincial subsidy being pledged as security for the guarantee.
4. The same procedure as outlined in three, with the exception that the assignment of the subsidy would constitute the bondholders' protection and the Dominion guarantee would not be attached.

A Royal Commission, as recommended, was appointed by the federal government in the summer of 1937.

Provincial Loan Refused

The central bank is empowered to make loans to provinces under two sections of the Bank of Canada Act. One provides for six months' advances against the pledge of readily marketable securities.[19] The other provides for loans up to one-fourth of the provincial government's estimated revenues for the fiscal year but requires repayment within three months after the fiscal year end.[20] Into both sections may be read the requirement that the borrowing Government should be a good financial risk.

The Bank of Canada recently refused to make a loan of from three to five millions of dollars to the Province of Alberta to

[19] Section 21 (j).
[20] Section 21 (k).

enable the province to meet maturing bond issues. Because of the financial difficulties of the province and the attitude of the Social Credit administration toward contracts and monetary matters, the credit position of the province has been seriously impaired, affecting the marketability of its securities.

THE BANK OF CANADA EARMARKS GOLD

The Bank of Canada is permitted by its charter to earmark gold for foreign central banks. It is not required to make public its dealings in earmarked gold, and no item concerning the amount of gold earmarked for the account of central banks abroad appears in the Bank of Canada's weekly or monthly statement of assets and liabilities. This apparent lack of information has led to some criticism. Mr. J. P. Bell, former General Manager of the Bank of Hamilton and later Manager-in-Chief of the Hamilton Division of the Canadian Bank of Commerce, in an address before the Winnipeg Bankers' Lecture Club on April 13, 1937, stated that the Bank:

> "Is in a position to handle gold transactions without the public knowing anything about it. . . . The only information on gold purchases and sales available to us is that secured from the figures of actual exports or imports of metal, as shown by the monthly government trade figures and the changes shown in the Bank of Canada statement. Since the opening of the Bank its gold holdings have remained practically unchanged, except for the adjustments necessitated by the revaluations. On March 17th of this year, an increase of $3,500,000 was reported, this being the first such addition, and $4,500,000 has been added since. This might indicate the beginning of an attempt by the Bank of Canada to utilize gold as a means of controlling the rate.
>
> "It is rather interesting to note in this connection that during the year 1936 our total gold production was about $126,000,000, whereas our reported exports amounted to $85,600,000 only, and at the same time the Bank of Canada did not add to their stock as reported. It would be rather interesting to know what happened to the remainder." [21]

It was subsequently pointed out that a statement of the Bank's holdings is published in a footnote to the *Monthly Trade Return*

[21] J. P. Bell, "Banking in Canada, Past and Present". Address before Winnipeg Bankers' Lecture Club.

of Canada, published by the Government, but Mr. Bell is, however, of the opinion that the logical place would be a footnote to the Bank of Canada statement.

Changes in Balance Sheet of Bank of Canada in 1938

The Statement of Assets and Liabilities of the Bank of Canada on the 31st day of December, 1938, showed an increase in assets held by the Bank of approximately $14½ millions over the assets of the Bank at the close of 1937. The Bank's holdings of gold coin and bullion at the close of 1938 amounted to $185,912,000, an increase of $6,148,000 over the holdings of the year before. Of this increase, $4,325,000 was attributable to the addition of 122,890 ounces to the Bank's stock of gold, and the balance was largely due to the fact that the premium on the United States dollar as of December 31, 1938, was 31/32 of 1 per cent. as compared with 3/32 of 1 per cent. on December 31, 1937.[22] The Exchange Fund Act provides that all gold held as reserve by the Bank of Canada shall be valued at the current market price, namely, the amount realizable from the sale of gold in London or New York converted into Canadian dollars at the current rate of exchange.

Silver bullion, valued at $2,993,000 in the balance sheet of the Bank on December 31, 1937, was sold during the year.[23] The Bank now holds no silver bullion.

The growth of approximately $95 millions in the note issue and liabilities of the Bank since December 31, 1935, together with some increase in Canadian dollar deposits in chartered banks, owned by persons resident outside of Canada, made it desirable that the Bank should add to its reserves from time to time. The management of the Bank felt that it was essential that such reserves should be maintained in a form which would insure their immediate availability in case of need without exposing the Bank to risk of loss. The increase in the gold holdings of the Bank during 1938, to an extent that more than offset the sale of its silver bullion, is in line with the policy to which reference has just been made.

During the course of the year the Bank's holdings of sterling and U.S.A. dollars almost doubled, increasing from $14,884,810.21

[22] *Annual Report* of the Governor of the Bank of Canada to the Minister of Finance, February 6th, 1939, pp. 4, 5.

[23] Ibid., p. 5.

at the close of 1937 to $28,354,420.52 on December 31, 1938. In comparing the Bank's holdings of pounds sterling and U.S. dollars with those of December 31, 1937, account must be taken of the changes in the item "Other Securities". These "Other Securities" may consist of obligations of the United Kingdom, any British Dominion, the United States of America, or France, subject to the restrictions in respect to dates of maturity set forth in paragraphs (e) and (f), subsection 1, Section 21 of the Bank of Canada Act as amended. On December 31, 1937, "Other Securities" amounted to $12,212,437.38. The statement of assets of the Bank at the close of 1938 disclosed no such item among the Bank's assets. The decrease of over $12,212,000 in "Other Securities" during 1938 is a little more than offset by an increase of $13,470,000 in the item "Sterling and U.S.A. Dollars".

The Bank of Canada's holding of Dominion and provincial government securities, valued at $185,516,000, shows an increase of $11,607,000 for the year 1938. The substantial increase in short-term obligations from $82,343,729.14 to $144,620,866.07 and decrease in investments having a maturity in excess of two years from $91,564,709.67 to $40,894,995.88 is largely due to the fact that the Dominion Government issue of 3 per cent. bonds, due March 1, 1940, fell in the short-term classification March 1, 1938.[24] The issue of $115,013,636 was initially held in its entirety by the Bank of Canada, which received it from the Dominion Government in part settlement of the liability assumed by the Bank for redemption of Dominion notes outstanding on March 11, 1935, the date on which the Bank commenced operations.

The item "Bank premises" showed an increase of approximately $480,000 during the year 1938. The amount shown in the Bank's statement at the close of 1938 was $1,647,580.14. This figure includes the total cost of all land and buildings owned by the Bank, together with the cost of furnishings and equipment, less the amounts which have been written off for depreciation. In addition to its Head Office building in Ottawa, the Bank owns its Agency premises at Vancouver, Calgary, Regina, and Toronto, while rented premises are occupied by the Agencies at Winnipeg, Montreal, Halifax, Saint John, and Charlottetown.[25]

[24] Ibid., p. 6.
[25] Ibid.

At the close of December, 1938, the note issue of the Bank of Canada stood at $175,260,000, an increase of $9,929,000 for the year. An increase of $6,992,000 in the amount of the Bank's notes in the hands of the public was more than offset by a reduction of $7,696,000 in the note issues of the chartered banks. Thus the net active circulation at the end of the year was $704,000 less than at the end of 1937.

During the year 1938 "Deposits of Chartered Banks" increased $4,606,000. Notes of the Bank of Canada held by the chartered banks as at December 31, 1938, were $2,937,000 higher than the year before, so that the total increase in the cash reserves of the chartered banks was $7,543,000.

Profit and Loss

After providing for contingencies and reserves, the amount available for distribution in 1938 was $2,033,100.97. Deducting dividend requirements of $367,800 the balance remaining to be apportioned between the Rest Fund and the Dominion Government was $1,665,300.97, compared with $1,814,096.36 for the preceding year. During 1938 the Bank's investments averaged $17,107,000 more than in 1937, but the average yield declined sufficiently to cause a slight falling off in earnings. Another factor which reduced the profits of the Bank was a loss on silver amounting to $135,740.18 compared with $13,847.41 in 1937.[26]

Public Debt Division

Acting under powers conferred by Section 23 (2) of the Bank of Canada Act, the Minister of Finance directed that the Bank should, beginning April 1, 1938, act as Agent for the Government in the payment of interest and principal and in respect to the management of the public debt of Canada. For the purpose of carrying out this function the Bank of Canada established what is called "The Public Debt Division of the Bank", and on April 1, 1938, the staff of the Loans and Interest Branch of the Department of Finance entered the service of the Bank.[27] In view of the fact that so much of the work of the former Loans and Interest Branch had been interwoven with the work performed by the Bank in its capacity as fiscal agent of the Dominion

[26] Ibid., p. 9.
[27] Ibid.

Government, it was felt that the amalgamation would be in the interests of efficiency and economical operation.

The permanent employees of the Bank now number 359, an increase of 139 since 1937, reflecting for the most part the establishment of the Public Debt Division of the Bank, to which reference has just been made.

Bank Rate

The Bank Rate remained unchanged throughout 1938 at 2½ per cent. As in previous years, there has been no need for the chartered banks to borrow.

Chartered Banks' Cash Reserves

The ratio of cash held by the chartered banks to their deposit liabilities payable in Canadian dollars averaged 10.5 per cent. in 1938. There is usually an increase in the banks' cash reserves during the last few months of each year. In 1937, the ratio of cash to deposits in Canadian dollars rose from 9.9 per cent. in September to 11.4 per cent. in November. In 1938 the rise was from 10 per cent. in July to 11.2 per cent. in November. The increase in the banks' cash takes place mainly through a reduction in their holdings of Dominion Government Treasury bills, and an increase in the Bank of Canada's holdings of these obligations. The management of the Bank of Canada estimated that between the end of July and the end of November in 1938 the holdings of the banks were reduced by approximately $21 millions. During that period the investments of the Bank of Canada in all forms of Dominion and provincial government securities increased by some $27 millions.[28]

The desire of the chartered banks to build up their cash reserves during the closing months of each year is based on demands in connection with the movement of crops, and the practice of showing a strong cash position at fiscal year ends.

Foreign Exchange

Fluctuations in the relationship between the pound sterling and the U.S. dollar were more extensive in 1938 than in any year since 1933 due largely to the uncertainties of the European situation. The Canadian dollar was naturally subject to some

[28] Ibid., p. 11.

extent to the same influences as the pound but fluctuated much less widely. Both the pound and the Canadian dollar declined in terms of the United States dollar but the decline of the Canadian dollar in New York was small in comparison with that of the pound. The main cause of the drop in sterling—a heavy movement of funds out of the United Kingdom—found no counterpart in Canada. On the contrary, there was an increase of foreign purchases of Canadian securities, and an inward movement of funds for deposit in Canadian banks.[29] These factors, and the continued strength of the Canadian balance of international payments on current account, explain the relative strength of the Canadian dollar during 1938.

Growth of the Bank of Canada

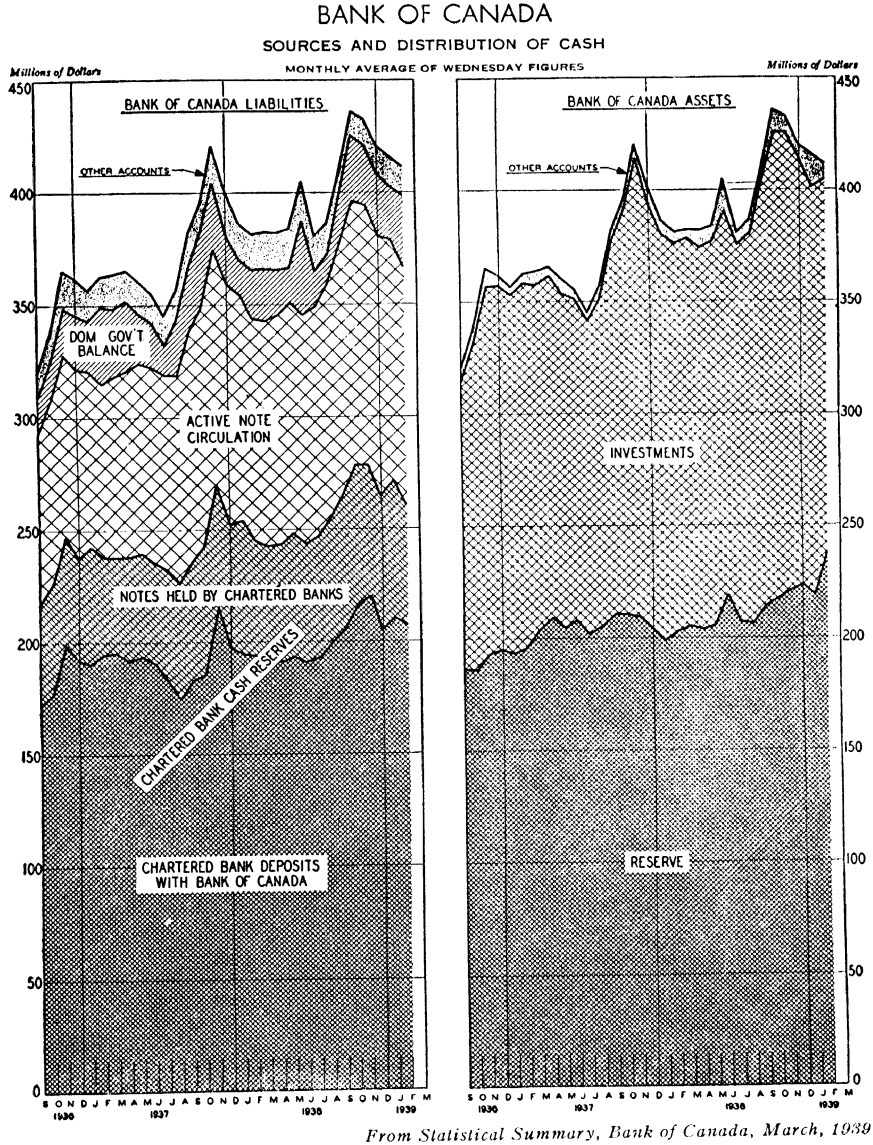
The period since the establishment of the Bank of Canada has been marked by a steady and sound growth. When the Bank was established its total assets or liabilities were $259,314,757. At the end of December, 1938, these had increased to a little more than $404,000,000. On the asset side there has been a striking increase in the holdings of Dominion Government short-term securities and a decrease in the holdings of Dominion-Provincial long-term securities. Likewise there has been a substantial increase in the holdings of foreign currencies. Since the close of 1935 gold holdings have increased a little more than $5 millions.[30]

On the liability side, chartered bank deposits at the Bank of Canada have varied considerably at times, depending on the open market operations of the Bank, increasing sharply in the fall and decreasing around December 1st. Bank of Canada notes in active circulation and in the tills of the chartered banks have increased in amount, reflecting in part reduction in the note circulation of the chartered banks and partly because of the higher business volume.

The following charts taken from the *Statistical Summary* published by the Bank of Canada, March, 1939, set forth in detail the changes in the assets and liabilities of the Bank since its inception.

[29] Ibid., p. 14.

[30] In the first few months of 1939 the gold holdings of the Bank increased rapidly.



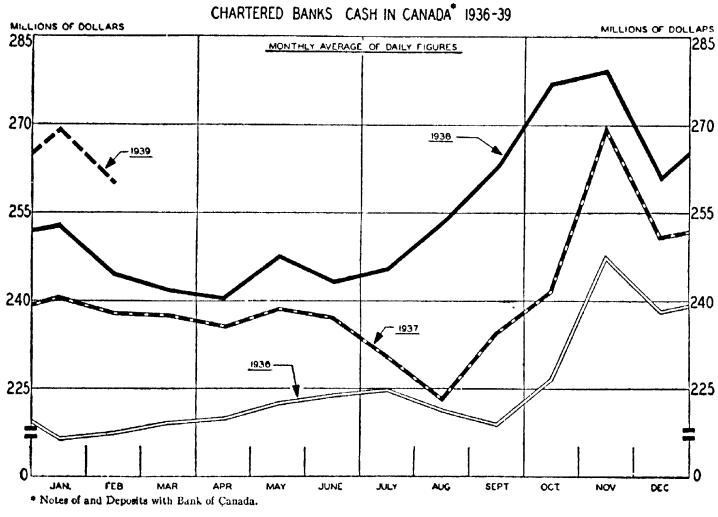
From Statistical Summary, Bank of Canada, March, 1939

CHART I

Millions of Dollars I—BANK

	LIABILITIES							
	Chartered Bank Cash			Govt. Deposits	Other Deposits	Active B. of C. Note Circulation	All Other Accounts	Total Assets or Liabilities
	Notes in Tills	Deposits at B. of C.	Total					
Average of Wednesday Figures								
1935– 9 Mths.	37 2	176 5	**213.7**	23.9	.7	48.9	6.8	**294.0**
1936–12 Mths.	40.4	184.7	**225.1**	22 5	1 0	64 0	9.4	**322.0**
1937–12 Mths.	49 8	191.4	**241.2**	25.8	1.2	90.6	13.5	**372.2**
1938–12 Mths.	56.0	199.6	**255.6**	22 8	2 1	105.9	12.5	**399.0**
1938—Feb.	51.6	193.7	**245.3**	21 6	2 4	98 6	13.3	**381.3**
Mar.	49.6	193 2	**242.8**	23.4	2.6	100.0	13 6	**382.4**
Apr.	52.8	190.7	**243.5**	20 3	2.7	101 9	13.8	**382.2**
May	54.9	193.3	**248.2**	16 4	2 8	102.1	14.4	**383.9**
June	53 0	190 8	**243.8**	42 4	2.1	101.4	15.1	**404.8**
July	55.1	192 6	**247.7**	16 0	2.0	101.3	13.7	**380.7**
Aug.	55 4	199 8	**255.2**	13.3	1.6	104.3	12 9	**387.2**
Sept.	60.2	205.5	**265.7**	21 4	1.0	111.5	9.3	**408.9**
Oct.	62.0	216.2	**278.2**	28.6	1.4	118.4	9.5	**436.0**
Nov.	58.3	219.9	**278.2**	26 6	1.5	116.4	10.5	**433.2**
Dec.	59.6	204.6	**264.2**	28.4	2.3	115.6	10.1	**420.6**
1939—Jan.	61.1	210 4	**271.5**	23.6	3.3	107.5	10.1	**416.0**
Feb.	53.4	207.0	**260.4**	31.8	3.1	106.0	10.4	**411.7**
Wednesdays								
Mar. 1	51.6(2)	206.9	**258.5**(2)	18.2	3.1	107.0(2)	10 5	**397.3**
8	52.3(2)	206 2	**258.5**(2)	16.1	3.3	107.0(2)	8 5	**393.5**
15	53.6(2)	206 4	**260.0**(2)	20.2	3.3	106.1(2)	9.0	**398.6**
22	53.7(2)	204 1	**257.8**(2)	22 7	5 4	105 5(2)	8 8	**400.2**

(1) Includes "Other Securities" (2) Estimates

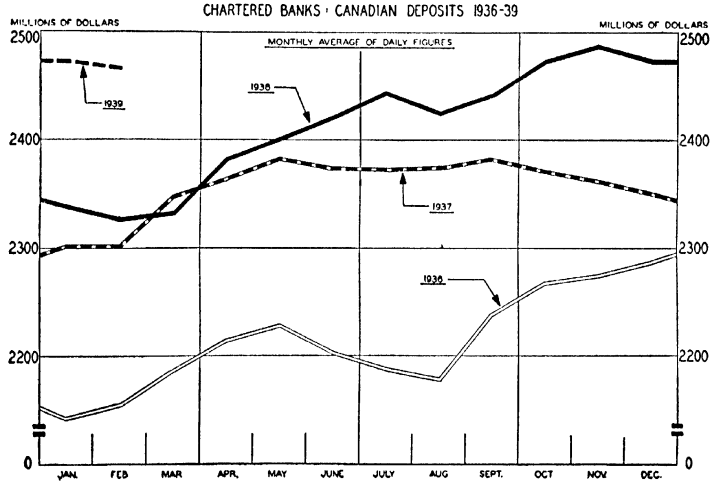


From Statistical Summary, Bank of Canada, March, 1939

CHART II

OF CANADA *Millions of Dollars*

ASSETS										
Reserve					Securities					
Gold	Silver	Foreign Currencies	Total Reserve	*Reserve Ratio*	Dom.-Prov. Short	Dom.-Prov. Long	Total[1]	Advances	All Other Accounts	Average of Wed Figures
154.6	1.4	10.3	**166.2**	*57.87*	25.6	94.0	**119.6**	4 1	4.0	1935– 9 Mths.
179.7	1.8	11.4	**192.9**	*61 69*	37 0	86.3	**123.2**	1 7	4.2	1936–12 Mths.
182.0	2.5	20.4	**204.8**	*57.11*	57.9	98.4	**162.2**	. . .	5.1	1937–12 Mths.
181.0	.9	28.7	**210.6**	*54 50*	122.5	53.0	**181.2**	.9	6.3	1938–12 Mths.
180.0	3 0	20.3	**203.4**	*55 26*	72.7	88 2	**173.1**	. . . . .	4.8	Feb.—1938
180.2	3.0	22.3	**205.5**	*55.72*	119.3	41.5	**173.1**	.	3.8	Mar.
180.7	1.8	21.5	**204.0**	*55.37*	116 3	41 5	**170.1**	2.8	5 4	Apr.
181.3	.4	24.4	**206.1**	*55.78*	120 7	39 0	**170.9**	. . .	7 0	May
181.9	.....	37.7	**219.6**	*56.34*	113.3	51.9	**171.3**	. . . . .	14.0	June
180.8	.....	26.5	**207.3**	*56.48*	114.5	52.5	**167.8**	. . .	5.6	July
180.5	.....	26.0	**206.5**	*55.17*	121.3	52.5	**173.8**	.....	6.9	Aug.
181.5	.....	32.9	**214.4**	*53.65*	139.8	48.9	**188.7**	. . .	5.8	Sept.
181.4	.....	36.2	**217.6**	*51.02*	161.9	46.1	**208.0**	4 8	5.6	Oct.
181.2	.....	39.8	**220.9**	*52 27*	162.2	42.5	**204.7**	2.0	5.6	Nov.
182.4	.....	40.9	**223.3**	*54.40*	151.0	40.5	**191.4**	.....	5.9	Dec.
188.4	.....	31.1	**219.5**	*54.09*	140.1	41.6	**181.7**	.....	14.7	Jan.—1939
194.6	.....	42.1	**236.8**	*59.01*	128.8	39 1	**167.9**	....	7.0	Feb. Wednesdays
200.2	.....	29.0	**229.1**	*59.24*	128 4	33 7	**162.0**	. . .	6.1	Mar. 1
201.7	.....	28.6	**230.3**	*59.82*	128.4	30.5	**158.9**	.	4.3	8
201.8	.....	35.2	**237.0**	*60.82*	130.8	25 5	**156.3**	. . . .	5 4	15
202.1	.....	36.4	**238.5**	*60.93*	130.8	26.1	**156.9**	.	4.8	22



From Statistical Summary, Bank of Canada, March, 1939

CHART III

CHAPTER XII

THE ROLE OF THE BANK IN THE CANADIAN ECONOMIC SYSTEM

THE Bank of Canada was established for the purpose of performing certain functions and accomplishing specific objectives, namely: to manage the internal currency and credit structure, to provide a suitable instrument for the execution of an international policy and the control of the external value of the dollar and to mitigate by its influence fluctuations in the general level of production, trade, prices and employment, so far as may be possible within the scope of monetary action, and generally to promote the economic and financial welfare of the Dominion. In addition, the Bank was intended to be a dependable source of information and an adviser to the Government in both internal and international financial and economic situations.

It is now pertinent to consider to what extent the Bank of Canada has attained the objects for which it was created and how far it is possible for the Bank to do so.

In the short period of its existence the Bank of Canada has built up a complete central banking organization with nine branches. It has assumed the role of governmental banker and agent for the Government in the payment of interest and principal, and generally in respect to the management of the public debt of Canada. It has managed a number of loans and conversion operations. The Bank has been active in the field of credit and currency, and has managed the many adjustments incidental to its own organization without causing any serious disturbances. It took over the gold and reserve balances of the chartered banks, replaced the Dominion note issue by Bank of Canada notes, began the ten-year withdrawal programme of the notes of the chartered banks, revalued its gold holdings, established an exchange fund for the future protection of the Canadian currency, and has assisted in broadening the market for Dominion Treasury bills of three months' duration.

Bank of Canada Control of Paper Currency

Paper money in Canada now consists of two types: first, chartered bank notes, and second, Bank of Canada notes. Chartered bank notes are subject to rigid limitation under the existing law as to maximum issue. That maximum will decrease year by year until 1945, when the banks will have the right to issue only up to twenty-five per cent. of the amount of their paid-up capital. Bank of Canada notes may be issued by the Bank subject only to the limitation that the Bank must keep a reserve of at least twenty-five per cent. in gold against its total note and deposit liabilities. The small denominations of Bank of Canada notes, chiefly the ones, twos, and fives, constitute the large change of hand-to-hand circulation. In addition Bank of Canada notes have another important function. Being legal tender they may constitute legal reserves for the chartered banks. In other words, the chartered banks keep Bank of Canada notes as well as deposits in or balances with the Bank of Canada as the cash reserves which they are required to maintain against their demand liabilities, comprising both notes and deposits payable in Canadian dollars.

Bank of Canada's Instruments of Credit Control

To carry out the purposes for which it was established the Bank of Canada was given three instruments of control: (1) variation of the rediscount rate; (2) open market operations, and (3) foreign exchange operations. By virtue of the position it occupies the Bank may employ a fourth—exhortation and advice. The Bank has not been established long enough as yet, to determine the effectiveness of these weapons.

The successful execution of an appropriate monetary policy depends largely upon the structure of the financial system and upon the efficiency of its operation. The relative efficiency of instruments of credit control is conditioned by the organization of the money market. In view of these facts how far may credit control in Canada be regarded as a practical possibility? This requires an examination of the probable effectiveness of the Bank of Canada's instruments of control, having regard to the Canadian economy and the existing financial structure.

The Bank of Canada exercises its control over the chartered banks by operating on the cash reserves of the banking system

either by altering its rediscount rate or by conducting so-called open market operations, or by both. The chartered banks, like all commercial banks, are accustomed to keep a certain proportion of cash reserves against their note and deposit liabilities. In practice they have found it necessary to keep this cash reserve in order to be able to meet the demands for cash that may be made upon them at any time by their note holders or by their depositors. In Canada the cash reserves of the chartered banks consist of notes of the Bank of Canada and deposits by the chartered banks with the Bank of Canada. The Canadian chartered banks as a group think it expedient to maintain an average reserve of approximately ten per cent. By law they must maintain at least five per cent.

The Bank Rate

The bank rate is one of the devices by which a central bank exercises control over the banking system. The bank or rediscount rate is the rate of interest at which the central bank will lend money. Under a central banking system the commercial banks are normally dependent upon the central bank for emergency funds, for example, the surplus funds required in financing heavy seasonal requirements, or the later stages of a period of business expansion. The banks, in order to expand their cash reserves to take care of these requirements, obtain funds from the central bank by selling to it high-grade securities or by rediscounting commercial paper which they have discounted for their customers. By raising the rediscount or bank rate the central bank tends to discourage borrowing by the commercial banks, and conversely, by lowering the rate, encourages borrowing and expansion of credit.

The effectiveness of discount policy depends to some extent upon the ability of the central bank to shape the loan policies of the commercial banks. It depends more upon the effectiveness of the discount rate in influencing market rates of interest and customer rates at banks than on the effect upon the volume of funds borrowed. There are serious limitations to the effectiveness of the rate even in some countries with a highly developed money market. While changes in the rate are effective in France and Great Britain, this is not true of the United States. While the Canadian banking system is a highly centralized system, thus

differing from the American system, Canada has not a developed money market with a highly sensitive structure of interest rates as is found in London and a number of other countries. Operations in Montreal and Toronto are not likely to be influenced as greatly as would operations in centres like London and Paris.

In the absence of a highly developed money market in Canada, it is doubtful if a variation in rediscount rates would spread automatically and readily through the pressure of market competition to other rates of interest. Nevertheless, it may be expected that higher or lower rates of rediscount will influence to some extent, at least, the demands of the chartered banks for loans and rediscounts from the central bank and thereby the general volume of credit. The control exercised by this method is indirect rather than direct, and it may not be very effective unless there is a well developed money market sensitive to changes in discount rates.

Snyder has expressed the opinion that changes in the bank rate are rather useless in the control of business expansion through the regulation of the amount of credit. "The direct effect of interest rates upon the course of the business cycle seems less than many have supposed. . . . In the main, the more important changes in business seem to take place before the movement of interest rates could be of any material importance. All of which has an important bearing upon the problem of stabilizing trade or moderating the extremes of the business cycle by means of changes in the bank rate." [1]

One weakness of the bank rate is that variations in the rate can be used as an instrument of control only when the commercial banks apply for loans. The effectiveness of the bank rate depends on the initiative of the borrowers, the commercial banks.

When the Bank of Canada was established it set the rate at 2½ per cent. and it has remained unchanged. The figure is the same as that which was being charged for advances under the Finance Act, prior to the establishment of the Bank. It is the rate which the Bank would ordinarliy charge the chartered banks for advances. This rate is, as the Governor has pointed out,

[1] Carl Snyder, *Business Cycles and Business Measurements* (1927), p. 299.

quite out of touch with the Treasury bill rate.[2] This, the Governor has stated, is not at present of any particular significance.[3] "When money is in plentiful supply, the need for loans or rediscount facilities seldom arises. It is in times of greater stringency that accommodation from the central bank is essential. A central bank must be what is known as a lender of last resort, which implies that in times of real need its rediscounting and lending facilities will be freely accorded."

With the exception of two occasions in 1935 and the same number in 1936, when relatively small amounts for short periods were borrowed from the Bank of Canada, the chartered banks have had sufficient funds of their own to supply Canadian requirements, thus obviating recourse to the central bank. To date not a single weekly statement of the Bank of Canada has shown any bills discounted. It is thus quite evident that one of the chief instruments of credit control has not been available to the Bank. There is no occasion for rediscounting paper when business conditions are such that there is no opportunity for the chartered banks to lend the enormous deposits they have. At present there is no opportunity for the Bank of Canada to function as a rediscount bank.

The fact that rediscounting by the banks has not been resorted to does not mean that that method of controlling credit and currency is obsolete. The time may come when the raising or lowering of the rediscount rate may effectively operate to expand or curtail credit in Canada.

Open Market Operations

Open market operations, through buying and selling of securities and commercial paper, are expected to form one of the most effective means the Bank may use to influence the volume of credit and thereby general business activity and the general price level. However, since the short-term market in Canada is of a limited scope, it is expected that open market operations of the Bank will, for some time to come, be largely in government and government guaranteed securities. Mr. Rogers, Secretary of the Canadian Bankers' Association, points out that the Bank's

[2] *Report*, First Annual General Meeting of Shareholders, February 25, 1936, p. 16.
[3] Ibid.

dealings in short-term securities will, no doubt, for the most part, be in Treasury bills, greater use of which by the provinces may be encouraged by the Bank in an effort to build up a short-term money market in Canada.[4]

The Dominion Government has, to an increasing extent, relied on short-term financing during the past two or three years. The Government is in the process of organizing a money market. As much progress as can be expected has been made thus far. It now appears to be the policy of the Dominion Government to keep a sufficient amount of Treasury notes outstanding to make a good market. Dominion Treasury bills now outstanding amount to about $150,000,000. The Government is not expected to issue Treasury bills proportionately as heavily as in Great Britain or the United States. To do so would appear to be dangerous.

Treasury bills were formerly sold without tender at the absurdly high rate of 4 - 4½ per cent. The present Deputy Minister of Finance, Dr. Clarke, adopted the tender system when he was appointed to office. In June, 1938, the average yield of successful tenders of three months' Treasury bills was .465 per cent.[5] In February, 1939, it was .681.[6] During 1936 the amount of Dominion Government Treasury bills outstanding was increased from $105 millions to $150 millions. At the close of 1938 Dominion Treasury bills outstanding amounted to $150 millions.[7] The average yield of Treasury bills for 1938 was .590 as compared with .719 for 1937.[8]

In regard to the Treasury bill market, **Mr. Towers, Governor** of the Bank, had this to say in his first annual report in February, 1936:

> "It is universally recognized that a central bank is hampered in its operations when an active bill market does not exist. Few countries, however, have the bill market they would like. Under present conditions a fairly satisfactory market can be established if there is a sufficient volume of Treasury bills, if there is a good institutional distribution of these, and, in particular, if it is the commercial banks' policy to hold Treasury bills as their secondary reserve. The mere existence of a central bank at once widens and strengthens

[4] *Journal of the Canadian Bankers' Association*, October, 1934, p. 32.
[5] *Statistical Summary*, Bank of Canada, February, 1939, p. 25.
[6] Ibid.
[7] Ibid., p. 23.
[8] Ibid., p. 25.

the market for first-class bills, since the central bank itself will be a large holder and will engage in purchase and sales in pursuance of its open market policy, and for other reasons. In so doing, it is likely to have the effect of steadying the rate. The Bank of Canada can, I feel, claim it has been of assistance in both these respects.

"In times past, New York call loans and bankers' acceptances were, to a large extent, regarded as the secondary reserve of Canadian banks. Fluctuating exchange rates have practically ruled out these items as a means of employment of that portion of a bank's Canadian assets which need not be kept in cash, but which must be convertible into cash, in large volume and without sacrifice, at a moment's notice. Canada has been lacking in facilities of this kind. I hope the deficiency will be remedied. Treasury bills can be made to play an increasingly important role in our banking life, if further experience and a further widening of the market demonstrate—as I believe they will—the utility of this form of temporary investment. One should not think of such bills as being merely a means of cheap governmental financing, and nothing more."

In his second annual report, February 23, 1937, Mr. Towers, in his remarks concerning the establishment of an active bill market, said:

"One must recognize, however, the goal is a long way off. I feel it is quite likely that if money conditions ever become less easy than they have been in the past few years, Treasury bills may be rather neglected, and that holders may tend to allow their bills to run off through a desire to obtain additional cash. Such a development would call for the refunding of a suitable portion—perhaps a substantial portion—of the bills now outstanding. The market would then be short of assets which can properly be classified as second line reserves. I think it is probable that experience over a period of years, and of a variety of conditions will be necessary before we can achieve a satisfactory bill market in Canada."

While it is perfectly true that Canada has no money market which can compare with the markets in London or New York, there has been too much of a tendency to conclude that there is no money market at all. A reading of some of the evidence submitted to the Macmillan Commission might readily lead to the conclusion that it would be impossible for a central bank to conduct open market operations on any scale in governmental securities. It is true that there are times when it is difficult,

if not impossible, to buy or sell very large blocks of government securities within the course of a few days without a serious disturbance to the market. It should be remembered, however, that at a time when it is extremely difficult to sell in a hurry, the central bank will not likely want to do so—and the same statement applies to buying operations.

A study of the Bank's holdings of governmental securities shows wide fluctuations. Between July, 1937, and November of the same year they increased by approximately $65 millions; and between November, 1937, and April, 1938, they decreased by some $35 millions. In relation to the Bank's total assets and liabilities, these are very substantial amounts. Certainly movements of the same relative importance would be regarded as very large by the Federal Reserve System or the Bank of England. One must conclude, therefore, that open market operations on a large scale have been conducted without any particular difficulty by the Bank. As already stated, it does not mean that large amounts can be bought or sold without delay. In these days banks cannot always rely on selling large blocks of the United Kingdom or United States securities in London or New York.

Anyone who takes the trouble to do so can find the Bank of Canada's policy mirrored in its own weekly or monthly statements or in its *Statistical Summary* issued monthly, and the effects of that policy in the monthly statements of the chartered banks.

An examination of the statistical data and charts issued by the Bank reveals the fact that the Bank's holdings of securities acquired through open market operations show a sharp rise during the latter half of each year. Beginning in December, usually, these holdings decrease. There is a similar or corresponding rise and fall in the cash reserves of the chartered banks and in the active note circulation of the Bank of Canada. This policy is similar to that followed by the Federal Reserve System in the United States.

It is apparent that the Bank of Canada through appropriate monetary action is seeking to provide ample funds and credit to meet seasonal requirements of agriculture and industry. In the fall, during the movement of the crop, additional credit needs are usually experienced.

On March 1, 1935, the end of the first month in which the Bank of Canada was in operation, the cash reserve of the chartered banks was $200,600,000 and their Canadian deposits were $2,033,600,000. As at December 31, 1938, cash reserves of the chartered banks had increased to $264,000,000, and Canadian deposits had increased to $2,498,000,000.[9] This increase has come about largely through open market operations. From March 31, 1935, to April 30, 1938, cash reserves of the chartered banks increased by about 21.2 per cent. while deposits increased during the same period by about 20.2 per cent.[10]

It is a matter of judgment how much deposits should be forced up by operations of the central bank. From March 31, 1935, to April 30, 1938, bank reserves in England increased 15.1 per cent. and deposits 17.9 per cent.[11] If the United Kingdom be taken as the model, cash reserves and deposits in Canada expanded considerably more than in the United Kingdom for the corresponding period.

Moral Suasion

In view of the statements made by the Governor of the Bank of Canada, there may be a question in the minds of many as to whether, in the absence of a highly sensitive money market, a central bank in Canada will find itself in a position to make effective any policy of control over the financial mechanism. In a country with a highly centralized banking system, where there are only ten banks, four of which conduct over three-fourths of the total banking business, there is the possibility that exhortation and advice or "moral suasion" on the part of the central bank will be more effective in carrying out a given monetary policy than the ordinarily mechanical means of enforcement such as the rediscount rate and open market operations. Moral suasion is likely to be far more effective in Canada than in the United States due to the fact that the managements of a few large commercial banks feel more responsible for credit conditions than the managements of 15,000 banks can be made to feel. There is the likelihood that the chartered banks in Canada will co-operate closely with the Bank of Canada just as the joint stock banks in England do with the Bank of England.

[9] *Statistical Summary*, Bank of Canada, January, 1939, pp. 2 and 4.
[10] Mr. Ilsley (Acting Minister of Finance), *Debates, House of Commons, 1938* (unrevised), p. 4645.
[11] Ibid.

The force of moral suasion depends on the prestige and reputation built up over a period of years and the willingness of the chartered banks to accept that advice. The respect given to the advice tendered by the central bank will depend upon the quality of that advice. This, to a large extent, depends upon the character of the personnel of the central bank. In this respect the Bank of Canada has, in the four years of its life, got off to a good start. It is highly creditable that, from the Governor down, most of the chief officials of the Bank have relinquished posts which offered far greater financial opportunities than the Bank can offer. Thus the tradition of public service is well established. In the opinion of Mr. Plumptre, Lecturer in Money, Credit and Prices at the University of Toronto, this is the outstanding achievement of the Bank of Canada so far.[12] As the Bank becomes older its influence and prestige may be expected to increase.

Foreign Exchange Operations

Another and at times an exceedingly important instrument of central bank control is its operations in the foreign exchange market. By buying or selling foreign currencies the Bank of Canada may affect their prices in terms of Canadian dollars. Upon the price of British pounds depends, in part, the return the Canadian farmer receives for wheat sold in Liverpool. Upon the price of American dollars depends, in part, the burden of Canadian debts payable in New York. Due to the extensiveness of her external trade Canada's prosperity is largely dependent upon the relationship of the Canadian dollar to other currencies. Over this exchange value the Bank of Canada can exercise a considerable measure of influence through the wide powers conferred upon it.

In the field of foreign exchange the Bank will compete with the chartered banks, and, it is expected, will exercise a dominating influence therein with a view to maintaining the foreign exchange value of the Canadian dollar. This will be an important as well as a difficult function in view of the importance of the foreign commercial relations of Canada, the average per capita foreign trade of which was almost four times that of the United States in the years immediately preceding the depression, and in view of the relatively large foreign investments in Canada.

[12] *Financial Post*, October 26, 1935.

It is not assumed that the Bank will be able to control the effects of a major international financial collapse, but it is expected that it will prevent, as far as possible, fluctuating exchange rates beyond certain limits.

To enable the Bank to carry out its authority to mitigate fluctuations in exchange rates the Act authorized the Bank to appoint branches and agents, on approval, abroad, to open accounts in the central bank of any country or the Bank for International Settlements, and to act as agent, depository, or correspondent of any of these banks, and to deal in short-term foreign exchange bills or drafts not exceeding ninety days, and in short-term government obligations of the United Kingdom and the United States, and to maintain a reserve in the form of balances with specified foreign banking institutions.

By holding foreign exchange and by holding balances abroad the Bank can by appropriate purchases or sales of foreign currencies offset minor fluctuations but not major trends.

The Bank Has Not Taken Over Control of Foreign Exchange

Chartered banks continue to buy and sell foreign exchange, on their own initiative, through brokers. The Bank of Canada has not taken over the control of such. Dominion Government operations in foreign exchange are carried on through the Bank of Canada. Possibly some of the provincial foreign exchange operations are also performed by the Bank. Most provincial foreign exchange operations are conducted through the chartered banks.

The Bank of Canada has no foreign branches. It buys and sells foreign exchange through foreign exchange brokers and through the chartered banks. Since its opening the Bank of Canada has not in any way attempted to influence the exchange rate one way or another. Canada is, apparently, one of the few important countries of the world not doing so.

Canadian Dollar Fluctuates Between Pound and U.S. Dollar

One feature of Canada's finance in recent years has been the extraordinary level maintained by the Canadian dollar in international exchange. In 1935, 1936, 1937, and 1938, the Canadian

dollar exhibited a remarkable tendency when not at parity with the pound or the United States dollar, to take up an intermediate position. The entire range of fluctuations with the United States dollar during 1937 was 37/64 per cent., compared with 1¼ per cent. in the preceding year. Against the pound sterling the range of fluctuations was approximately 3 1/16 per cent. compared with 4 per cent. in 1936.[13] In the long run, the purchasing power of the Canadian dollar must approximate that of the United States dollar and the pound sterling or there would be a marked divergence in exchange rates. Credit for the stability, the Governor of the Bank of Canada stated in his third annual address, must go to the tripartite agreements between Great Britain, the United States, and France. "Had there been no machinery of this kind in operation it is probable—perhaps one might say certain—that the disturbing developments which have taken place from time to time during the past year, would have been quite sufficient to cause wide fluctuations in the rates."[14] In his first annual address the Governor stated: "From the point of view of short-term movements, it is probable that the large volume of United States and United Kingdom investments in Canada, and the existence of so many Canadian bonds payable in two or three currencies—a feature of our financial economy which is not found in any important degree in any other country —have had a tendency to restrict fluctuations in our exchange rate." [15]

Fluctuations in relationship between sterling and the U.S. dollar were more extensive in 1938 than in any year since 1933. The Canadian dollar was naturally influenced to some extent by the uncertainties of the European situation during the spring and autumn. After remaining near par until early in March, it declined to an average discount in terms of U.S. funds of 1.09 per cent. in June. It rose somewhat during July and August, but fell during the last four months of the year to an average discount of .82 per cent. The range for the year of the Canadian dollar in New York, using noon rates, was 2.19 per cent., as compared with a little more than ½ of 1 per cent. in 1937. The Canadian

[13] The Governor of the Bank of Canada, Third Annual General Meeting of the Shareholders, February 22, 1938.

[14] Ibid.

[15] February 25, 1936.

dollar fluctuated between .06 per cent. premium and 2.13 per cent. discount.[16]

In his Annual Report to the Minister of Finance in February, 1939, the Governor of the Bank of Canada pointed out that the decline of the Canadian dollar in New York was small in comparison with that of the pound. The main cause of the drop in sterling, namely a heavy movement of funds out of the United Kingdom, found no counterpart in Canada. On the contrary, there was an increase in foreign purchases of Canadian securities and an inward movement (probably of relatively moderate proportions) of funds for deposit in Canadian banks. Mr. Towers said these factors, and the continued strength of the Canadian balance of international payments on current account, make the relative strength of the Canadian dollar during 1938 easily understandable.

Ever since it started operations the Bank of Canada has been increasing its holdings of foreign currency to protect the Canadian dollar. Because the Dominion depends to such a great degree upon her trade, both export and import, confidence that the Canadian dollar in relation to other important national currencies will remain fairly stable is a matter of utmost importance to Canadians.

In the case of a marked divergency between the pound and the United States dollar, some people have speculated as to the attitude of the Bank of Canada, whether it would attempt to tie the Canadian dollar to the pound or to the United States dollar. Fortunately, no decision has had to be made and at the present time the matter is purely an academic one. The view on the part of some in Ottawa is that it would probably be better to leave the Canadian dollar untied to either.

Exchange Fund

The Exchange Fund, created under the control of the Minister of Finance, has not been proclaimed as yet. It has been created but is not operative. At present there is no need to use it. The fund was created as an additional instrument of control so that it would be available, if and when required, to iron out fluctuations in the rate of foreign exchange. It may never be

[16] The data used were taken from the *Annual Report* of the Governor of the Bank of Canada to the Minister of Finance, February 6, 1939.

necessary to use the fund. Some critics have expressed the view that the fund is much too small to be of any use. That may be true. However, because of the close trade relationships with both the United States and Great Britain, the Canadian dollar tends to fluctuate with the currencies of these nations. A large fund is, therefore, not necessary. The present co-operation of the United States and Great Britain through the tripartite agreement to stabilize foreign exchange rates has relieved Canada of much anxiety concerning the external value of her dollar. As a consequence, the Exchange Fund, although ready for action, has not been used.

Improvements in Canada's balance of international payments has made the task of upholding the Canadian dollar on the exchange markets of the world a comparatively easy one. While total Canadian exports during 1936, 1937, and 1938 averaged 17 per cent., or $220 millions a year less than in the earlier period, merchandise imports fell much more than exports, averaging 36 per cent., or $400 millions a year less than they had been in the earlier period.[17] This had the effect of leaving unusually large credit balances on current account to be devoted to the repayment of foreign debts.

Variations in Reserve Requirements

Unlike the powers given to the Board of Governors of the Federal Reserve System in the United States, the Bank of Canada has no power to vary the reserve requirements of the chartered banks. This promises to be the most potent of the instruments of credit control available to the Federal Reserve System. Some are in favour of having the same instrument incorporated in the Bank of Canada Act. Possibly some time in the future the principle of having flexible or varying reserve ratios may be adopted. The effect on the Canadian banking structure would probably not be as harsh as in the case of the American banking structure with its thousands of unit banks.

Control of Borrowing Abroad

Some individual thought has been given to the control of foreign borrowing but that is as far as it has gone. The Governor of the Bank stated in February, 1936:

[17] Ibid.

"The extent to which Canadian borrowers incur foreign obligations and later discharge them, and the manner in which such commitments are taken, are matters of public interest affecting our balance of payments and the exchange value of the Canadian dollar. The situation is one which can not fail to involve close attention on the part of a central bank."

Advisory Functions of the Bank

In its capacity as government banker, the Bank of Canada plays an important role as financial adviser and agent of the Government. The Bank acts as agent of the Minister of Finance in handling all direct or government-guaranteed issues in Canada. Dr. Marvin, Economist of the Royal Bank of Canada, states that "presumably this means not only that it takes care of mechanical arrangements, such as the receipt of subscriptions, making allotments and deliveries, but also that its advice is sought in regard to the timing, pricing, and the general terms of Government and Canadian National Railways' financing. If this is the case, it is reasonable to assume that the Bank of Canada must take considerable responsibility with regard to such issues, although it does not underwrite them as does the Commonwealth Bank of Australia." [18]

Through its advisory function the Bank can do much toward solving an important problem, if given an opportunity. This is the problem of organized borrowing in Canada. In the past the Dominion and provincial governments have sought funds where they pleased and to the extent they believed them available. Debt maturities often compelled provinces to compete with each other. A limited market has been surfeited with new issues by provinces seeking funds, thereby upsetting the plans of each other and increasing the costs of borrowing. The chartered banks did their best to exert a regulatory influence in such matters, but the general feeling is they were not altogether successful.

Obviously, there is a need for some responsible authority which will provide expert and disinterested advice, particularly to the provincial governments, on financial matters, and offer facilities for some co-ordination of borrowing operations. The central bank with its facilities for studying economic and monetary conditions at home and abroad, and its machinery for handling

[18] *The Canadian Banker*, October, 1937, p. 26.

loans, can be of great assistance to the provinces. In addition, temporary accommodation may be granted by the Bank at appropriate times. There is here, obviously, a fertile field for reaping tangible benefits hitherto undeveloped through lack of an appropriate agency.

The Bank has expressed its willingness to act as financial adviser to the provincial governments. Dr. Marvin, economist to the Royal Bank of Canada, points out, however, that in point of fact the Bank of Canada has not yet been accepted as the financial adviser of any of the provinces.[19] Whether or not it will assume this function in the future remains uncertain. Dr. Marvin states that it is probable there is some reluctance on the part of the provinces to seek financial advice from the Bank because of the fear that within the provinces the cry will be raised against federal domination. If such fears are entertained by the provincial governments they are baseless, for it is the duty of the Bank to offer independent and impartial advice to the provinces without reference to the fact that it stands in a special relationship to the Dominion Government.

Since one of the important responsibilities of a central bank is to influence the volume and the cost of credit, close co-operation with the central government is essential. It is possible for the Bank of Canada to carry out this responsibility without the same kind of co-operation with the provincial governments; nevertheless co-operation between the Bank and such governments is desirable and can be very helpful both to the individual governments concerned and to the country as a whole. The Governor of the Bank of Canada has stated that if the Bank should be requested at any time to act as financial adviser to any province, that relationship should be entered into on the understanding that it would be of a continuing character, for without a close and continuous connection the Bank would not be able to acquire that full knowledge of a province's position which would enable it to give the province the best service of which it is capable in the matters of expert advice.[20] If such a relation were established, the Bank could perform for the provincial government much the same kind of services it now undertakes for the Dominion Government. It would not be necessary for the Bank

[19] Ibid.

[20] *Report* to First Annual General Meeting of the Shareholders, February 25, 1936, p. 13.

to become the sole banker of the province: existing connections with the chartered banks need not be disturbed.

Central Bank Co-operation

The Governor of the Bank of Canada is keenly aware of the advantages of central bank co-operation. In his report to the First Annual General Meeting of the Shareholders, Mr. Towers said:

> "The desirability of increased co-operation between central banks has been much discussed for a number of years, and has been stressed at various international conferences. There is much that can be done in the way of interchange of information. Business conditions in a country's main markets have an important bearing on domestic trade. A central bank which contented itself with a knowledge of home affairs and turned a blind eye to developments elsewhere would not be fulfilling its duty to its own people. The central banks of other countries constitute an excellent source of information. They can provide facts rather than surmises. Co-operation along these lines is extremely helpful, and can be developed by arrangement between central banks.... Few countries are more dependent than Canada upon international trade. In our own interests we must welcome and encourage any loosening of the shackles which have been placed on world business during the years since the War. . . ."

Canada has now the appropriate machinery for co-operating with the other central banks of the world. Although it has not been called upon to send delegates to any financial conference, the Bank is in touch with other central banks and with the Bank for International Settlements.

Establishment of Bank Furthers Intra-Empire Relations

The self-governing nations of the Empire have each established a central bank. Co-operation among these banks may be expected to result in a closer co-ordination of Empire monetary policy and technique. This chain of Empire central banks has been completed while the economic affairs of the world were in a state of flux. As a tangible result there is likely to be a greater identity of economic interests.

When the Bank of Canada was first established the *Financial Post*, *Le Devoir*, and a number of other papers in Canada feared that the Bank, together with those in the other self-governing

Dominions, might become mere branches of the Bank of England. There was a fear that Canadian monetary and financial policies would be dominated by Threadneedle Street. It was believed that the establishment of a central bank in Canada, working closely with the Bank of England, would place Canadian financial policy at the mercy of a group who would dictate it for purposes and objectives quite foreign to Canadian interests. Apparently this view was held by some in England.

The *Ottawa Citizen,* on November 11, 1933, carried an article which was an excerpt from the *New English Weekly* stating:

> "Whatever the origins of the movement for the central bank in Canada, our Canadian friends will not, we are sure, be deceived into supposing it possible for a committee of the constitution of Lord Macmillan's to have any other final goal than the subjection of Canada to international central bank control regardless of the well-being of her people."

Mr. Towers, Governor of the Bank of Canada, at the First Annual General Meeting of the Shareholders, took cognizance of such views and said:

> "While I am on the subject, I might mention that one of the Empire central banks, namely, the Bank of England, is supposed by some persons to exercise a universal and malign influence in financial matters the world over. I should like to say that, in my opinion, that is just nonsense, and that in any case one can rely safely upon the central banks and governments of the respective Dominions to see that no undue or pernicious influence is exerted. In these unsettled times, the real problems of central banks are grave enough in all conscience. It would be regrettable if the burden were increased by the addition of imaginary complications."

The Central Bank and the Chartered Banks

While the chartered banks, with one or two exceptions, were opposed to the establishment of a central bank, they have co-operated willingly with it. Their profits will be reduced somewhat as a result of the restriction of their note-issuing powers. This curtailment of earning power will possibly reduce the ability of the banks to maintain unproductive branches in the smaller communities.

The functions of the Bank of Canada are regulatory and supplementary and in no way competitive with the chartered banks. The Bank will not deal with the public. It cannot accept

deposits or make loans and advances except to the chartered banks, the banks incorporated under the Quebec Savings Bank Act, and the Dominion and provincial governments. The banking needs of the country will continue to be met by the chartered banks. The Bank is the fiscal agent of the Dominion Government and a bank for the chartered banks whose deposits with it will comprise a major part of their bank reserves.

While the establishment of the Bank of Canada may result in a somewhat lower rate of profit for the chartered banks there are certain advantages which accrue to these banks. The possibility of securing loans from the central bank is most valuable, for it means that they can rest assured of being able to tide over, at a price, stringencies that might otherwise prove embarrassing. The Bank of Canada provides a clearing house for the chartered banks. Each day's clearings for the whole of Canada are settled in the Bank of Canada by debiting or crediting the accounts of the chartered banks.

In commenting on the effect of the central bank on the chartered banks Mr. J. P. Bell said:

> "As far as the actual effect of the Bank of Canada on the banks up to the present is concerned, it has not been very unfavourable. The stipulation as to certain reserves being kept with it or in its notes free from interest, involves no greater hardship than before, when the reserves were kept in cash and Dominion notes. There is the loss of a profit estimated at one and one-half per cent. on the average circulation in excess of existing limits, which is not very vital, a loss of exchange profit, and the loss of what profit the banks may have made in handling government business now handled by the Bank of Canada. It is hoped that the authorities will see the fairness of paying the banks for the large amount of work they still do for them without any compensating balance." [21]

Effectiveness of the Bank's Instruments of Control

The fundamental job of the Bank of Canada is that of controlling the amount of money circulating in the Dominion and the volume of credit. By far the most important of the Bank's activities is that of determining the amount of the chartered banks' cash reserves. The commercial banking structure of the country is based on these reserves.

[21] J. P. Bell, *Banking in Canada, Past and Present*, p. 9.

In the absence of a sensitive money market in Canada, and the difficulty of constructing a satisfactory one, some have been sceptical of the effectiveness of the bank rate and open market operations as instruments in influencing the general volume of credit and the general price level. While conditions that have obtained in Canada have made it difficult for the Bank to function with respect to credit, the Bank has been able to carry out substantial open market operations from time to time and to vary considerably the size of the reserves of the chartered banks, with a view to making credit conditions easier. If business improves, if conditions in the Dominion reach the point where chartered banks are not compelled to invest their money in the country's securities but can find outlets for their funds in commercial loans, the open market operations of the Bank of Canada will increase in importance and effectiveness. On the other hand, under existing conditions of easy money, the Bank cannot make the rediscount rate effective. Variation of the bank rate, in any case, is not likely to prove satisfactory as an instrument of credit control.

Due to the peculiarities of the Canadian economy and Canada's dependence on the results of international trade, a purely domestic policy such as the stabilization of the level of wholesale prices must be subordinated to the achievement of stability of the foreign exchange value of the Canadian dollar in terms of the currencies of the countries with which Canada trades. Through the purchase and sale of sterling and United States dollars and the securities of the Governments of Great Britain and the United States much can be done by the Bank to mitigate fluctuations in exchange rates.

Through moral suasion the Bank may be expected to secure the co-operation of the chartered banks in making effective a given monetary policy. When the central bank was first discussed the chartered bank executives were virtually unanimous in condemning it as unnecessary and undesirable. That primary hostility has apparently pretty well faded. While chartered bank heads may not altogether enjoy having the Bank of Canada make decisions which they formerly made, their relations are cordial and co-operation is of the closest.

Part of the role of the Bank is and will be that of acting as the fiscal agent, banker, and economic adviser of the federal government. The Bank is not acting as the adviser to any

provincial government at the present time. It is hardly possible, at this time, to suggest that such a function is likely to be in the near future an important part of the Bank's activities. That will depend on the attitude of the provinces.

It is claimed that the Bank has been a factor in the reduction of interest rates in Canada and that the Dominion Government has been the chief benefactor. On the other hand, some have suffered from this policy, and murmurs are heard in certain quarters as to whether it has not gone too far. It must be remembered that an easy money policy was initiated by the Dominion Government before the Bank was established. It is the traditional method of attempting to stimulate recovery. In carrying out such a policy the Bank is pursuing a policy laid down by the Government itself. Similar policies prevail in both the United Kingdom and the United States.

The Board of Governors of the Federal Reserve System emphasized recently the problem created by the existing large volume of bank deposits and bank reserves in the United States. The Board pointed out to Congress that the ability of the banks to expand greatly the volume of their credit without resort to the Federal Reserve banks would make it possible for a speculative situation to get under way that would be beyond the power of the system to check or control.[22] Some are of the opinion that a similar problem exists in Canada, although it has arisen differently. The view has been expressed that the chartered banks are not in a position of "imminent dependence" and until they are the Bank of Canada can only work through moral suasion. To those who hold this view it is a moot question whether this position of "imminent dependence" should be brought about by increasing the legal reserve requirements of the chartered banks or whether it should be left to come about through the gradual increase of Canadian economic activity.

A situation similar to that existing in the United States does not appear to exist in Canada. The Canadian banks, as a whole, have for many years endeavoured to operate on a cash ratio of, say, 9½ to 10 per cent. There have been some years when the cash ratio averaged somewhat less than 9½ per cent., but the

[22] "Problems of Banking and Bank Supervision". Excerpts from the 1938 *Annual Report* of the Board of Governors of the Federal Reserve System, Washington, 1939.

circumstances which produced these lower ratios are unlikely to return. For one thing, some banks in those earlier days maintained a ratio of less than 5 per cent.; that is now impossible. It therefore appears that from a practical point of view the difference between the legal minimum cash ratio of 5 per cent. and a figure of, say, 9½ or 10 per cent., does not constitute "excess" reserves. Thus the true excess at the present time is very moderate. Taking absolute figures, one could say that at the present time, on a 9½ per cent. basis the excess is about $18 millions, or on a 10 per cent. basis about $5 millions.

Objectives and Criteria of Central Bank Action

The objectives of the Bank of Canada and of the Government which controls it were clearly stated by Mr. Dunning, Minister of Finance, in a speech before the House of Commons, as follows: [23]

> "These objectives are the maximum possible sustained level of productivity and the minimum possible level of unemployment."

Mr. Dunning in outlining objectives and criteria of central bank action said: [24]

> "If the country is suffering from abnormal unemployment and if the volume of production is relatively low, then there is a prima facie case for an easy money policy. If production and employment in the country as a whole are at a high level, the objective is naturally to maintain the equilibrium. Gradual growth in the population of productivity per capita might in such a case call for a moderate enlargement of the credit base, that is, the cash reserve of the banking system year by year. The third case which we may visualize is one in which boom conditions, sure to be accompanied by an unwise use of credit and increased maladjustments, are seen to be developing. In such circumstances the central bank may try a direct attack on the source of trouble if it is limited in its character; but if it is widespread, general restrictive action may be necessary."

The Minister of Finance pointed out that this description of monetary policies, which might be appropriate under varying conditions must, of necessity, be of a very general nature. For the purpose of determining the proper monetary policy at any

[23] March 8, 1938.
[24] Ibid.

given time the Bank must keep itself informed relative to the changes and trends which are constantly taking place. The most important indications of change, Mr. Dunning said, are to be found in a study of all data relating to production, distribution, and employment; changes in the general price level of wholesale and retail goods, in the cost of living and in the relationship of these to one another; changes in the relationship between prices of consumers' and producers' goods, manufactured goods and primary commodities, especially foodstuffs; and changes in import and export prices, in other words, the "terms of trade". Lack of equilibrium between these separate sets of prices is liable to upset the balance of payments and the national income.

The Minister did not suggest that monetary policy by itself can restore equilibrium in such cases, but developments of the kind indicated are danger signals which must be observed by a central bank because of the effect which they may have on general business, and because of the possibility that action by the Bank, or by the Government in a non-monetary field, may contribute to the restoration of the equilibrium.

Other factors which Mr. Dunning stated may create disturbances in the national economy and which should be watched closely by the Bank are: the budgets and policies of the national, provincial and municipal governments; capital movements, short-term and long-term; speculation in the stock market, in commodities, or real estate; changes in imports and exports and the country's balance of payments. The effect of tariffs at home and abroad should be studied and an examination should be made of the debtor or creditor status of the country. The Bank should keep itself as well informed as possible relative to the outlook for business in the country's principal markets.

Having taken all these factors into consideration, the Bank must then determine what the volume of cash should be; that is, the size of the combined cash resources of the commercial banks, upon which their credit structure is based. The Minister of Finance stated that the appropriate amount of cash at any given moment cannot be determined without reference to the rate of turn-over of the medium of payment; that is, the rate of turn-over of bank deposits and money, sometimes called the velocity of circulation. This cannot be known with exactness, but the Minister suggested that bank deposits, clearings, and the course

of prices give a good indication. He regarded changes in the national income as more conclusive evidence but it might be available too late to be of use.

History has shown many examples of the policy of a central bank being determined by the real or supposed short-term needs of its Government; sometimes, as in the case of war, their needs are so pressing that they get the right of way, even if the actions taken are not in the long-term interest of the country as a whole. Mr. Dunning stated that it is obvious that in the ordinary course of events such considerations should be definitely subordinated to the long-term requirements of the economy as a whole.

The Minister in discussing the objectives of the central bank, and the criteria by which it must govern its actions stated he did not want to convey the idea that a central bank by studying all of these factors can arrive at conclusions which can be stated in precise mathematical terms. All this information must be the subject of continuous study and continuous intelligent interpretation. It must be mixed with experience, business sense and a sound sense of public psychology.

Limitations of Central Banks

There are many false expectations as to what a central bank can accomplish. The public should neither expect too little nor too much from the Bank of Canada. There are very definite limitations to the power of a central bank to accomplish fully the objectives set forth.

These limitations find their origin in many factors. In the first place central banks are operated by men who may err in their analysis of business conditions and in their prescription of a particular remedy. Furthermore, central banking technique is a relatively recent development. While some of the traditional weapons have been used for many years by a few of the great central banks of the world, it is only since the War that the full arsenal of weapons has been developed. Much is yet to be learned. Central bankers are dealing in the rarefied atmosphere of monetary finance.

Another limitation is the fact that many non-monetary factors are in part responsible for the rhythmic swings of business activity and the fluctuations in price levels. No economic problem

is more the subject of warm controversy among economists than that of the relative importance of, and the causal relations between monetary and non-monetary factors in the business cycle. When unsound business conditions are due primarily to non-monetary factors it may not be subject to effective treatment by purely monetary methods.

A further limitation in the ability of a central bank to accomplish its objective of monetary control and stable price levels is to be found in the fact that no country lives unto itself alone. This is particularly true of Canada. Many disturbances of business are the result of disturbed economic or political conditions internationally. Therefore, it is idle to expect such business fluctuations to be cured by purely domestic policies. It is necessary that there be co-operation (without, by any means, the surrendering of any degree of autonomy or independence) with the central banks of the world. There must be, as indicated before, an intelligent and continuous co-operation between central banks.

A successful functioning of a central bank implies an intelligent understanding on the part of the public of the possibilities for good inherent in such an institution and the difficulties it must surmount in order, measurably, to accomplish its objectives. If the Bank of Canada is to be a real success it must have a well-informed and intelligent public opinion on monetary and banking matters, a public opinion that will allow the Bank to play the role it is designed to play and will not expect it to work miracles. The Bank is not going to meet the wishes of those who hope to see an institution dispensing government credit in unlimited amounts at little or no cost to all and sundry. The Bank of Canada is not a "Lady Bountiful".

There is the danger that certain economic and political groups will expect the Bank to accomplish much in short periods of time. The Bank may find that its friends and advocates will cause it more embarrassment than its opponents. Tangible results will be looked for. It should be borne in mind that a central bank is an instrument and a force; it is a long-term influence and its effect on the financial and economic structure of a country may not be easily observed or capable of measurement.

The Bank must not be made a political football nor the puppet of whatever government is in power. The Bank should not be

regarded simply as another arm of the Government although there should be close co-operation between the Bank and Treasury officials. It should be free from political influence and should be conducted solely on lines of prudent finance. While the Bank should be subordinate in that the ultimate responsibility for the Dominion's monetary and financial policy lies with the Government of the day, it should be an independent adviser, accessible to the Government at all times.

The Bank is feeling its way along. Its credit policies and technique will develop along the lines experience dictates. Four years of experience indicate that the Bank will move carefully and guardedly with a view to making the institution a force with recognized prestige in the financial and banking organization of the country.

The Bank of Canada has not yet been faced with a major crisis and has still to prove itself. The Bank has still to show what it can do in the terms of the preamble of its charter "to mitigate by its influence fluctuations in the general level of production, trade, prices and employment so far as may be possible within the scope of monetary action."

APPENDIX I

24-25 GEORGE V.

CHAP. 43.

An Act to incorporate the Bank of Canada.

(*Assented to 3rd July, 1934.*)

Preamble.

WHEREAS it is desirable to establish a central bank in Canada to regulate credit and currency in the best interests of the economic life of the nation, to control and protect the external value of the national monetary unit and to mitigate by its influence fluctuations in the general level of production, trade, prices and employment, so far as may be possible within the scope of monetary action, and generally to promote the economic and financial welfare of the Dominion: Therefore, His Majesty, by and with the advice and consent of the Senate and House of Commons of Canada, enacts as follows:—

SHORT TITLE

Short title.

1. This Act may be cited as the *Bank of Canada Act.*

INTERPRETATION

Definitions.

2. In this Act unless the context otherwise requires:—

"Board of Directors."

(a) "Board of Directors" or "Board" means the Board of Directors of the Bank of Canada;

"Chartered Bank."

(b) "chartered bank" means a bank to which the Bank Act applies;

"Director"

(c) "director" means a member of the Board of Directors other than the Governor or the Deputy Governor;

"Dominion notes."

(d) "Dominion notes" means notes payable to bearer on demand issued and outstanding, which on the day on which the Bank of Canada is authorized to

commence business, constitute a direct liability of the Dominion of Canada;

"Meeting." *(e)* "meeting" means a special or general meeting of the shareholders;

"Minister." *(f)* "Minister" means the Minister of Finance;

"Notes." *(g)* "notes" means notes of the Bank of Canada payable to bearer on demand and intended for circulation;

"Receiver General." *(h)* "Receiver General" means the Receiver General of Canada;

"The Bank." *(i)* "the Bank" means the Bank of Canada;

"Treasury Board." *(j)* "Treasury Board" means the Treasury Board as constituted by the Department of Finance and Treasury Board Act.

CONSTITUTION OF THE BANK

The Bank constituted. **3.** (1) There shall be established a bank to be called the Bank of Canada.

Body corporate. (2) When the capital stock of the Bank has been subscribed as hereinafter provided, the Minister shall give public notice of the fact in the *Canada Gazette* and on the publication of such notice the shareholders shall become a body corporate.

Head Office. **4.** (1) The head office of the Bank shall be in the city of Ottawa.

Branches and agencies. (2) The Bank may establish branches and agencies and appoint agents in Canada and may also, with the approval of the Governor in Council, establish branches and appoint agents elsewhere than in Canada.

Board of directors. **5.** (1) The Bank shall be under the management of a Board of Directors composed of a Governor, a Deputy Governor and seven directors. There may also be an Assistant Deputy Governor who shall not as such be a member of the Board.

Deputy Minister to be member of Board. (2) In addition to the Members of the Board as constituted by subsection one of this section, the Deputy Minister of Finance or, in case of his absence or incapacity at any time, such other officer of the Department of Finance as the Minister may nominate for the time being, shall be, by virtue of his office or of such nomination, as the case may be, a member of the Board, but shall not have the right to vote.

Governor and Deputy Governor. **6.** (1) The Governor and Deputy Governor shall be men of proven financial experience and each shall devote the whole of his time to the duties of his office.

(2) No person shall hold office as Governor or Deputy Governor or Assistant Deputy Governor, who,— Persons disqualified for appointments.

(a) is not a British subject; or

(b) is a member of either House of Parliament or of a Provincial Legislature; or

(c) is employed in any capacity in the public service of Canada or of any Province of Canada or holds any office or position for which any salary or other remuneration is payable out of public moneys; or

(d) is a director, officer or employee of any other bank or financial institution or has an interest as a shareholder in any bank or other financial institution; or

(e) has reached the age of seventy-five years.

MANAGEMENT.

7. (1) The Governor of the Bank shall be the chief executive officer and shall on behalf of the Board have the direction and control of the business of the Bank, with authority to act in connection with the conduct of the business of the Bank in all matters which are not by this Act or by the by-laws of the Bank specifically reserved to be done by the Board or by the Executive Committee or by a meeting of shareholders. Powers of Governor of the Bank.

(2) The Deputy Governor and the Assistant Deputy Governor shall perform such duties as are assigned by the Board. Duties of Deputy Governors.

(3) In the event of absence or incapacity of the Governor from whatever cause arising, the Deputy Governor shall have and may exercise all the powers and functions of the Governor. Absence or incapacity of Governor.

(4) In the event of absence or incapacity of both the Governor and the Deputy Governor, the Board of Directors shall authorize the Assistant Deputy Governor or one of the members of the Board to act as the Governor for the time being, but no such person shall have authority to act as Governor for a period exceeding one month without the approval of the Governor in Council. Absence or incapacity of Governor and Deputy Governor.

8. (1) The Governor, Deputy Governor and Assistant Deputy Governor shall each be appointed as hereinafter provided for a term of seven years or, in the case of the first Governor, Deputy Governor and Assistant Deputy Governor, for such shorter period as the Governor in Council may determine. Tenure of office.

Appointment of first Governor, Deputy and Assistant.

(2) The first Governor, Deputy Governor and Assistant Deputy Governor shall be appointed and their salaries shall be fixed by the Governor in Council and thereafter appointments shall be made by the directors with the approval of the Governor in Council.

Salaries.

(3) Except as provided in the next preceding subsection the Governor, Deputy Governor and Assistant Deputy Governor shall, subject to the approval of the Governor in Council, receive such salaries as the directors from time to time determine, but no such remuneration shall be in the form of a commission or be computed by reference to the income or profits of the Bank.

Re-appointment.

(4) The Governor, the Deputy Governor and the Assistant Deputy Governor shall on the expiry of their terms of office be eligible for re-appointment.

Condition of tenure.

(5) The Governor, Deputy Governor and Assistant Deputy Governor shall each hold office for the aforesaid term during good behaviour.

DIRECTORS

Provisional directors.

9. (1) Notwithstanding anything contained in section ten of this Act, the first, or provisional, directors of the Bank shall be the following members of the Civil Service of Canada, namely, The Deputy Minister of Finance; The Counsellor of the Department of External Affairs; The Comptroller, Government Guarantee Branch; The Comptroller of the Treasury; The Comptroller of Currency; The Director of Estimates and Assistant Secretary to the Treasury Board, and The Solicitor to the Treasury, who shall remain in office until replaced by directors duly elected in their stead at the first general meeting of shareholders. The said first or provisional directors shall serve without remuneration.

Remain in office until directors are elected.

Term of office of elected directors.

(2) At the first general meeting of shareholders aforesaid, directors shall be elected for terms to run as follows: one until the third annual general meeting, two until the fourth annual general meeting, two until the fifth annual general meeting and two until the sixth annual general meeting respectively.

Election of directors.

(3) Thereafter directors shall be elected by the shareholders at annual general meetings and shall hold office for terms of five years.

Vacancies.

(4) In the event of a vacancy amongst the directors the Board shall appoint a qualified person to hold office

until the next annual general meeting, when the shareholders shall elect a person to fill the vacancy, for the remainder of the term.

(5) The directors shall on the expiry of their terms of office be eligible for re-election. Re-election.

10. (1) No person except a shareholder who is the registered owner of ten shares of the capital stock and who has paid all calls thereon shall be elected or shall continue to hold office as a director. Qualification.

(2) The directors shall be selected from diversified occupations, but no person shall be eligible to be a director who is a director, officer or employee of a chartered bank and any person nominated for election as a director who is a shareholder of a chartered bank shall if elected divest himself of ownership of his shares within three months of the date of his election and shall not thereafter during the period of his office have an interest, either directly or indirectly, as a shareholder in a chartered bank. Directors to represent diversified occupations.

(3) No person shall be elected or shall continue to hold office as a director, who— Persons disqualified to be directors

(a) is not a British subject ordinarily resident in Canada; or

(b) is employed in any capacity in the public service of Canada or of any Province of Canada or holds any office or position for which any salary or other remuneration is payable out of public moneys; or

(c) has reached the age of seventy-five years.

(4) If any director, in the opinion of the Board, becomes permanently incapacitated, he may be removed from office by resolution of the Board approved by the Governor in Council. Removal if permanently incapacitated.

11. The directors shall be entitled to receive for attendance at directors' meetings and executive committee meetings, such fees as may be fixed by the Board and approved at a general meeting, but the aggregate amount of the fees paid to all directors, exclusive of expenses, shall not exceed twenty thousand dollars in any year. Fees of directors.

12. The members of the Board shall select a chairman of the Board from amongst their number. Chairman.

EXECUTIVE COMMITTEE

Constitution of Executive Committee.

13. (1) There shall be an Executive Committee of the Board, consisting of the Governor, the Deputy Governor and one director selected by the Board.

Deputy Minister to be member of executive committee.

(2) In addition to the Members of the Executive Committee as constituted by subsection one of this section, the Deputy Minister of Finance or, in case of his absence or incapacity at any time, such other officer of the Department of Finance as the Minister may nominate for the time being shall be by virtue of his office or of such nomination, as the case may be, a member of the Executive Committee, but shall not have the right to vote.

Powers.

(3) The Executive Committee shall be competent to deal with any matter within the competence of the Board but every decision of the committee shall be submitted to the Board at its next meeting.

Rate of discount and rediscount.

(4) Except when the Board is in session the Executive Committee shall determine the minimum rates at which the Bank is prepared to discount or rediscount bills or to make advances and the Bank shall at all times make public the rates at which it is prepared to discount or rediscount bills or to make advances.

Minutes.

(5) The Executive Committee shall keep full minutes of its proceedings, which shall be submitted to the Board at its next meeting.

All action must be concurred in by Governor or Deputy Governor.

14. No action or decision of the Board of Directors, or of the Executive Committee, shall have any effect unless the same is concurred in by the Governor, or in his absence or incapacity, by the Deputy Governor.

BANK STAFF

Officers and employees.

15. (1) Such other officers, clerks and employees may be employed as in the opinion of the Executive Committee may be necessary.

Salaries.

(2) In the case of officers, clerks and employees of the Bank who at the date of appointment were officers, clerks or employees of the Civil Service of Canada, the salaries to be paid by the Bank shall be at rates not less than the rates which such persons were receiving in the Civil Service.

(3) Any officer, clerk or employee mentioned in subsection two of this section who was a contributor under the provisions of the *Civil Service Superannuation Act*, chapter twenty-four of the Revised Statutes of Canada, 1927, may continue as a contributor under the provisions of the said Superannuation Act for a period not exceeding one year after the date of his appointment by the Bank, and shall during such period continue his contributions to the Civil Service Superannuation Fund and the Bank shall during the said period contribute to the said Fund a like amount. Subject to the provisions of subsection four of this section, at the expiration of one year after the date of the appointment by the Bank of any such officer, clerk or employee his benefits under the provisions of the said Superannuation Act shall be calculated and determined as of the date of the expiration of the said year as if he had at that time retired from the Civil Service by reason of abolition of his office, in which case the enjoyment of the said benefits shall be deferred until such time as he leaves the service of the Bank.

Contributor under Superannuation Act may continue payments for one year. Bank to contribute like amount.

Adjustment at end of year, subject to right of election.

(4) Upon the said officer, clerk or employee becoming a contributor to or participant in any pension scheme which the Bank may establish he may elect either—

Right of election when he becomes contributor to Bank pension fund. Benefits calculated at date of becoming contributor to Bank pension fund.

(i) to have his benefits under the provisions of the said Superannuation Act calculated and determined as at the date of his becoming a contributor to or participant in any pension scheme which the Bank may establish or at the expiration of one year from the date of his appointment as aforesaid, whichever shall first occur, in which case the enjoyment of the said benefits shall be deferred until such time as he leaves the service of the Bank; or

Waiver of rights under Superannuation Act.

Period in Civil Service to be counted.

(ii) to waive his right to any payment or benefit under the said Superannuation Act and in that case his period of service in the Civil Service shall be counted as service with the Bank for the purposes of the Bank's pension scheme to the extent that such service would have counted under the said Superannuation Act. The Governor in Council and the Bank may enter into an agreement as to the amount to be paid to the Bank with reference to the assumption by the Bank of liability under its pension scheme with respect to the said period of service in the Civil Service. The Minister may pay the amount agreed upon out of any unappropriated moneys in the Consolidated

Agreement as to amount to be paid to Bank on assumption of liability.

Revenue Fund, which shall be recorded as a payment from the said Superannuation Fund, and the Bank shall pay the said amount into its Pension Fund.

Payment.

Regulations.

(5) The Governor in Council may make such regulations as may be deemed necessary to give effect to the provisions of subsections three and four of this section.

Pension fund.

(6) The Board may by by-law establish a pension fund for the officers, clerks and employees of the Bank and their dependents, and may contribute to it out of the funds of the Bank, and such pension fund shall be invested in securities in which a trust company may invest under the Trust Companies Act.

Oath of directors and staff.

16. Every director, officer, clerk and employee of the Bank shall before entering upon his duties take before a Justice of the Peace or a Commissioner for taking affidavits, an oath of fidelity and secrecy in the form prescribed in Schedule A to this Act.

CAPITAL AND SHARES

Capital.

17. (1) The capital of the Bank shall be five million dollars but may be increased from time to time pursuant to a resolution passed by the Board and ratified at a meeting of shareholders and approved by the Parliament of Canada.

Shares.

(2) The capital shall be divided into shares of fifty dollars each, represented by share certificates, which shall be offered by the Minister at not less than par for public subscription in Canada and shall be allotted by him to persons eligible to hold shares, in such manner as he may in his discretion determine.

Public subscription.

Minister may subscribe for shares not taken up.

(3) In the event of any of the shares (whether of the original or any subsequent issue) not being subscribed for by the public within a reasonable period the Minister shall subscribe for such shares, and notwithstanding any other provision of this Act, payment for the same shall be made out of the Consolidated Revenue Fund.

Offered to public.

(4) The Minister shall from time to time offer shares held by him or shares representing any increase of capital for subscription by the public at not less than par, whenever in the opinion of the Minister it is desirable to do so.

(5) The sum of twelve dollars and fifty cents, or such greater amount as the Minister may determine, shall be payable in respect of each share on application, and the balance shall be paid in one or more instalments within such period thereafter, not exceeding twelve months, as may be fixed by the Minister. Payment for shares.

(6) Shares held by the Minister shall be registered in his name and he shall be entitled to vote in respect of such shares. Shares held by Minister to be registered.

(7) The liability of every shareholder shall be limited to the amount for the time being unpaid in respect of shares held by such shareholder. Limited liability.

(8) Shares may be held only by or for the beneficial ownership of British subjects ordinarily resident in Canada, or corporations organized under the laws of the Dominion of Canada or of any province and controlled by British subjects ordinarily resident in Canada but not more than fifty shares shall be held by or for the benefit of any one person other than the Minister. British subjects only to hold shares. Fifty shares to any one shareholder.

(9) The Bank shall open and maintain one or more share registry offices at places to be designated by the Board. Registry offices.

18. (1) No shares of the capital stock of the Bank shall be held by or for the benefit of any chartered bank or any director, officer, clerk or employee of any such bank, and no chartered bank shall have any interest, directly or indirectly or through the medium of any officer, clerk, employee or other person, in any share of the Bank. No shares to be held by chartered banks.

(2) On the last day of January in each year the General Manager of every chartered bank shall transmit to the Minister a statement in the form of Schedule B to this Act that he has duly inquired and has found that no share of the Bank nor any interest therein is or has been during the preceding year held by or for the chartered bank contrary to the provisions of this section, or as the case may be. Statement from general manager.

19. If shares are held by a person not eligible to hold shares or if shares in excess of fifty are held by one person, the Governor shall require the shareholder to transfer or dispose of the shares or the shares in excess of fifty, as the case may be. If a shareholder fails to comply with this requirement within three months, the shares in question shall *ipso facto* on the expiration of three months from the mailing at Ottawa by registered Transfer or disposal of shares held in excess of fifty or by person ineligible.

mail of such requirement in the form of a notice in writing by the Minister to such shareholder be forfeited to the Crown and shall be registered in the name of the Minister without further proceedings or formality, and may be sold by the Minister and the proceeds of any such sales shall be deposited in the Consolidated Revenue Fund.

COMMENCEMENT OF BUSINESS

Certificate to commence business.

20. (1) Whenever the capital stock of the Bank has been subscribed and payment in money made to the amount of twelve dollars and fifty cents per share, or such larger amount as the Minister determines, the Minister, when authorized by the Governor in Council, may issue a certificate authorizing the Bank to commence business on a date to be fixed therein.

Permission to commence.

(2) The Bank shall not issue notes or otherwise engage in business until the date fixed in such certificate except to do what is necessary or advisable to enable it to commence business on the said date.

BUSINESS AND POWERS OF THE BANK

21. (1) The Bank may

Coin and bullion.

(a) buy and sell gold, silver, nickel and bronze coin and gold and silver bullion;

Exchange.

(b) effect transfers of funds by telegram, letter or other method of communication, and buy and sell transfers effected by such means, trade acceptances, bankers' acceptances, bankers' drafts, and bills of exchange drawn in or on places outside of Canada and having a maturity not exceeding ninety days excluding days of grace, or not exceeding ninety days after sight excluding days of grace, from the date of acquisition by the Bank;

Investments.

(c) buy and sell or rediscount short term securities issued or guaranteed by the Dominion of Canada or any province, having a maturity not exceeding two years from the date of acquisition by the Bank;

(d) buy and sell securities issued or guaranteed by the Dominion of Canada or any province, having a maturity exceeding two years from the date of acquisition by the Bank but the Bank shall at no time hold such securities (exclusive of securities transferred to the Bank under paragraph *(c)* of subsection three of section twenty-five) of a par

value in excess of three times the amount of the paid-up capital of the Bank;

(e) buy and sell short term securities issued by the United Kingdom, any British Dominion, the United States of America, or France, having a maturity not exceeding six months from the date of acquisition by the Bank;

(f) buy and sell securities issued by the United Kingdom or the United States of America, having a maturity exceeding six months from the date of acquisition by the Bank, but the Bank shall at no time hold such securities in excess of one-half of the amount of the paid-up capital of the bank;

(g) buy and sell or rediscount bills of exchange and promissory notes endorsed by a chartered bank drawn or issued in connection with the production or marketing of goods, wares and merchandise as defined in *The Bank Act*, excepting those mentioned in paragraph *(h)* of this subsection, and having a maturity not exceeding ninety days excluding days of grace, or not exceeding ninety days after sight excluding days of grace, from the date of acquisition by the Bank; Discounts.

(h) buy and sell or rediscount bills of exchange and promissory notes endorsed by a chartered bank, drawn or issued in connection with the production or marketing of products of agriculture, the forest, the quarry and mine, or the sea, lakes and rivers, as defined in *The Bank Act*, and having a maturity not exceeding one hundred and eighty days excluding days of grace from the date of acquisition by the Bank: Provided that the Bank may by regulation limit to a percentage of its total assets the amount of such paper having a maturity in excess of ninety days excluding days of grace but not exceeding one hundred and eighty days excluding days of grace, from the date of acquisition by the Bank;

(i) make loans or advances for periods not exceeding six months to chartered banks or to banks incorporated under the *Quebec Savings Banks Act* on the pledge or hypothecation of the foregoing classes of securities, bills of exchange or promissory notes, or of Canadian municipal securities, or of securities issued by a school corporation or parish trustees, or of securities issued pursuant to the statutes of a province making provision for the payment thereof and the interest thereon by Loans and advances

the province, or of gold or silver coin or bullion, or documents of title relating thereto;

(j) make loans or advances for periods not exceeding six months to the Dominion government or the government of any province on the pledge or hypothecation of readily marketable securities issued or guaranteed by the Dominion of Canada or any province;

(k) make loans to the Dominion Government or the government of any province, but such loans outstanding at any one time shall not, in the case of the Dominion Government, exceed one-third of the estimated revenue of such government for its fiscal year, and shall not in the case of any provincial government exceed one-fourth of such government's estimated revenue for its fiscal year; and such loans shall be repaid before the end of the first quarter after the end of the fiscal year of such government;

Open market operations.

(l) for the purpose of its open market operations, buy and sell in the open market from or to any person, either in or outside of Canada, securities, cable transfers, bankers' acceptances, and bills of exchange of the kinds and maturities defined in, and subject to the limitations, if any, contained in paragraphs *(b)*, *(c)*, *(d)*, *(e)*, *(g)* and *(h)* of this subsection with or without the endorsement of a chartered bank;

Deposits.

(m) accept from the Dominion Government or the government of any province or from any chartered bank or from any bank incorporated under the *Quebec Savings Banks Act* deposits which shall not bear interest;

(n) open accounts in a central bank in any other country or in the Bank for International Settlements and act as agent, depository or correspondent of such other central banks or the Bank for International Settlements;

Real estate.

(o) acquire by purchase or lease and hold real or immovable property for the actual use and occupation of the Bank in connection with its business and sell and dispose of the same;

(p) do anything ancillary to all or any of the above purposes.

Acquisition of collateral securities.

(2) The Bank may acquire from any chartered bank and hold any warehouse receipt, bill of lading and other security, held by such chartered bank pursuant to the provisions of *The Bank Act,* as collateral security for

the repayment of any bill of exchange or promissory note acquired by the Bank under the provisions of the next preceding subsection; and the Bank may exercise every right and remedy in respect of such collateral security as could have been exercised by the chartered bank aforesaid.

Prohibited business.

22. The Bank shall not, except as authorized by this Act,

(a) engage or have a direct interest in any trade or business whatsoever;

(b) purchase its own stock or the shares of any other bank except the Bank for International Settlements or make loans upon the security thereof;

(c) lend or make advances upon the security of any real or immovable property; provided that in the event of any claims of the Bank being in the opinion of the Board endangered, the Bank may secure itself on any real property of the debtor or any other person liable and may acquire such property, which shall, however, be resold as soon as practicable thereafter;

(d) make loans or advances without security;

(e) accept deposits for a fixed term or pay interest on any moneys deposited with the Bank;

(f) allow the renewal of maturing bills of exchange, promissory notes or other similar documents purchased or discounted by or pledged to the Bank; provided that the Board may make regulations authorizing in special circumstances not more than one renewal of any such bill of exchange, promissory note or other document.

Fiscal agent of Dominion Government and of provinces.

23. (1) The Bank shall act as fiscal agent of the Government of Canada without charge and, subject to the provisions of this Act, by agreement, may also act as banker or fiscal agent of the government of any province.

To manage public debt.

(2) The Bank, if and when required by the Minister so to do, shall act as agent for the Government of Canada in the payment of interest and principal and generally in respect of the management of the public debt of Canada.

Dominion Government cheques to be paid at par.

(3) The Bank shall not make any charge for cashing any cheque drawn on the Receiver General or on his account or for cashing any other instrument issued as authority for the payment of money out of the Con-

solidated Revenue Fund or upon any cheque drawn in favour of the Government of Canada or any department thereof and tendered for deposit in the Consolidated Revenue Fund.

NOTE ISSUE

Sole right of note issue.

24. (1) On and after the day on which the Bank is authorized to commence business the Bank shall, except as provided in *The Bank Act,* have the sole right to issue notes payable to bearer on demand and intended for circulation in Canada and may, subject to the provisions of section twenty-six of this Act, issue such notes to any amount. Such notes shall be legal tender, and shall be the first charge upon the assets of the Bank.

Arrangements for issue.

(2) It shall be the duty of the bank to make adequate arrangements for the issue of its notes at its head office and at its branch offices and agencies in Canada, and to supply such notes as required for circulation in Canada.

Denominations.

(3) Notes of the Bank shall be in such denominations as the Governor in Council from time to time determines and shall be signed by two persons nominated by the Board. Facsimiles printed from engravings may be

Signatures.

substituted for signatures in the proper handwriting of one or both persons nominated to sign, but if both

Facsimiles.

of the signatures are printed then a distinguishing device and serial number shall be printed on each note after the notes have been delivered by the printer and engraver to the Bank and while in the custody of the officers of the Bank.

Form and material.

(4) The form and material of the notes shall be subject to approval by the Minister: Provided that notes in either the English or the French language shall be available as required.

No torn or defaced notes.

(5) The Bank shall not re-issue notes which are torn, partially defaced or soiled and provision may be made by the Bank for the disinfection and sterilization of notes before re-issue.

REDEMPTION OF NOTES

Payment in gold.

25. (1) The Bank shall sell gold to any person who makes demand therefor at the head office of the Bank and tenders the purchase price in legal tender, but only in the form of bars containing approximately four hundred ounces of fine gold.

(2) The Governor in Council, from time to time and for such period as he may deem desirable, may suspend the operation of the next preceding subsection and remove such suspension. Power to suspend.

(3) On the day on which the Bank is authorized to commence business the Minister shall transfer to the Bank Gold and securities to be turned over to Bank.

(a) gold held by the Minister for redemption of Dominion notes;

(b) silver held by the Minister for redemption of Dominion notes valued at the market price of the fine silver content thereof;

(c) securities of the Dominion of Canada bearing interest at three per centum per annum, payable half-yearly and having a maturity not exceeding five years, valued at par;

to the amount of Dominion notes outstanding on that day, except notes issued under the authority of the *Finance Act.*

(4) On and after the day on which the Bank is authorized to commence business the Bank shall be responsible for the redemption of all Dominion notes then issued and outstanding and such notes shall be and continue to be legal tender. Redemption of outstanding notes.

(5) On the day on which the Bank is authorized to commence business, the chartered banks shall repay all advances then outstanding under the *Finance Act.* Repayment of advances under Finance Act.

(6) The Minister, for the purposes of paragraph *(c)* of subsection three of this section, is authorized to issue securities under the provisions of *The Consolidated Revenue and Audit Act, 1931,* and payment of the principal of and interest on such securities shall be made out of the Consolidated Revenue Fund. Power to issue securities 1931, c. 27.

RESERVES

26. (1) The Bank shall always maintain a reserve, as hereinafter provided, as security against its outstanding notes and deposit liabilities. Reserve.

(2) The reserve required by this section to be maintained shall consist of gold coin and bullion in the unrestricted ownership of the Bank equal to an amount not less than twenty-five per centum of the notes and deposit liabilities aforesaid; and may in addition include "Reserve" defined.

(a) silver bullion received from the Minister under the next preceding section or purchased under the

authority of subsection four hereof, valued at the market price of the fine silver content thereof; and

(b) foreign exchange, which shall mean

(i) balances with the Bank of England, the Bank for International Settlements, the Federal Reserve Bank of New York, and a central bank in any country whose currency by law and in fact is convertible on demand at a fixed price into exportable gold;

(ii) Treasury bills or other obligations of the United Kingdom or the United States of America having a maturity not exceeding three months from the date of acquisition by the Bank;

(iii) Bills of exchange having a maturity not exceeding ninety days excluding days of grace, or not exceeding ninety days after sight excluding days of grace from the date of acquisition by the Bank payable in London or New York or in a country whose currency by law and in fact is convertible on demand at a fixed price into exportable gold,

less any liabilities of the Bank payable in the currency of the United Kingdom, the United States of America, or any country, whose currency is by law and in fact convertible on demand at a fixed price into exportable gold.

Power to suspend gold reserve requirement.

(3) At the request in writing of the Board, the Governor in Council may suspend the operation of this section insofar as it requires the Bank to maintain a reserve of gold equal to an amount not less than twenty-five per centum of its notes and deposit liabilities. Such suspension shall be for such period not exceeding sixty days as may be specified by the Governor in Council, but on the further request in writing of the Board may be extended from time to time for further periods not exceeding sixty days each, provided, however, that no such suspension shall continue for a period longer than one year without the sanction of Parliament.

(4) The Bank shall during the years 1935, 1936 and 1937 purchase and hold newly-mined Canadian silver as and when required so to do by the Minister but the Bank shall never be required to purchase more than 1,671,802 fine ounces in any year.

Reserve to be maintained by chartered banks.

27. (1) Every chartered bank shall on and after the day on which the Bank is authorized to commence business maintain a reserve of not less than five per centum of its deposit liabilities within Canada and such reserve shall consist of a deposit with the Bank and of notes of the Bank held by such bank.

Returns.

(2) For the purposes of this section, every chartered bank shall make a return to the Bank to be signed by the chief accountant or acting chief accountant and by the general manager or acting general manager of such bank, showing the amount of its deposit liabilities within Canada and also the amount of its deposit with the Bank and the amount of the notes of the Bank held by such bank, at the end of each juridical day of the month last preceding the date of the return, and showing for the month the daily average amount of such deposit liabilities and of its deposit with the Bank and of the notes of the Bank held by such bank. Such return shall be delivered or transmitted to the Bank at the same time as the return to the Minister, pursuant to section one hundred and twelve of *The Bank Act*, is transmitted or delivered.

Basis of amount of reserve.

(3) The daily average amount of deposit liabilities within Canada for each chartered bank shall be the basis of determining the amount of the reserve to be maintained by such bank during the month next following the month in which such return was made.

Penalty.

(4) If any chartered bank knowingly makes default in complying with the requirements of this section, it shall be liable to a penalty at the rate of ten per centum per annum of the amount of deficiency for each day on which there is a deficiency in the amount of the reserve maintained by the chartered bank, and such penalty shall be payable to the Bank and recoverable by it by civil action.

Inspection.

(5) For the purpose of this section the Bank may authorize the Inspector General of Banks or one of its own officers to make an inspection of the books, accounts and documents of any chartered bank, and the chartered bank shall give the Inspector General or such officer access to the books, accounts and documents of the bank for such purpose, and if the Inspector General or officer is obstructed or delayed in making an inspection the chartered bank shall be guilty of an offence and liable on summary conviction to a fine of one hundred dollars for each and every day during which the obstruction or delay continues.

Government guarantee.

(6) In the event of the property and assets of the Bank being insufficient to pay its debts and liabilities, and if the Bank suspends payment of any of its liabilities, the deposit made hereunder by every chartered bank is hereby guaranteed, and the Governor in Council, on the recommendation of the Minister of Finance, shall authorize payment out of the Consolidated Revenue Fund of such moneys as may be necessary to implement such guarantee.

Quebec Savings Banks.

(7) Every bank incorporated under the *Quebec Savings Banks Act* shall maintain against its deposit liabilities such reserves in the form of notes of the Bank or deposits with the Bank or a chartered bank as may be deemed to be sufficient by the Bank and shall furnish such information as may be required by the Bank from time to time to satisfy it that such reserves are so maintained.

SURRENDER OF GOLD

Chartered banks to deliver gold held.

28. (1) Every chartered bank shall, on the day on which the Bank is authorized to commence business, transfer to the Bank all gold coin or bullion owned and held by it in Canada.

Power to enforce this requirement.

(2) The Governor in Council may from time to time thereafter require every chartered bank or every other person to transfer to the Bank any or all gold coin or bullion held in Canada which is owned by such chartered bank or by such other person; and the Governor in Council may authorize all measures deemed necessary or expedient to enforce any such transfer and to impose and recover penalties in respect of any neglect or refusal to make any transfer so required.

VALUATION OF GOLD

Valuation o gold.

29. Whenever gold is sold by, transferred to, held as reserve by, or deposited with the Bank pursuant to subsections one or three of section twenty-five, section twenty-six, or section twenty-eight of this Act, the value of the said gold shall be computed on the basis established by the *Currency Act* at the date of the relevant transaction.

Disposition of profits from sales.

30. Any profits resulting from the sale by the Bank of gold coin and bullion transferred to the Bank pursuant to subsection three of section twenty-five, or section twenty-eight of this Act, or from an increase in the value of such gold resulting from any change in the

monetary standard of Canada shall be paid by the Bank to the Receiver General for the Consolidated Revenue Fund: Provided, however, that the aforesaid provisions of this section shall not apply in the case of gold transferred under subsection one of section twenty-eight, if the Governor in Council is satisfied that the said gold was at the time of the transfer being held by a chartered bank against liabilities elsewhere than in Canada, and in such case the said profit shall belong to the chartered bank.

PROFITS OF THE BANK

Application of profits.

31. The Bank shall establish a rest fund and after making such provision as the Board thinks proper for bad and doubtful debts, depreciation in assets, pension funds and all such matters as are properly provided for by banks and after deducting an amount equal to four and one-half per centum of the paid-up capital which may be utilized for the payment of cumulative dividends at a rate of four and one-half per centum per annum, payable half-yearly, the ascertained surplus available from the operations of the Bank during each financial year shall be applied by the Board as follows:

(a) If the rest fund of the Bank is less than the paid-up capital, one-third of such surplus shall be allocated to the rest fund and the residue shall be paid to the Receiver General and placed to the credit of the Consolidated Revenue Fund;

(b) If the rest fund is not less than the paid-up capital but is less than twice the paid-up capital, one-tenth of such surplus shall be allocated to the rest fund and the residue shall be paid to the Receiver General and placed to the credit of the Consolidated Revenue Fund;

(c) If the rest fund is not less than twice the paid-up capital, the whole of such surplus shall be paid to the Receiver General and placed to the credit of the Consolidated Revenue Fund.

AUDIT

Appointment of first auditors.

32. (1) For the purpose of auditing the affairs of the Bank, the Minister shall appoint two auditors, eligible to be appointed as auditors of a chartered bank, who shall continue to act as auditors until the first annual general meeting.

Annual appointment.

(2) The shareholders at each annual general meeting shall appoint two auditors, eligible to be appointed as

auditors of a chartered bank, but no person shall be eligible for appointment if he or any member of his firm has been auditor for two successive years during the three next preceding years.

Vacancies.

(3) If any vacancy occurs in the office of auditor of the Bank, notice thereof shall forwith be given by the Bank to the Minister, who thereupon shall appoint some other auditor eligible to be appointed as an auditor of a chartered bank to serve until the next annual general meeting.

Persons who may not act.

(4) No director or officer of the Bank and no member of a firm of auditors of which a director is a member shall be eligible for appointment as an auditor.

Reports to Minister.

(5) The Minister may from time to time require the auditors to report to him upon the adequacy of the procedure adopted by the Bank for the protection of its creditors or shareholders and as to the sufficiency of their own procedure in auditing the affairs of the Bank; and the Minister may, at his discretion, enlarge or extend the scope of the audit, or direct that any other procedure be established or that any other examination be made by the auditors or by the Inspector-General of Banks as the public interest may seem to require.

Copies of reports to be sent to Minister.

(6) A copy of every report made by the auditors to the Bank under this section shall be transmitted to the Minister by the auditors at the same time as such report is transmitted to the Bank.

RETURNS

Weekly statement of assets and liabilities.

33. (1) The Bank shall as soon as practicable after the close of business on Wednesday of each week, make up and transmit to the Minister in the form of Schedule C to this Act a statement of its assets and liabilities as at the close of business on that day.

Publication.

(2) A copy of every such statement shall be published in the next succeeding issue of the *Canada Gazette*.

Weekly statement of note circulation.

(3) The Bank shall also as soon as practicable after the close of business on Wednesday of each week, make up and transmit to the Minister a statement of the amount of its notes in circulation on each business day during the preceding seven day period.

(4) The Bank shall on or before the seventh day of each month make up and transmit to the Minister in the form of Schedule C to this Act a statement of its assets and liabilities on the last business day of the preceding month. Monthly statement of assets and liabilities.

(5) Every return required under the last preceding subsection shall be accompanied by declarations which shall be a part of the return, and the declarations shall be in the form set forth in Schedule C to this Act, and shall be signed by the Chief Accountant or by the acting Chief Accountant, and by the Governor or the person then acting as Governor, and by the Deputy Governor or the Assistant Deputy Governor or other principal officer next in authority to the Assistant Deputy Governor at the time at which the declaration is signed. Declarations.

(6) The Governor in Council may from time to time, as he deems necessary, amend the form of Schedule C to this Act. Powers to amend.

34. (1) The fiscal year of the Bank shall be the calendar year. Fiscal year.

(2) Within six weeks after the end of each fiscal year, the Bank shall transmit to the Minister a statement of its accounts for the fiscal year, signed by the Governor, the Deputy Governor and the Chief Accountant of the Bank and certified by the Auditors, in the form prescribed by the by-laws of the Bank. Yearly statement of accounts.

(3) A copy of the accounts so signed and certified shall be forthwith published in the *Canada Gazette*, and if Parliament is then sitting, shall within fourteen days after the receipt thereof by the Minister be laid before Parliament, or if Parliament is not sitting, it shall be laid before Parliament within fourteen days after the commencement of the next ensuing session thereof. Laid before Parliament.

35. The Bank shall within sixty days after the end of each fiscal year transmit to the Minister a list of the names, addresses and descriptions of the shareholders of the Bank at the end of the year, and of the number of shares then held by each shareholder. Such list shall, if Parliament is then sitting, be laid before Parliament by the Minister within fourteen days after the receipt thereof, or if Parliament is not sitting, it shall be laid before Parliament within fourteen days after the commencement of the next ensuing session thereof. Annual list of shareholders.

Annual meeting.

36. (1) The annual general meeting of shareholders shall be held on the last Tuesday of February in each year at the head office of the Bank.

Special meeting.

(2) A special general meeting of the shareholders may be called at any time by the Board and shall be called by the Board whenever a request for such meeting is made in writing by not less than one hundred shareholders, holding not less than one thousand shares.

Voting.

(3) Every shareholder shall have one vote for each share registered in his name for at least three months before the date of the meeting, but no person, other than the Minister, shall vote for more than fifty shares.

Ballots.

(4) The voting of the shareholders shall, in the case of the election of directors, be by ballot. No person

Proxies.

shall vote by proxy except that any shareholder may give to the Minister, in writing, instructions as to the manner in which he desires to vote on any business of the meeting. In any such case the Minister shall inform the scrutineers appointed at the meeting of the instructions so received and the scrutineers shall record the vote of each such shareholder in accordance with the instructions so given.

Notice of meeting and of business thereat.

(5) Notice of every general meeting of shareholders shall be given to every shareholder in writing, and such notice shall be accompanied by notice of all business to be transacted at such meeting, including the names if any of persons nominated as directors, and no person shall be eligible to be elected as a director unless notice of his nomination has been so given.

OFFENCES AND PENALTIES

Holding office when ineligible.

37. Every person who holds office or continues to hold office as a Governor, Deputy Governor, Assistant Deputy Governor or director of the Bank, knowing that he is not eligible for such office, shall be guilty of an indictable offence and liable to imprisonment for not more than three years and not less than three months.

Verifying false statement, account or list.

38. Every director, officer or auditor of the Bank who verifies any statement, account or list required to be furnished to the Minister pursuant to the provisions of this Act, or who has to do with the delivering or transmitting of the same to the Minister, knowing the same to be false in any material particular, shall be

guilty of an indictable offence and liable to imprisonment for not more than five years and not less than six months.

Transmitting any false statement.

39. Any officer of a chartered bank who transmits any statement to the Minister pursuant to the provisions of this Act or who has to do with preparing or transmitting the same to the Minister knowing the same to be false in any material particular, shall be guilty of an indictable offence and liable to imprisonment for not more than two years and not less than three months.

Contravention of Act.

40. Any officer of the Bank or any officer of a chartered bank or any other person who fails or omits to comply with any provision of this Act shall be guilty of an offence and, unless otherwise provided by this Act, shall be liable on summary conviction to a fine of not less than one hundred dollars and not more than five hundred dollars.

LIQUIDATION OR WINDING UP

Winding up or insolvency.

41. No statute relating to the insolvency or winding-up of any corporation shall apply to the Bank and in no case shall the affairs of the Bank be wound up unless Parliament so provides; provided, however, that if provision is made for winding up the Bank the notes of the Bank outstanding shall be the first charge upon the assets and in no case shall the shareholders receive any payment in excess of the paid-up capital of the Bank and accrued dividends, if any.

ORGANIZATION EXPENSES

Payment of expenses of organization.

42. All moneys required to be expended in connection with the organization of the Bank before the day on which the Bank is authorized to commence business not exceeding one hundred thousand dollars, or in connection with the issue of increased capital stock, shall be paid out of any unappropriated moneys in the Consolidated Revenue Fund, and shall be recoverable from the Bank as a debt due to the Crown at any time after the Bank has been authorized to commence business.

BY-LAWS

By-laws.

43. (1) The Governor in Council shall make by-laws not repugnant to the provisions of this Act with respect to

(a) the keeping of stock books, the recording of subscriptions and the enforcement of payment by subscribers and shareholders of instalments of capital due the Bank from such persons, and generally all questions relating to the obligations of the Bank to the shareholders and of the shareholders to the Bank;

(b) the transfer and transmission of shares;

(c) the declaration and payment of dividends;

(d) the calling of meetings of shareholders and of the Board and of the Executive Committee, and what number of persons shall constitute a quorum in each case, and how questions considered at such meetings shall be determined, and the nomination of directors and auditors, and generally as to the procedure governing such meetings; and such by-laws may provide for the nomination of directors before any annual general meeting and what constitutes such nomination;

(e) the duties and conduct of officers, clerks and employees of the Bank;

(f) the form of the annual statement of accounts;

(g) generally as to the management and disposition of the stock, property and undertakings of the Bank.

Amendment or repeal.

(2) The Board may with the approval of the Governor in Council amend or repeal such by-laws or make others with respect to the matters mentioned in subsection one hereof.

Publication.

(3) Every by-law and every amendment or repeal thereof shall take effect when published in the *Canada Gazette*.

SCHEDULE A.

OATH OF FIDELITY AND SECRECY

I, ... do solemnly swear that I will faithfully, truly and to the best of my judgment, skill and ability, execute and perform the duties required of me as a director *(officer or employee as the case may be)* of the Bank of Canada and which properly relate to any office or position in the said Bank held by me.

I further solemnly swear that I will not communicate or allow to be communicated to any person not legally entitled thereto any information relating to the affairs of the Bank, nor will I allow any such person to inspect or have access to any books or documents belonging to or in the possession of the Bank and relating to the business of the Bank.

SCHEDULE B.

STATEMENT OF GENERAL MANAGER

January 31st,

To The Honourable the Minister of Finance.

Pursuant to section eighteen of the *Bank of Canada Act,* I have duly inquired whether any shares of the capital stock of the Bank of Canada have at any time during the calendar year been held by or for the benefit of *(name of chartered bank)* contrary to the provisions of the *Bank of Canada Act,* and I have found that no shares were held by or for the benefit of *(name of chartered bank) (or as the case may be).*

. . . . . .

General Manager.

SCHEDULE C

Statement of Assets and Liabilities of Bank of Canada as at , 19 .

LIABILITIES—		ASSETS—	
1. CAPITAL PAID UP		1. RESERVE—	
2 REST FUND		Gold coin and bullion	
3. NOTES IN CIRCULATION		Silver bullion	
4. DEPOSITS—		Reserve in Sterling funds	
(a) Dominion Government		Reserve in U S funds.	
(b) Provincial Governments		Reserve in funds of other countries on a gold standard	
(c) Chartered banks		Total	
(d) Other		2. SUBSIDIARY COIN	
Total		3 BILLS DISCOUNTED—	
5. LIABILITIES PAYABLE IN STERLING, U S AND FOREIGN GOLD CURRENCIES		(a) Commercial Bills	
6 ALL OTHER LIABILITIES		(b) Agricultural Bills, etc	
		(c) Dominion Government Treasury Bills	
		(d) Provincial Government Treasury Bills	
		Total	
		4. LOANS AND ADVANCES—	
		(a) Dominion Government	
		(b) Provincial Governments	
		(c) Chartered Banks	
		Total	
		5. BILLS BOUGHT IN OPEN MARKET	
		6. INVESTMENTS—	
		(a) Dominion Government short-term securities	
		(b) Provincial Government short-term securities	
		(c) Other Dominion Government securities	
		(d) Other Provincial Government securities	
		(e) United Kingdom, other British Dominions or United States long term securities	
		Total	
		7. BANK PREMISES	
		8. ALL OTHER ASSETS	
TOTAL..		TOTAL	

Ratio of Net Reserve (Item 1 of Assets less Item 5 of Liabilities) to Notes and Deposit Liabilities: per centum.

I declare that the foregoing return is correct according to the books of the Bank;

E.F.,

Chief Accountant (or acting Chief Accountant as the case may be);

We declare that the foregoing return is to the best of our knowledge and belief correct, and shows truly and clearly the financial position of the Bank, as required by section thirty-three of the Bank of Canada Act.

Place this day of , 19 .

A.B.,

Governor (or person acting as Governor as the case may be);

C.D.,

Deputy Governor (Assistant Deputy Governor or officer next in authority as the case may be).

APPENDIX II

1 EDWARD VIII.

CHAP. 22.

An Act to amend the Bank of Canada Act.

[*Assented to 23rd June, 1936.*]

HIS Majesty, by and with the advice and consent of the Senate and House of Commons of Canada, enacts as follows:— 1934, c. 43.

1. This Act may be cited as the *Bank of Canada Act Amendment Act, 1936.* Short title.

2. (1) Section two of the *Bank of Canada Act*, chapter forty-three of the statutes of 1934, is amended by striking out paragraph *(c)* and substituting the following therefor:— Definitions.

"*(c)* 'Director' means a member of the Board of Directors other than the Governor or the Deputy Governor or the member acting in virtue of the authority conferred by subsection two of section five of this Act." "Director".

(2) Section two of the said Act is further amended by striking out paragraph *(d)* and substituting the following therefor:—

"*(d)* 'Dominion notes' means notes payable to bearer on demand, issued and outstanding, which immediately prior to the day on which the Bank of Canada was authorized to commence business constituted a direct liability of the Dominion of Canada." "Dominion notes".

(3) Section two of the said Act is further amended by inserting the following immediately after paragraph *(d)* thereof:—

"*(e)* 'Governor' means the Governor of the Bank of Canada or the person acting for him pursuant to the provisions of this Act." "Governor."

and by designating the subsequent paragraphs of the said section as *(f)*, *(g)*, *(h)*, *(i)*, *(j)* and *(k)*.

3. Subsection two of section three of the said Act is repealed and the following subsection substituted therefor:—

Body politic and corporate.

"(2) The Bank is and shall continue to be a body politic and corporate."

4. Subsection one of section five of the said Act is repealed and the following substituted therefor:—

Board of Directors.

"**5.** (1) The Bank shall be under the management of a Board of Directors composed of a Governor, a Deputy Governor and directors elected or appointed in accordance with the provisions of this Act. There may also be an Assistant Deputy Governor who shall not as such be a member of the Board."

5. Subsection two of section six of the said Act is amended by striking out paragraph *(d)* and substituting the following therefor:—

Persons disqualified for appointments.

"*(d)* is a director, officer or employee of any other bank or financial institution or has an interest as a shareholder in any other bank or financial institution; or"

6. Section nine of the said Act is repealed and the following substituted therefor:—

Directors.

"**9.** (1) The following persons shall be directors of the Bank:

(i) directors holding office at the date of the coming into force of this subsection, who shall continue as directors until the expiration of their several terms of office;

(ii) six directors to be appointed by the registered holders of the Class "B" shares of the Bank, with the approval of the Governor in Council, to hold office as follows: two until the annual general meeting in 1940; two until the annual general meeting in 1941, and two until the annual general meeting in 1942;

(iii) one director to be elected by the registered holders of the Class "A" shares of the Bank at the annual general meeting in 1940, to hold office for a term of two years;

(iv) two directors to be elected by the registered holders of the Class "A" shares of the Bank at the

annual general meeting in 1941, to hold office for terms of two years and three years respectively;

(v) directors, each of whom shall hold office for a term of three years, to be elected by the registered holders of the Class "A" shares of the Bank, one at the annual general meeting in 1942 and one at each annual general meeting thereafter;

(vi) directors, each of whom shall hold office for a term of three years, to be appointed by the registered holders of the Class "B" shares of the Bank, with the approval of the Governor in Council, two as of the day of the annual general meeting in 1940, and two as of the day of each annual general meeting thereafter.

Vacancies amongst directors of Class "A" shareholders.

(2) In the event of a vacancy amongst the directors elected by the Class A shareholders, the Board shall appoint a qualified person to hold office until the next annual general meeting, when the shareholders shall elect a person to fill the vacancy for the remainder of the term: Provided, however, that no director in office at the date of the coming into force of this subsection shall be so replaced if there are three or more directors elected by shareholders in office.

Proviso.

Vacancies amongst directors of Class "B" shareholders.

(3) In the event of a vacancy amongst the directors appointed by the registered holder of the Class "B" shares of the Bank, the registered holder of the said shares shall, with the approval of the Governor in Council, appoint a qualified person to hold office for the remainder of the term.

Number of votes.

(4) In the transaction of the business of the Bank, each director shall have one vote: Provided, however, that prior to the annual general meeting in 1940 each of the directors appointed by the registered holder of the Class "B" shares of the Bank shall be entitled to two votes.

Proviso.

Re-election and re-appointment.

(5) The directors shall on the expiration of their terms of office be eligible for re-election or re-appointment."

7. Section ten of the said Act is repealed and the following substituted therefor:

Qualifications.

"**10.** (1) No person except the registered holder of ten Class "A" shares of the Bank and who has paid all calls thereon shall be elected or shall continue to hold office as an elected director; but this qualification shall not be required in the case of a person appointed to be a director by the registered holder of the Class "B" shares of the bank.

Directors to represent diversified occupations.

(2) The directors shall be selected from diversified occupations; but no person shall be eligible for election or appointment who is a director, officer or employee of a chartered bank, and any person elected or appointed shall divest himself of ownership of his shares within three months of the date of his election or appointment and shall not thereafter during the term of his office have an interest, either directly or indirectly, as a shareholder in a chartered bank.

Persons disqualified to be directors.

(3) No person shall be elected or appointed, or shall continue to hold office as a director who—

(a) is not a British subject ordinarily resident in Canada; or

(b) is employed in any capacity in the public service of Canada or of any province of Canada, or holds any office or position for which any salary or other remuneration is payable out of public moneys; or

(c) has reached the age of seventy-five years.

Removal if permanently incapacitated.

(4) If any director, in the opinion of the Board, becomes permanently incapacitated, he may be removed from office by resolution of the Board approved by the Governor in Council."

8. Section twelve of the said Act is repealed and the following substituted therefor:—

Chairman.

"12. The Governor shall be Chairman of the Board of Directors."

9. Section fourteen of the said Act is repealed and the following substituted therefor:—

Governor's veto.

"14. (1) The Governor, or in the event of his absence or incapacity the Deputy Governor only, shall have power to veto any action or decision of the Board of Directors or of the Executive Committee, and if this veto power be exercised, the Governor or Deputy Governor, as the case may be, shall within seven days inform the Minister in writing of the circumstances and the Minister shall submit the veto to the Governor in Council who may confirm or disallow the veto.

To be submitted to Governor in Council.

View of director or member of the Executive.

(2) Any director or member of the Executive Committee may inform the Minister in writing of his view of the action or decision in question, which view shall also be transmitted to the Governor in Council."

10. Section seventeen of the said Act is repealed and the following substituted therefor:—

Capital.

"17. (1) The capital of the Bank shall be ten million one hundred thousand dollars consisting of one hundred

thousand shares (to be known hereafter as Class "A" shares) issued to the public, and one hundred and two thousand shares (to be known as Class "B" shares) to be issued to the Minister at par, to be held by him on behalf of the Dominion of Canada and to be paid for out of the Consolidated Revenue Fund.

Shares.

(2) The capital shall be divided into shares of fifty dollars each.

Class "B" shares.

(3) The Class "B" shares issued to the Minister hereunder shall carry with them the same rights and obligations as Class "A" shares of the capital of the Bank, except that the registered holder thereof shall not be entitled to vote at the election of directors.

Limited liability.

(4) The liability of every shareholder shall be limited to the amount for the time being unpaid in respect of shares held by such shareholder.

British subjects only to hold shares.

(5) Class "A" shares may be held only by or for the beneficial ownership of British subjects ordinarily resident in Canada, or corporations organized under the laws of the Dominion of Canada or of any province and controlled by British subjects ordinarily resident in Canada, but, save as hereinafter provided, not more than fifty shares shall be held by or for the benefit of any one person: Provided, however, that a trustee may hold shares in trust for other persons in excess of fifty shares so long as the shares held by him in trust for any one such other person do not exceed fifty shares; and provided further that a trustee holding shares in trust under the provisions of this proviso in excess of fifty shares shall not be entitled to vote with respect to any such shares in excess of fifty.

Registry Offices.

(6) The Bank shall open and maintain one or more share registry offices at places to be designated by the Board."

11. Section nineteen of the said Act is repealed and the following substituted therefor:

Transfer or disposal of shares held in excess of fifty or by person ineligible.

"**19.** If Class "A" shares are held by a person not eligible to hold shares, or if shares in excess of fifty are held by one person, the Governor shall require the shareholder to transfer or dispose of the shares or the shares in excess of fifty, as the case may be. If a shareholder fails to comply with this requirement within three months, the shares in question shall *ipso facto*, on the expiration of three months from the mailing at Ottawa by registered mail of such requirement in the form of a notice in writing by the Minister to such shareholder, be forfeited to the Crown and shall be

registered in the name of the Minister without further proceedings or formality, and may be sold by the Minister and the proceeds of any such sales shall be deposited in the Consolidated Revenue Fund."

Commencement of business.

12. Section twenty of the said Act is repealed.

13. Subsection one of section twenty-one of the said Act is amended by striking out paragraphs *(b)*, *(d)*, *(f)*, *(g)* and *(p)* and substituting the following paragraphs therefor:—

Exchange.

"*(b)* effect transfers of funds by telegram, letter or other method of communication, and buy and sell transfers effected by such means, trade acceptances, bankers' acceptances, bankers' drafts and bills of exchange drawn in or on places outside of Canada and having a maturity not exceeding ninety days, excluding days of grace, from the date of acquisition by the Bank;

Investments.

(d) buy and sell securities issued or guaranteed by the Dominion of Canada or any province having a maturity exceeding two years from the date of acquisition by the Bank, but the Bank shall at no time hold such securities having a par value in excess of fifty per cent. of its outstanding note issue and deposit liabilities, nor shall the Bank at any time hold such securities maturing more than ten years from the date of acquisition of a par value in excess of three times the amount of the paid-up capital and rest fund of the Bank;

Securities issued by U.K. or U.S.A.

(f) buy and sell securities issued by the United Kingdom or the United States of America, having a maturity exceeding six months from the date of acquisition by the Bank, but the Bank shall at no time hold such securities of a par value in excess of twenty-five per cent. of the amount of the paid-up capital of the Bank;

Discounts.

(g) buy and sell or rediscount bills of exchange and promissory notes endorsed by a chartered bank drawn or issued in connection with the production or marketing of goods, wares and merchandise as defined in *The Bank Act*, 1934, c. 24. excepting those mentioned in paragraph *(h)* of this subsection, and having a maturity not exceeding ninety days, excluding days of grace, from the date of acquisition by the Bank;

ncid ental lowers.

(p) do any other banking business incidental to or consequential upon the provisions of this Act and not prohibited by this Act."

14. Subsection three of section twenty-three of the said Act is repealed and the following substituted therefor:—

"(3) The Bank shall not make any charge for cashing or negotiating any cheque drawn on the Receiver General or on his account, or for cashing or negotiating any other instrument issued as authority for the payment of money out of the Consolidated Revenue Fund, or upon any cheque drawn in favour of the Government of Canada or any department thereof and tendered for deposit in the Consolidated Revenue Fund."

Dominion Government cheques to be paid or negotiated at par.

15. (1) Subsections three and four of section twenty-four of the said Act are repealed and the following substituted therefor:—

"(3) Notes of the Bank shall be in such denominations and shall be printed and signed or otherwise executed as the Governor in Council shall by regulation determine.

Denominations.

"(4) The form and material of the notes shall be subject to approval by the Minister; Provided, however, that each said note shall be printed in both the English and the French languages."

Form and material.

(2) As soon as practicable after the coming into force of this Act, each note of the Bank shall be printed in both the English and the French languages; Provided, however, that any such note printed before the coming into force of this Act and issued thereafter and any such note theretofore issued shall nevertheless be a valid and binding obligation of the Bank.

Notes printed before to be valid obligation of the Bank.

16. Subsections three, five and six of section twenty-five of the said Act are repealed: Provided, however, that the authority to pay the principal of and interest on securities issued to the Bank under the aforesaid subsections three and six shall continue.

Gold and securities to be turned over to Bank.

Repayment of advances under Finance Act.

Power to issue securities.

17. Paragraph *(b)* of subsection two of section twenty-six of the said Act is repealed and the following substituted therefor:—

Reserve defined.

"*(b)* foreign exchange which shall mean:—

"Foreign exchange".

(i) balances in pounds sterling, United States of America dollars and currencies which by law and in fact are convertible on demand at a fixed price into exportable gold, held in the Bank of England,

the Federal Reserve Bank of New York, the Bank for International Settlements or a central bank in any country the currency of which is convertible as hereinbefore described;

(ii) treasury bills or other obligations of the United Kingdom or the United States of America having a maturity not exceeding three months from the date of acquisition by the Bank;

(iii) bills of exchange having a maturity not exceeding ninety days, excluding days of grace, from the date of acquisition by the Bank, payable in pounds sterling, United States of America dollars or in a currency which by law and in fact is convertible on demand at a fixed price into exportable gold,

less any liabilities of the Bank payable in the currency of the United Kingdom, the United States of America, or any country whose currency is by law and in fact convertible on demand at a fixed price into exportable gold."

18. Subsection five of section twenty-seven of the said Act is repealed and the following substituted therefor:—

Inspection.

"(5) For the purpose of this section the Inspector General of Banks shall annually make such inspection of the books, accounts and documents of every chartered bank as he may deem necessary or expedient for the purpose of satisfying himself that the return required by subsection two of this section is correct, and shall certify to the Bank whether in his opinion the said return is correct, and every chartered bank shall give the Inspector General access to the books, accounts and documents of the bank for such purpose; and if the Inspector General is obstructed or delayed in making the inspection, the chartered bank shall be guilty of an offence and liable on summary conviction to a fine of one hundred dollars for each and every day during which the obstruction or delay continues."

Profits of the Bank.

19. Paragraphs *(a)*, *(b)* and *(c)* of section thirty-one of the said Act are repealed and the following substituted therefor:—

Application of profits.

"*(a)* If the rest fund of the Bank is less than one-half the paid-up capital, one-third of such surplus shall be allocated to the rest fund and the residue shall be paid to the Receiver General and placed to the credit of the Consolidated Revenue Fund;

(b) If the rest fund is less than the paid-up capital but is not less than one-half the paid-up capital, one-tenth of such surplus shall be allocated to the rest fund and the residue shall be paid to the Receiver General and placed to the credit of the Consolidated Revenue Fund;

(c) If the rest fund is not less than the paid-up capital, the whole of such surplus shall be paid to the Receiver General and placed to the credit of the Consolidated Revenue Fund."

20. Section thirty-two of the said Act is repealed and the following substituted therefor:—

Appointment of auditors.

"32. (1) For the purpose of auditing the affairs of the Bank, the Governor in Council shall, on the recommendation of the Minister, not later than January thirty-first each year, appoint two auditors, eligible to be appointed as auditors of a chartered bank, but no person shall be eligible for appointment if he or any member of his firm has been auditor for two successive years during the three next preceding years.

Vacancies.

(2) If any vacancy occurs in the office of auditor of the Bank, notice thereof shall forthwith be given by the Bank to the Minister who thereupon shall appoint some other auditor eligible to be appointed as an auditor of a chartered bank to serve until January thirty-first next following.

Persons who may not act.

(3) No director or officer of the Bank and no member of a firm of auditors of which a director is a member shall be eligible for appointment as an auditor.

Reports to Minister.

(4) The Minister may from time to time require the auditors to report to him upon the adequacy of the procedure adopted by the Bank for the protection of its creditors or shareholders and as to the sufficiency of their own procedure in auditing the affairs of the Bank; and the Minister may, at his discretion, enlarge or extend the scope of the audit or direct that any other procedure be established or that any other examination be made by the auditors as the public interest may seem to require.

Copies of reports to be sent to Minister.

(5) A copy of every report made by the auditors to the Bank under this section shall be transmitted to the Minister by the auditors at the same time as such report is transmitted to the Bank."

21. Subsection five of section thirty-three of the said Act is repealed and the following substituted therefor:—

Declarations.

"(5) Every return required under the next preceding subsection shall be accompanied by declarations which shall be a part of the return, and the declarations shall be in the form set forth in Schedule C to this Act, and shall be signed by the Chief Accountant or by the Acting Chief Accountant, and by the Governor or the Deputy Governor or the Assistant Deputy Governor."

Schedule C.

22. Subsection two of section thirty-four of the said Act is repealed and the following substituted therefor:—

Yearly statement of accounts.

"(2) Within six weeks after the end of each fiscal year, the Bank shall transmit to the Minister a statement of its accounts for the fiscal year, signed by the Governor or the Deputy Governor or the Assistant Deputy Governor and the Chief Accountant or Acting Chief Accountant of the Bank, and certified by the auditors in the form prescribed by the by-laws of the Bank."

APPENDIX III

2 GEORGE VI.

CHAP. 42.

An Act to amend the Bank of Canada Act.

[*Assented to 1st July, 1938.*]

HIS Majesty, by and with the advice and consent of the Senate and House of Commons of Canada, enacts as follows:— 1934, c. 43. 1936, c. 22.

1. This Act may be cited as the *Bank of Canada Act Amendment Act, 1938.* Short title.

2. Paragraph *(f)* of section two of the *Bank of Canada Act*, being chapter forty-three of the statutes of 1934, is repealed and the subsequent paragraphs of the said section are designated *(f)*, *(g)*, *(h)*, *(i)* and *(j)*. Meeting

3. Subsection one of section five of the said Act, as enacted by section four of the *Bank of Canada Act Amendment Act, 1936*, is repealed and the following substituted therefor:— 1936, c. 22.

"**5.** (1) The Bank shall be under the management of a Board of Directors composed of a Governor, a Deputy Governor and eleven directors appointed in accordance with the provisions of this Act. There may also be an Assistant Deputy Governor who shall not as such be a member of the Board." Board of directors.

4. Subsection one of section seven of the said Act is repealed and the following substituted therefor:—

"**7.** (1) The Governor of the Bank shall be the chief executive officer and shall on behalf of the Board have the direction and control of the business of the Bank, with authority to act in connection with the conduct of the business of the Bank in all matters which are not Powers of Governor.

by this Act or by the by-laws of the Bank specifically reserved to be done by the Board or by the Executive Committee".

5. Section nine of the said Act, as enacted by section six of the said amending Act, is repealed and the following substituted therefor:—

Directors.

"9. (1) The Minister with the approval of the Governor in Council shall as of the first day of March in each year appoint for terms of three years each a sufficient number of directors to provide that there shall be eleven directors: Provided, however, that every director holding office at the date of the coming into force of this subsection shall continue as a director up to and including the last day of February in the year of the expiration of the term of office for which he was elected or appointed.

Vacancy.

(2) In the event of a vacancy amongst the directors the Minister shall, with the approval of the Governor in Council, appoint a qualified person to hold office for the remainder of the term.

Votes.

(3) In the transaction of the business of the Bank each director shall have one vote.

May be re-appointed.

(4) The directors shall on the expiration of their terms of office be eligible for re-appointment."

6. Section ten of the said Act, as enacted by section seven of the said amending Act, is repealed and the following substituted therefor:—

Selection of directors.

"10. (1) The directors shall be selected from diversified occupations; but no person shall be eligible for appointment who is a director, officer or employee of a chartered bank, and any person appointed as a director who is a shareholder of a chartered bank shall divest himself of ownership of his shares within three months of the date of his appointment and shall not thereafter during the term of his office have an interest, either directly or indirectly, as a shareholder in a chartered bank.

Disqualifications.

(2) No person shall be appointed, or shall continue to hold office as a director who—

(a) is not a British subject ordinarily resident in Canada; or

(b) is employed in any capacity in the public service of Canada or of any province of Canada, or holds any office or position for which any salary or other remuneration is payable out of public moneys;

provided, however, that a director may perform temporary services for the Government of Canada or any province for which he may be reimbursed actual living and travelling expenses; or

(c) has reached the age of seventy-five years.

(3) If any director, in the opinion of the Board, becomes permanently incapacitated, he may be removed from office by resolution of the Board approved by the Governor in Council." Removal if permanently incapacitated

7. Section eleven of the said Act is repealed and the following substituted therefor:—

"11. The directors shall be entitled to receive for attendance at directors' meetings and executive committee meetings, such fees as may be fixed by the by-laws of the Bank, but the aggregate amount of the fees paid to all directors, exclusive of expenses, shall not exceed twenty thousand dollars in any year." Directors' fees.

8. Section seventeen of the said Act, as enacted by section ten of the said amending Act, is repealed and the following substituted therefor:—

"17. (1) The capital of the Bank shall be five million dollars but may be increased from time to time pursuant to a resolution passed by the Board of Directors and approved by the Governor in Council and by the Parliament of Canada. Capital.

(2) The capital shall be divided into one hundred thousand shares of the par value of fifty dollars each, which shall be issued to the Minister to be held by him on behalf of the Dominion of Canada. Shares.

(3) The shares issued to the Minister shall be registered by the Bank in his name in the books of the Bank at Ottawa." Registered in Minister's name.

9. The said Act is further amended by inserting after section seventeen the following section:—

"17A. (1) The Minister shall, as of the date of the coming into force of this subsection, exchange one hundred thousand Class "B" shares of the Bank out of the one hundred and two thousand Class "B" shares of the Bank then held by him for one hundred thousand shares of the capital of the Bank authorized to be issued by section seventeen of this Act and the said one hundred thousand Class "B" shares of the Bank so exchanged shall forthwith be cancelled. Exchange of shares.

Price to be paid for Class "A" shares.

(2) The Bank shall on the date of the coming into force of this subsection pay to each holder of Class "A" shares of the Bank the sum of fifty-nine dollars and twenty cents for each Class "A" share registered in his name at the close of business on the fifteenth day of July, 1938 together with the amount of dividends accrued to the date of the coming into force of this subsection and all Class "A" shares of the Bank shall be deemed to be cancelled as of the date of the coming into force of this subsection.

Minister to reimburse the Bank.

(3) The Minister shall as of the date of the coming into force of this subsection reimburse the Bank the amount by which payments made by the Bank to the holders of Class "A" shares, excluding any amount paid by way of dividend, exceed the par value of such shares and such reimbursement shall be effected by surrendering to the Bank for cancellation two thousand of the Class "B" shares held by the Minister having the aggregate par value of one hundred thousand dollars and by paying to the Bank out of any unappropriated moneys in the Consolidated Revenue Fund the sum of eight hundred and twenty thousand dollars.

Bank to pay accrued dividends upon Class "B" shares.

(4) The Bank shall, on the date of the coming into force of this subsection, pay to the Minister on behalf of the Dominion of Canada, the amount of dividends accrued up to the said date upon the one hundred and two thousand Class "B" shares of the Bank held by the Minister as of the said date."

Repeal.

10. Section eighteen of the said Act is repealed.

Repeal.

11. Section nineteen of the said Act, as enacted by section eleven of the said amending Act, is repealed.

12. Paragraphs *(d)* and *(f)* of subsection one of section twenty-one of the said Act, as enacted by section thirteen of the said amending Act, are repealed and the following substituted therefor: —

Bank may buy and sell Dominion or provincial securities.

"*(d)* buy and sell securities issued or guaranteed by the Dominion of Canada or any province, having a maturity exceeding two years from the date of acquisition by the Bank, but the Bank shall at no time hold securities not maturing within two years having a par value in excess of fifty per cent. of its outstanding note issue and deposit liabilities, nor shall the Bank at any time hold securities not maturing within ten years of a par value in excess of five times the amount of the paid-up capital and rest fund of the Bank;

(f) buy and sell securities issued by the United Kingdom or the United States of America having a maturity exceeding six months from the date of acquisition by the Bank, but the Bank shall at no time hold such securities of a par value in excess of one-half of the amount of the paid-up capital of the Bank." Securities of the U.K. or U.S.

13. Subsections one, two and three of section twenty-seven of the said Act are repealed and the following substituted therefor:—

"27. (1) Every chartered bank shall maintain a reserve of not less than five per centum of such of its deposit liabilities as are payable in Canadian dollars, and such reserve shall consist of a deposit with the Bank and of notes of the Bank held by such bank. Reserves to be maintained by chartered banks.

(2) For the purposes of this section, every chartered bank shall make a return to the Bank to be signed by the chief accountant or acting chief accountant and by the general manager or acting general manager of such bank, showing the amount of such of its deposit liabilities as are payable in Canadian dollars and also the amount of its deposit with the Bank and the amount of the notes of the Bank held by such bank, at the end of each juridical day of the month last preceding the date of the return, and showing for the month the daily average amount of such deposit liabilities and of its deposit with the Bank and of the notes of the Bank held by such bank. Such return shall be delivered or transmitted to the Bank at the same time as the return to the Minister, pursuant to section one hundred and twelve of *The Bank Act,* is transmitted or delivered. Chartered banks to make returns. 1934, c. 24.

(3) The daily average amount of such of its deposit liabilities as are payable in Canadian dollars for each chartered bank shall be the basis of determining the amount of the reserve to be maintained by such bank during the month next following the month in which such return was made." Basis of reserve of chartered banks.

14. Section thirty-one of the said Act, as amended by section nineteen of the said amending Act, is repealed and the following substituted therefor:—

"31. The Bank shall establish a rest fund and after making such provision as the Board thinks proper for bad and doubtful debts, depreciation in assets, pension funds and all such matters as are properly provided for by banks and after deducting an amount equal to four and one-half per centum of the paid-up capital which Rest fund.

may be utilized for the payment of cumulative dividends at a rate of four and one-half per centum per annum, payable half-yearly, the ascertained surplus available from the operations of the Bank during each financial year shall be applied by the Board as follows:

(a) If the rest fund of the Bank is less than the paid-up capital, one-third of such surplus shall be allocated to the rest fund and the residue shall be paid to the Receiver General and placed to the credit of the Consolidated Revenue Fund;

(b) If the rest fund is not less than the paid-up capital but is less than twice the paid-up capital, one-tenth of such surplus shall be allocated to the rest fund and the residue shall be paid to the Receiver General and placed to the credit of the Consolidated Revenue Fund;

(c) If the rest fund is not less than twice the paid-up capital, the whole of such surplus shall be paid to the Receiver General and placed to the credit of the Consolidated Revenue Fund."

15. Section thirty-four of the said Act, as amended by section twenty-two of the said amending Act, is repealed and the following substituted therefor:—

Fiscal year.

"34. (1) The fiscal year of the Bank shall be the calendar year.

Certified statement of accounts to Minister.

(2) Within six weeks after the end of each fiscal year, the Bank shall transmit to the Minister a statement of its accounts for the fiscal year, signed by the Governor or the Deputy Governor or the Assistant Deputy Governor and the Chief Accountant or Acting Chief Accountant of the Bank, and certified by the auditors in the form prescribed by the by-laws of the Bank, together with such summary or report by the Governor as he may deem desirable or as may be required by the Minister.

Governor's report.

Statement and report in Gazette.

(3) A copy of the accounts so signed and certified and of the Governor's report shall be forthwith published in the *Canada Gazette*, and if Parliament is then sitting, shall within fourteen days after the receipt thereof by the Minister be laid before Parliament, or if Parliament is not sitting, it shall be laid before Parliament within fourteen days after the commencement of the next ensuing session thereof."

Annual list of shareholders.

16. Section thirty-five of the said Act is repealed.

Meetings.

17. Section thirty-six of the said Act is repealed.

18. Section forty-one of the said Act is repealed and the following substituted therefor:—

"41. No statute relating to the insolvency or winding-up of any corporation shall apply to the Bank and in no case shall the affairs of the Bank be wound up unless Parliament so provides: Provided, however, that if provision is made for winding up the Bank the notes of the Bank outstanding shall be the first charge upon the assets." Insolvency and winding-up.

19. Section forty-three of the said Act is repealed and the following substituted therefor:—

"43. (1) The Board, with the approval of the Governor in Council, may make by-laws not repugnant to the provisions of this Act with respect to By-laws.

(a) the declaration and payment of dividends;

(b) the calling of meetings of the Board and of the Executive Committee and what number of persons shall constitute a quorum in each case, and how questions considered at such meetings shall be determined;

(c) the fees of directors and the duties and conduct of officers, clerks and employees of the Bank;

(d) the form of the annual statement of accounts; and

(e) generally as to the management and disposition of the stock, property and undertakings of the Bank; and may amend or repeal such by-laws.

(2) Every by-law and every amendment or repeal thereof shall take effect when published in the *Canada Gazette*".

20. Subsection one of section twenty-four of the French version of the said *Bank of Canada Act* is amended by striking out the word "vingt-cinq" in the sixth line thereof and substituting therefor the word "vingt-six". French version amended.

21. This Act shall come into force on a date to be fixed by proclamation. Coming into force.

APPENDIX IV

EXTRA

THE CANADA GAZETTE

PUBLISHED BY AUTHORITY

OTTAWA, MONDAY, MARCH 11, 1935

[573]

AT THE GOVERNMENT HOUSE AT OTTAWA

Wednesday, the 6th day of March, 1935.

PRESENT:

HIS EXCELLENCY THE GOVERNOR GENERAL IN COUNCIL

WHEREAS subsection one of section twenty of the Bank of Canada Act, chapter forty-three of the Statutes of Canada, 1934, provides that whenever the capital stock of the Bank has been subscribed and payment made to the amount set out in said section, the Minister of Finance, when authorized by the Governor in Council, may issue a certificate authorizing the Bank to commence business on a date to be fixed therein;

AND WHEREAS the Minister of Finance reports that the said provisions as to subscription and initial payment have been met;

THEREFORE His Excellency the Governor General in Council, on the recommendation of the Minister of Finance and under the authority of said section twenty of the Bank of Canada Act, is pleased to authorize and doth hereby authorize the Minister of Finance to issue a certificate authorizing the Bank of Canada to commence business on a date to be fixed therein.

E. J. LEMAIRE,
Clerk of the Privy Council.

CERTIFICATE AUTHORIZING THE BANK OF CANADA TO COMMENCE BUSINESS

WHEREAS subsection one of section twenty of the Bank of Canada Act, chapter forty-three of the Statutes of Canada, 1934, provides as follows:

> "(1) Whenever the capital stock of the Bank has been subscribed and payment in money made to the amount of twelve dollars and fifty cents per share, or such larger amount as the Minister determines, the Minister, when authorized by the Governor in Council, may issue a certificate authorizing the Bank to commence business on a date to be fixed therein."

WHEREAS the conditions as to subscription and payment for said stock contained in said subsection one of section twenty have been complied with; and

WHEREAS the Minister of Finance has been authorized by an Order of the Governor in Council, dated March 6, 1935, P.C. 573, to issue a certificate authorizing the Bank to commence business on a date to be fixed therein;

I HEREBY, under the authority of said subsection one of section twenty of the Bank of Canada Act and of the said Order of the Governor in Council, dated March 6, 1935, P.C. 573, by this certificate authorize the

Bank of Canada to commence business on the eleventh day of March, 1935.

EDGAR N. RHODES,
Minister of Finance

Ottawa, March 7, 1935.

BESSBOROUGH
[L.S.]

CANADA

GEORGE THE FIFTH, by the Grace of God of Great Britain, Ireland and the British Dominions beyong the Seas, KING, Defender of the Faith Emperor of India.

TO ALL TO WHOM these Presents shall come or whom the same may in anywise concern,

GREETING:

A PROCLAMATION

W. STUART EDWARDS, Deputy Minister of Justice, Canada.

WHEREAS in and by section 2 of Chapter 34 of the Statutes of Canada, 1934, an Act to amend the Dominion Notes Act, it is provided that the said Dominion Notes Act, Chapter 41 of the Revised Statutes of Canada, 1927, as amended by Chapter 12 of the Statutes of Canada 1932-33 and by said Chapter 34, shall be repealed on and from a date to be fixed by proclamation of Our Governor in Council.

AND WHEREAS in and by section 1 of Chapter 30 of the Statutes of Canada 1934, An Act to repeal Chapter 4 of the Statutes of Canada 1915, it is provided that Chapter 4 of the Statutes of Canada 1915, An Act respecting certain issues of Dominion Notes, shall be repealed on and from a date to be fixed by proclamation of Our Governor in Council.

AND WHEREAS it is provided by section 2 of said Chapter 30 of the Statutes of Canada 1934, that said Chapter 30 shall come into force on a day to be fixed by proclamation of Our Governor in Council.

AND WHEREAS in and by section 2 of Chapter 35 of the Statutes of Canada 1934, An Act to repeal the Finance Act, it is provided that the said Act shall come into force on a day to be fixed by proclamation of Our Governor in Council.

AND WHEREAS it is expedient and Our Governor in Council has been pleased to order that a proclamation do issue directing that the Dominion Notes Act, Chapter 41 of the Revised Statutes of Canada 1927, as amended by Chapter 12 of the Statutes of Canada 1932-33 and by Chapter 34 of the Statutes of Canada 1934, be repealed upon, from and after the eleventh day of March in the year of Our Lord one thousand nine hundred and thirty-five.

AND WHEREAS OUR GOVERNOR in Council has been pleased to further order that Chapter 30 of the Statutes of Canada 1934, An Act to repeal Chapter 4 of the Statutes of Canada 1915; and Chapter 35 of the Statutes of Canada 1934, An Act to repeal the Finance Act, shall come into force upon, from and after the eleventh day of March in the year of Our Lord one thousand nine hundred and thirty-five.

NOW KNOW YE that We by and with the advice of Our Privy Council for Canada do by this Our Proclamation declare and direct that the said Dominion Notes Act, Chapter 41 of the Revised Statutes of Canada 1927, as amended by Chapter 12 of the Statutes of Canada 1932-33, and by Chapter 34 of the Statutes of Canada 1934, be repealed upon, from and after the eleventh day of March in the year of Our Lord one thousand nine hundred and thirty-five; and that the said Chapter 30 of the Statutes of Canada 1934, An Act to repeal Chapter 4 of the Statutes of 1915, and the said Chapter 35 of the Statutes of Canada 1934, An Act to repeal the Finance Act, shall come into force and have effect upon, from and after the eleventh day of March in the year of Our Lord one thousand nine hundred and thirty-five.

OF ALL WHICH Our Loving Subjects and all others whom these Presents may concern are hereby required to take notice and to govern themselves accordingly.

IN TESTIMONY WHEREOF, We have caused these Our Letters to be made Patent and the Great Seal of Canada to be hereunto affixed. WITNESS: Our Right Trusty and Right Well-beloved Cousin and Counseller, Vere Brabazon, Earl of Bessborough, a Member of Our Most Honourable Privy Council, Knight Grand Cross of Our Most Distinguished Order of Saint Michael and Saint George, formerly Captain in Our Territorial Army, Governor-General and Commander-in-Chief of Our Dominion of Canada.

AT OUR GOVERNMENT HOUSE, in Our City of Ottawa, this seventh day of March, in the year of Our Lord one thousand nine hundred and thirty-five and in the twenty-fifth year of Our reign.

By Command,

E. H. COLEMAN,

37-3 Under-Secretary of State.

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[574]

AT THE GOVERNMENT HOUSE AT OTTAWA

Wednesday, the 6th day of March, 1935.

PRESENT:

HIS EXCELLENCY THE GOVERNOR GENERAL IN COUNCIL

WHEREAS subsection one of section twenty-five of the Bank of Canada Act, Chapter forty-three of the Statutes of Canada, 1934, provides that the Bank shall sell gold to any person who makes demand therefor at the head office of the Bank and tenders the purchase price in legal tender, but only in the form of bars containing approximately four hundred ounces of fine gold;

AND WHEREAS subsection two of said section twenty-five provides that the Governor in Council may, from time to time and for such period as he may deem desirable suspend the operation of said subsection one of section twenty-five and remove such suspension;

THEREFORE His Excellency the Governor General in Council, on the recommendation of the Minister of Finance and under the authority of subsection two of section twenty-five of the Bank of Canada Act, is pleased to order that the operation of said subsection one of section twenty-five of the Bank of Canada Act be and it is hereby suspended for a period of one year from and after the tenth day of March, 1935.

E. J. LEMAIRE,
Clerk of the Privy Council.

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[578]

AT THE GOVERNMENT HOUSE AT OTTAWA

Wednesday, the 6th day of March, 1935.

PRESENT:

HIS EXCELLENCY THE GOVERNOR GENERAL IN COUNCIL

WHEREAS subsection 3 of section 24 of the Bank of Canada Act, chapter 43 of the Statutes of Canada, 1934, provides that notes of the Bank of Canada shall be in such denominations as the Governor in Council from time to time determines.

NOW THEREFORE, His Excellency the Governor General in Council, on the recommendation of the Minister of Finance, and under the authority above cited, is pleased to order and doth hereby order and determine that the following shall be the denominations of notes of the Bank of Canada:

$ 1.00	$ 20.00
2.00	50.00
5.00	100.00
10.00	500.00
$1.000.00	

and that there shall be a note of the denomination of $25.00, to be issued in commemoration of the twenty-fifth anniversary of the Accession to the Throne of His Gracious Majesty King George V.

E. J. LEMAIRE,
Clerk of the Privy Council.

NOTICE OF INTENTION UNDER SECTION 88 OF THE BANK ACT

UNDER the authority of subsection nineteen of section eighty-eight of the Bank Act, chapter twenty-four of the Statutes of Canada, 1934, I hereby prescribe that on and after the eleventh day of March, 1935, the following shall be the offices at which notices of intention to give a bank security under the authority of said section eighty-eight shall be registered, in the manner provided by the said section namely:—

The branch or agency of the Bank of Canada at the following places, namely:—

Halifax—in and for the Province of Nova Scotia;
Charlottetown—in and for the Province of Prince Edward Island;
Saint John—in and for the Province of New Brunswick;
Montreal—in and for the Province of Quebec;
Toronto—in and for the Province of Ontario;
Winnipeg—in and for the Province of Manitoba;
Regina—in and for the Province of Saskatchewan;
Calgary—in and for the Province of Alberta;
Vancouver—in and for the Province of British Columbia.

EDGAR N. RHODES,
Minister of Finance.

Ottawa, March 7, 1935.

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[576]

AT THE GOVERNMENT HOUSE AT OTTAWA

Wednesday, the 6th day of March, 1935.

PRESENT:

HIS EXCELLENCY THE GOVERNOR GENERAL IN COUNCIL

WHEREAS section thirty-three of the Bank of Canada Act provides that the Bank shall make and transmit to the Minister of Finance weekly and monthly statements in the form set out in Schedule C to the Act;

AND WHEREAS subsection six of said section thirty-three provides that the Governor in Council may from time to time amend the form of Schedule C to the Act;

THEREFORE His Excellency the Governor General in Council, on the recommendation of the Minister of Finance, is pleased to amend the form of Schedule C to the said Act and it is hereby amended as follows:—

1. The heading to read—"Bank of Canada Statement of Assets and Liabilities as at . . . . ";

2. Item 5 on the Liabilities side to read—"*Sundry* Liabilities payable in Sterling, U.S.A., and Foreign Gold Currencies";

3. The fourth item under No. 1 on the Assets side to read—"Reserve in U.S.A. funds";

4. The heading of No. 4 on the Assets side to read—"Advances *to*";

5. No. 5 on the Assets side to read —"Bills Bought in Open Market, *not including Treasury Bills*";

6. Sub-paragraph (*e*) of No. 6 on the Assets side to read—"(*e*) United Kingdom, other British Dominions or U.S.A. securities *of a maturity exceeding three months*";

7. The word "Ottawa" is inserted in the date line of the declaration instead of the word "place."

E. J. LEMAIRE,
Clerk of the Privy Council.

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[603]

AT THE GOVERNMENT HOUSE AT OTTAWA

Thursday the 7th day of March, 1935

PRESENT:

HIS EXCELLENCY THE GOVERNOR GENERAL IN COUNCIL

HIS Excellency the Governor General in Council, on the recommendation of the Minister of Finance, and pursuant to the provisions of Section 43 of The Bank of Canada

Act, is pleased to approve the annexed By-laws passed by the Board of Directors of the Bank of Canada at a meeting held March 5, 1935, and they are hereby approved and substituted for the by-laws previously made by the Governor in Council.

E. J. LEMAIRE,
Clerk of the Privy Council.

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BY-LAWS OF THE BANK OF CANADA

I

SHARES AND CERTIFICATES

(a) Subscription and Allotment

1. As soon as the Minister offers shares for public subscription, a share register shall be opened and each subscriber shall at the time of subscription give his post office address and description, together with a statutory declaration in the form of Schedule A to these by-laws that he is eligible to be a shareholder, and these facts shall be recorded in the register in connection with the name of the subscriber and the number of shares subscribed for.

2. The Minister shall give notice of the allotment of shares to subscribers by mailing the same to the post office address furnished by the subscribers and may by such notice fix the dates when the instalments on account of such shares shall be payable.

3. Failure or refusal on the part of the subscriber to accept shares allotted to him shall not entitle him to the return of the initial payment required to be made by him with his application as a subscriber, and in any such case every such sum shall be forfeited to the Bank.

4. The share certificates shall be in the form of Schedule B to these by-laws and shall be documents of no value except as memoranda; allotment certificates or receipts may be issued by the Minister in lieu of share certificates until the shares are fully paid up.

5. Interim share certificates may be issued and shall be substantially in the form of Schedule B (*i*) to these by-laws. The said interim share certificates shall be authenticated by printing thereon the facsimile of the signature of the Governor and by the countersignature of one of the officers in charge of the interim share register. The interim share certificates shall be in all ways subject to the provisions of the Bank of Canada Act and of by-laws passed under the provisions of the said Act. They shall be surrendered upon transfer of the shares they represent and upon the issue of the relative share certificates.

(b) Instalments of Capital

6. In the case of non-payment of any instalment on account of capital, the Board may in the corporate name of the Bank sue for, recover, collect and get in any such instalment, or may cause and declare the shares in respect of which any such default is made, to be forfeited to the Bank. The shareholder in any such case shall be given thirty days' notice of intention to forfeit, and if the instalment is not paid within the period of thirty days aforesaid the declaration of forfeiture shall be effective.

7. If the Board declares any shares to be forfeited it may sell the same at public auction.

8. The Governor or Deputy Governor shall execute the transfer of shares so sold.

9. Forfeiture shall include all dividends declared in respect of the forfeited shares and not actually paid before the forfeiture.

10. Notwithstanding the forfeiture of shares for non-payment of an instalment, the shareholder shall be liable to pay all instalments due at the time of forfeiture.

11. The forfeiture shall be noted in the register of shares.

12. In any action brought to recover any money due in respect of an instalment on account of capital, it shall be sufficient to prove that the name of the defendant is entered in the register as the holder of stock in respect of which such debt accrued and that notice by post was given of the date fixed for the payment of such instalment.

(c) Transfer and Transmission of Shares

13. (1) The Bank shall open and maintain, or cause to be opened and maintained, in any province of Canada in which it has resident shareholders, a share register at a place to be designated by the Board at which the shares of shareholders resident within the province shall be registered and at which and not elsewhere, except as hereinafter provided, such shares may be validly transferred.

(2) Shares of persons who are resident in Canada, but not at any province thereof, may be registered on the register in any province, and on the request in writing of the shareholder may be removed from one register to another, but such shares may be transferred only on the register on which they are at the time registered.

14. No transfer of shares shall be valid until entry thereof has been duly made in the share register.

15. No share shall be transferable until all instalments or calls due thereon, up to the date of transfer, have been fully paid or until it is declared forfeited for non-payment of an instalment or call.

16. The post office address and description of the transferee shall be entered in the share register.

17. No fractional part of a share or less than a whole share shall be transferable.

18. Whenever there is a change in the ownership of shares, and the new shareholder resides in a province other than that in which the former shareholder resided, and whenever there is a change in the residence of a shareholder from one province to another, the registration of the shares shall be changed to the register of the province in which the shareholder has his residence, and the shares of such shareholder shall thereafter be transferable at such register and not elsewhere, except as herein otherwise provided.

19. For the purposes of these by-laws a shareholder shall be deemed to be resident in the province in which he has, according to the books of the Bank, his post office address.

20. All sales or transfers of shares and all contracts and agreements in respect thereof shall be null and void, unless the person making the sale or transfer, or the person in whose name or behalf the sale or transfer is made, at the time of the sale or transfer,

(*a*) is the registered owner in the books of the bank of the share or shares so sold or transferred, or intended or purporting to be sold or transferred; or

(*b*) has the registered owner's assent to the sale given by means of power of attorney.

21. Notwithstanding anything in the two next preceding by-laws contained, the rights and remedies under any contract of sale of any purchaser who has no knowledge of non-compliance with the conditions and requirements of the said by-laws are hereby saved.

22. When any share in the capital stock has been sold under a writ of execution, the officer by whom the writ was executed shall, within thirty days after the sale, leave with the Bank an attested copy of the writ, with the certificate of such officer endorsed thereon, certifying to whom the sale has been made.

23. The Governor or Deputy Governor of the Bank shall execute the transfer of any share so sold to the purchaser.

24. Such transfer shall be to all intents and purposes as valid and effectual in law as if it had been executed by the holder of the said share.

25. If the interest in any share in the capital stock of the Bank is transmitted by or in consequence of

(*a*) the death, lunacy, bankruptcy, or insolvency of any shareholder; or

(*b*) the marriage of a female shareholder; or

(*c*) any lawful means, other than a transfer according to the provisions of these by-laws,

the transmission shall be authenticated by a declaration in writing, as hereinafter mentioned, or in such other manner as the Board may require.

26. Every such declaration shall distinctly state the manner in which and the person to whom the interest in the share has been transmitted, and shall give his post office address and description, and such person shall make and sign the declaration.

27. The person making and signing the declaration shall acknowledge or make the same before a judge of a court of record, or before the mayor or chief magistrate of a city, town or municipality, or before a notary public, or a commissioner for taking affidavits, in the place where the said declaration is made and signed.

28. Every declaration so signed, made and acknowledged shall be left with the officer in charge of the share register in which the said shares are registered, who shall thereupon enter the name of the person entitled under the transmission in the share register.

29. Until the transmission has been so authenticated no transfer shall be made and no person claiming by virtue thereof shall be entitled to participate in the profits of the Bank, or to vote in respect of any such share of the capital stock.

30. If the transmission of the interest in any share of the capital stock has taken place by virtue of the marriage of a female shareholder, the declaration shall be accompanied by a copy of the register of such marriage, or other particulars of the celebration thereof, and shall declare the identity of the wife with the holder of such share, and shall be made and signed by such female shareholder and her husband.

31. The declaration may include a statement to the effect that the share transmitted is the separate property and under the sole control of the wife, and that she may, without requiring the consent or authority of her husband, receive and grant receipts for the dividends and profits accruing in respect thereof, and dispose of and transfer the share itself.

32. The declaration shall be binding upon the Bank and persons making the same, until the said persons see fit to revoke it by a written notice to the Bank to that effect.

33. The omission of a statement in any such declaration that the wife making the declaration is duly authorized by her husband to make the same shall not invalidate the declaration.

34. The officer in charge of the share register in which the said shares are registered may require corroborative evidence of any fact alleged in any such declaration.

35. If the transmission has taken place by virtue of any testamentary instrument, or by intestacy, the probate of the will, or the letters of administration, or act of curatorship or tutorship, or an official extract therefrom, shall, together, with the declaration, be produced and left with the officer in charge of the register aforesaid.

36. The officer in charge of the register aforesaid shall thereupon enter in the share register the name of the person entitled under the transmission.

37. Notwithstanding anything in these by-laws, if the transmission of any share in the capital stock has taken place by virtue of the decease of any shareholder, the production to the Board and the deposit with it of

(*a*) any authenticated copy of the probate of the will of the deceased shareholder, or of letters of administration of his estate, or of letters of verification of heirship, or the act of curatorship or tutorship, granted by any court in Canada having power to grant the same,

(*b*) an authentic notarial copy of the will of the deceased shareholder, if such will is in notarial form according to the law of the province of Quebec,

shall be sufficient justification and authority for paying any dividend, or for transferring or authorizing the transfer of any share, in pursuance of and in conformity to the probate, letters of administration, or other such document as aforesaid.

38. The Bank shall not be bound to see to the execution of any trust, whether express, implied or constructive, to which any share of its capital stock is subject.

39. The receipt of the person in whose name any such share stands in the books of the Bank, or, if it stands in the names of more persons than one, the receipt of one of such persons shall be a sufficient discharge to the Bank for any dividend or any other sum of money payable in respect of any such share, unless, previously to such payment, express notice to the contrary has been given to the Bank.

40. The Bank shall not be bound to see to the application of the money paid upon such receipt, whether given by one of such persons or all of them.

41. (1) In the case of shares transferred or transmitted to any person by sale, gift, testamentary instrument, operation of law or otherwise, the person entitled shall furnish a statutory declaration in the form of Schedule C to these by-laws, indicating whether he is eligible to hold the shares, and if he is ineligible, the fact shall be noted in the register and he shall be required to transfer or dispose of the shares, in accordance with the provisions of section nineteen of the Bank of Canada Act.

(2) Where the person entitled is a corporation the statutory declaration shall be in the form of Schedule C (i).

II

The Board of Directors

(a) Nomination and Election of Directors

1. Not less than ten weeks before the general meeting of shareholders at which directors are to be elected, a nomination paper in the form of Schedule D to these by-laws shall be sent by post to every shareholder.

2. Every nomination of a director shall be signed by one or more shareholders and delivered to the Bank not less than seven weeks before the general meeting at which directors are to be elected. The nomination paper shall state the chief occupation of the nominee and proof of such occupation shall be made by statutory declaration of the shareholder or shareholders signing the nomination paper.

3. A meeting of the Board shall be held at least six weeks prior to the general meeting at which directors are to be elected for the purpose of determining what persons have been validly nominated.

4. No person shall be deemed to be validly nominated unless the Board is satisfied,

(*a*) that the nominee is eligible for election, and

(*b*) that the nominee accepts the nomination; and

(*c*) that the shareholders signing the nomination paper or papers hold at least two hundred and fifty shares.

5. The ballot paper for the election of directors shall be in the form of Schedule E, and in the case of the first general meeting of shareholders it shall be distinctly printed thereon that two directors shall be elected from those whose chief occupation is in primary industry, and two directors from those whose chief occupation is in commerce or manufacturing and three directors from those whose chief occupation is other than in primary industry or commerce or manufacturing.

6. The Board shall, immediately after any meeting held for the purpose of determining what persons have been validly nominated as directors, publicly announce and publish in *The Canada Gazette* the names of persons nominated as directors and shall cause the shareholders to be notified by post of such nominations, and such notice shall inform the shareholders that they may give to the Minister in writing instructions as to the manner in which the shareholders desire to vote on any business of the meeting. The instructions to the Minister shall be, as near as may be, in the form of Schedule F to these by-laws and shall be witnessed and delivered to the Minister at least ten clear days prior to the date of the meeting.

7. At the first general meeting the following persons shall be declared elected as directors,

(*a*) the two persons receiving respectively the greatest and the next greatest number of votes amongst those candidates whose chief occupation is in primary industry;

(*b*) the two persons receiving respectively the greatest and the next greatest number of votes amongst those candidates whose chief occupation is in commerce or manufacturing;

(*c*) the three persons receiving respectively the greatest and the two next greatest numbers of votes amongst those candidates whose chief occupation is other than in primary industry, commerce or manufacturing.

8. The two directors receiving respectively the greatest and the next greatest number of votes at the first general meeting of shareholders shall hold office until the sixth annual general meeting; the two directors receiving respectively the two next greatest numbers of votes shall hold office until the fifth annual general meeting and the two directors receiving respectively the two next greatest number of votes shall hold office until the fourth annual general meeting and the remaining director shall hold office until the third annual general meeting.

9. After the first general meeting, whenever the office of a director becomes or is about to become vacant, the Board shall be satisfied that the chief occupation of the person or persons nominated or appointed to fill the vacancy falls in the same general category ("primary industry", "commerce or manufacturing" or "occupation other than primary industry or commerce or manufacturing") as that of the director whose office is or is about to become vacant.

(b) Meetings of the Board

10. The Board of Directors shall meet as soon as possible after any general meeting of shareholders at which directors are elected, for the organization of the Board and for the selection of a chairman and of a director to be a member of the Executive Committee.

11. Each director upon his election shall forthwith register in a book kept at the head office of the Bank for that purpose, an address to which all notices may be sent or delivered.

12. The Board of Directors shall meet together for the dispatch of business at intervals to be fixed by the Board, but not less often than four times in each year and on any other occasion when a meeting is called by the Governor or, in the event of his absence or incapacity, by the Deputy Governor.

13. Notice of meetings of the Board shall be given to each director by delivering or mailing or telegraphing the same to his address in sufficient time to enable him to be present at the meeting.

14. In the absence or incapacity of the Chairman, the Governor or Deputy Governor shall preside at the meetings of the Board.

15. Questions arising at any meeting of the Board shall be decided by a majority of votes (each member having one vote) and in the event of an equality of votes, the presiding officer shall have a second or casting vote.

16. Any three elected directors, in addition to the Governor or Deputy Governor, shall constitute a quorum.

17. The Board shall cause minutes to be duly entered in a book of the Bank provided for that purpose, recording the names of directors present at each meeting and all resolutions and proceedings of the meeting. The minute book shall be kept in the custody of the secretary or acting secretary of the Bank.

(c) Business and Powers of the Board

18. The Board shall, subject to the provisions of the Bank of Canada Act, supervise and control the conduct of the business of the Bank.

19. The Board shall at each meeting receive and consider a full report of proceedings of the Executive Committee since the last meeting of the Board.

20. The Board shall determine the minimum rates at which the Bank is prepared to discount or rediscount bills or to make advances, and such rates shall be in force until altered by the Board or by the Executive Committee.

21. The Board may, subject to the provisions of the Bank of Canada Act, declare half-yearly dividends of so much of the profits of the Bank as to the majority of them seems advisable. Notice of declaration of every dividend shall be published in *The Canada Gazette.*

22. Dividends shall on and after the dates fixed for payment, be payable at such place or places and in such manner as the Board prescribes.

23. The Board may close the transfer books for a period not exceeding fifteen days before any general meeting of shareholders and before the payment of each dividend.

(d) Executive Committee

24. The Executive Committee of the Board shall meet at least once every week on a day to be fixed by the Executive Committee, and in addition special meetings may be called by the Governor, or in the case of his absence or incapacity by the Deputy Governor.

25. Two members of the Executive Committee shall constitute a quorum.

26. The Executive Committee shall determine the duties and responsibilities of the officers and employees of the Bank, and shall make rules governing the conduct of the staff.

27. The Executive Committee shall determine what officers or employees of the Bank shall be bonded, and all matters relating thereto.

(e) Common Seal of the Bank

28. The common seal of the Bank shall remain in the Bank in the custody of the Governor or of the Deputy Governor, one of whom shall affix it to all documents requiring the seal of the Bank and such documents shall then be signed by the Governor or the Deputy Governor as the case may be and the Secretary or acting secretary of the Bank. Every document so signed to which the seal is affixed shall be valid and binding upon the Bank and shall be reported to the Board at its next meeting.

(f) Meetings of Directors

29. Any two directors may by notice in writing call a meeting of the directors to perform any function vested in the directors by the Bank of Canada Act. Five directors shall constitute a quorum and the decision of the majority of those present shall be deemed to be the decision of the meeting.

III

Meetings of Shareholders

1. The Governor or, in the event of his absence or incapacity the Deputy Governor, shall be the chairman at every general meeting, and in the event of an equality of votes on any matter the chairman shall have a casting vote.

2. All questions considered by the meeting shall be determined by a majority vote.

3. The election of directors and auditors shall be by ballot.

4. The chairman may, with the consent of the meeting, adjourn the same from time to time, but no business shall be transacted at any adjourned meeting other than the business left unfinished at the meeting from which the adjournment took place.

5. Notice of any special general meeting shall be given by mailing the same to the shareholders at least thirty days prior to the date of the meeting. Such notice shall state the business to be transacted at the meeting.

6. Minutes of all proceedings at a general meeting shall be kept by the officer of the Bank authorized by the Board to keep such minutes.

IV

Annual Statement of Accounts

The form of the annual statement of accounts shall be substantially that of Schedule C to the Bank of Canada Act, supplemented by a Profit and Loss account appropriating the net profits of the Bank.

SCHEDULE "A"

STATUTORY DECLARATION

For individual applying for shares:

Dominion of Canada
Province of
County of

I, .. of
in the Province of do solemnly declare:—

1. I am a British subject, ordinarily resident in Canada and my chief occupation is

2. I am not a director, officer, clerk or employee of any chartered bank and my application for shares of the capital stock of the Bank is not made for the benefit of any chartered bank or any director, officer, clerk or employee of any such bank;

And I make this solemn declaration conscientiously believing it to be true and knowing that it is of the same force and effect as if made under oath and by virtue of the Canada Evidence Act.

Declared before me at
this . day of .
A.D. 193 ...

Notary Public, Justice of the Peace, Commissioner for taking Affidavits.

STATUTORY DECLARATION

For corporation applying for shares:

Dominion of Canada
Province of
County of

I, .. of
in the Province of . . do solemnly declare:—

1. I am the . of
. . . . ;
Name of corporation.

2. The said
Name of corporation
is the applicant for shares of the capital stock of the Bank of Canada;

3. The said
Name of corporation
is a corporation organized under the laws of (a) and is controlled by British subjects, ordinarily resident in Canada.

(c) Dominion of Canada; or name of Province.

And I make this solemn declaration conscientiously believing it to be true and knowing that it is of the same force and effect as if made under oath and by virtue of the Canada Evidence Act.

Declared before me at
this day of .
A.D. 193
. . ..

Notary Public, Justice of the Peace, Commissioner for taking Affidavits.

SCHEDULE "B"

CERTIFICATE NO. NO. OF SHARES

BANK OF CANADA

Incorporated under the Bank of Canada Act, Chapter 43 of the Statutes of Canada, 1934.

Authorized capital $5,000,000, divided into 100,000 shares of $50 each.

SHARE CERTIFICATE

This is to certify that, at the time of the issue hereof,
is
are the
holder of fully paid up shares of the Capital Stock of the Bank of Canada of Fifty Dollars each, transferable only by the holder in person, or by Attorney or legal representatives on the books of the Bank at its Agency in
Dated this day of 19

FOR THE BANK OF CANADA

.. ..
Agent

Countersigned

. . ...
Transfer Clerk.

N.B.—This certificate is not negotiable, transferable, or assignable by endorsement or otherwise. It should be returned to the Bank when a transfer is made.

BANK OF CANADA

INTERIM SHARE CERTIFICATE

No. .... Shares

Incorporated under the Bank of Canada Act, Chapter 43 of the Statutes of Canada, 1934.

Authorized Capital $5,000,000 divided into 100,000 shares of $50 each.

This certifies that . is the owner of shares of the capital stock of the Bank of Canada of fifty dollars each on which the initial instalment at the rate of $12.50 per share has been paid. Upon surrender of this interim certificate and payment of any unpaid instalment the registered owner is entitled to a share certificate for the said number of shares. This certificate is transferable only on the books of the Bank by the registered owner hereof in person or by attorney upon the surrender of this certificate.

Share certificates will be available for exchange for interim share certificates as soon as possible after January 2, 1935 (the date of payment of final instalment).

In any case where payment of the final instalment is made prior to the issue of definitive share certificates such final payment will be evidenced by a transfer officer filling in and signing the form printed hereunder.

In Witness Whereof the provisional directors of the Bank have caused this interim certificate to be authenticated by printing thereon the facsimile of the signature of the Governor and by the counter-signature of a transfer officer acting on behalf of the Bank of Canada this day of .

1934.

Countersigned on behalf of the Bank of Canada

....

Transfer Officer Governor

Amount of final instalment	Date of payment of final instalment	Signature on behalf of bank

BACK:

For value received, I (We) .. . . hereby sell, assign and transfer unto . . . . . .

. . . . . shares of the capital stock represented by the within interim certificate and do hereby irrevocably constitute and appoint . . . . . .

my (our) attorney to transfer the said stock on the books of the within named Bank.

Dated 193

. . . .

Witness Signature of transferor

NOTICE: The signature of this assignment must correspond with the name as written upon the face of the certificate in every particular, without alteration or enlargement, or any change whatever.

SCHEDULE "C"

BANK OF CANADA

Statutory declaration of person acquiring shares by transfer or transmission:

Dominion of Canada
Province of . .
County of .. .. . }

I, of in the Province of do solemnly declare:

1. I have acquired shares of the capital stock of the Bank of Canada by reason of .

2. To the following questions, I give the answers set opposite each question:—

Question: (*a*) Is the deponent a British subject, ordinarily resident in Canada?

Answer:

Question: (*b*) Is the deponent a director, officer, clerk or employee of any chartered bank?

Answer:

Question: (*c*) Is the deponent the holder of the said shares for the benefit of any chartered

bank or of any director, officer, clerk, or employee of any such bank?

Answer:

Question: (*d*) Is the deponent the owner of any other shares of the capital stock of the Bank of Canada, and if so how many shares?

Answer:

3. I declare that the answers to the foregoing questions are true and correct.

And I make this solemn declaration conscientiously believing it to be true and knowing that it is of the same force and effect as if made under oath and by virtue of the Canada Evidence Act.

Declared before me at this day of A.D. 193

Notary Public, Justice of the Peace, Commissioner for taking Affidavits.

SCHEDULE C (i)

BANK OF CANADA

Statutory declaration of corporation acquiring shares by transfer or transmission:

Dominion of Canada
Province of
County of

I,
of in the Province of
do solemnly declare:

1. I am the of
Name of corporation
;

2. The said has
Name of corporation
acquired shares of the capital stock of the Bank of Canada by reason of (*) transfer, transmission by sale, gift, testamentary instrument, operation of law, or otherwise;

3. To the following questions, I give the answers set opposite each question:—

Question: (*a*) Is the said a
Name of corporation
corporation organized under the laws of the Dominion of Canada or of a province of Canada (state which)?

Answer:

Question: (*b*) Is the said corporation controlled by British subjects ordinarily resident in Canada?

Answer:

Question (*c*) Is the said corporation the holder of the said shares for the benefit of any chartered bank or of any director, officer, clerk or employee of any such bank?

Answer:

Question (*d*) Is the said corporation the owner of any other shares of the capital stock of the Bank of Canada and if so how many shares?

Answer:

4. I declare that the answers to the foregoing questions are true and correct.

And I make this solemn declaration conscientiously believing it to be true and knowing that it is of the same force and effect as if made under oath and by virtue of the Canada Evidence Act.

Declared before me at this day of A.D. 193

Notary Public, Justice of the Peace, Commissioner for taking Affidavits.

SCHEDULE "D"

Nomination Paper

I/We the undersigned shareholder (s) of the Bank of Canada, being the holder (s) of shares,

submit the following nomination (s) for director (s) of the Bank.

A. *Persons whose chief occupation is in a primary industry:*

Name Address Chief Occupation

.....

.....

B. *Persons whose chief occupation is in commerce or manufacturing:*

Name Address Chief Occupation

.....

.....

C. *Persons whose chief occupation is other than as described in A and B:*

Name Address Chief Occupation

.....

.....

.....

Dated at the day of 193

Witness; Signature (s) Address (es)

Statutory declaration as to occupation of Nominee for Director

Dominion of Canada
Province of
County of

I,
of in the Province of
do solemnly declare:—

1. I am a signatory of the foregoing nomination paper for the office of director (s) of the Bank of Canada of the person (s) named in the said nomination paper;

2. To the best of my knowledge and belief the chief occupation of the said nominee (s) is as stated in the said nomination paper.

And I make this solemn declaration conscientiously believing it to be true and knowing that it is of the same force and effect as if made under oath and by virtue of the Canada Evidence Act.

Declared before me at
this day of
A.D. 193

.....
Notary Public, Justice of the Peace, Commissioner for taking Affidavits.

NOTE.—The following provisions of the Bank of Canada Act are appended for information—

"10 (1) No person except a shareholder who is the registered owner of ten shares of the capital stock and who has paid all calls thereon shall be elected or shall continue to hold office as a director.

(2) The directors shall be selected from diversified occupations, but no person shall be eligible to be a director who is a director, officer or employee of a chartered bank; and any person nominated for election as a director who is a shareholder of a chartered bank shall, if elected, divest himself of ownership of his shares within three months of the date of his election and shall not thereafter during the period of his office have an interest, either directly or indirectly, as a shareholder in a chartered bank.

(3) No person shall be elected or shall continue to hold office as a director, who

(*a*) is not a British subject, ordinarily resident in Canada; or

(*b*) is employed in any capacity in the public service of Canada or of any Province of Canada or holds any office or position for which any salary or other remuneration is payable out of public moneys; or

(*c*) has reached the age of seventy-five years.

(4) If any director, in the opinion of the Board, becomes permanently incapacitated, he may be removed from office by resolution of the Board approved by the Governor in Council."

The by-laws of the Bank require that two persons whose chief occupation is in a primary industry and two persons whose chief occupation is in commerce or manufacturing shall be elected as directors at the first general meeting of shareholders, and whenever the term of office of any such director expires or the office becomes vacant a person similarly occupied shall be appointed or elected to the vacancy. In addition three persons whose chief occupation is other than in a primary industry,

commerce and manufacturing shall be elected as directors.

SCHEDULE "E"

Ballot for Directors

Each shareholder may vote only for two directors in group A, two in group B and three in group C.

A. *Persons whose chief occupation is in a primary industry:*

Name Address Chief Occupation

. . . . . .

. . . . . .

B. *Persons whose chief occupation is in commerce or manufacturing:*

Name Address Chief Occupation

. . . . . .

. . . . . .

C. *Persons whose chief occupation is other than as described in A and B:*

Name Address Chief Occupation

. . . . . .

. . . . . .

. . . . . .

dated at . . the . . day of . . , 193

Signature . .

No. of shares held . .

SCHEDULE "F"

BANK OF CANADA

Instruction as to Voting

To the Honourable
The Minister of Finance,
Ottawa.

Under the provisions of Section 36 of the Bank of Canada Act, I beg hereby to give you the following instruction as to the manner in which I desire to vote at the General Meeting of shareholders of the Bank of Canada to be held at Ottawa on . the . day of . . 193

I am the registered owner of . . shares of the capital stock of the Bank and have held said shares since . . and I desire to vote as follows:—

For Directors:

A. *Persons whose chief occupation is in a primary industry:*

Name Address Chief Occupation

. . . . . .

. . . . . .

B. *Persons whose chief occupation is in commerce or manufacturing:*

Name Address Chief Occupation

. . . . . .

. . . . . .

C. *Persons whose chief occupation is other than as described in A and B:*

Name Address Chief Occupation

. . . . . .

. . . . . .

. . . . . .

I desire to vote on the following business to be transacted at such meeting as indicated below, namely:—

Witness:

. . . .

Note:

This instruction when duly executed should be forwarded by mail to the Minister of Finance, Ottawa, Canada, in time to reach him on or before the . day of 193

A shareholder must not vote for more than two persons in category A, two in category B, and three in category C.

This form is for the use of shareholders who are unable to attend a general meeting in person.

APPENDIX V

BY-LAWS OF THE BANK OF CANADA

SEPTEMBER 24, 1938

1. The Board of Directors shall meet together for the despatch of business at intervals to be fixed by the Board, but not less often than four times in each year and on any other occasion when a meeting is called by the Governor; moreover, a meeting shall be called by the Governor upon the written request of any three directors.

2. Notice of meetings of the Board shall be given to each director by delivering or mailing or telegraphing the same to his permanent address, as recorded in the books of the Bank, in sufficient time to enable him to be present at the meeting.

3. A majority of the members, one of whom shall be the Chairman, shall constitute a quorum.

4. Questions arising at any meeting of the Board shall be decided by a majority of votes and in the event of an equality of votes the Chairman shall have a second or casting vote.

5. At the first meeting of the Board of Directors, held subsequent to March 1st in each year, a director shall be selected to be a member of the Executive Committee and he shall continue in office until a subsequent appointment at any time.

6. The fee to be paid to a director shall be $150 for attendance at Board meetings, and the fee to be paid the director who is a member of the Executive Committee, shall be $50 for attendance at meetings of the Committee.

7. The Board shall cause minutes to be duly entered in a book of the Bank provided for that purpose, recording the names of directors present at each meeting and all resolutions and proceedings of the meeting. The minute book shall be kept in the custody of the Secretary of the Bank.

8. Subject to the provisions of the Bank of Canada Act the Board may declare half-yearly dividends of so much of the profits of the Bank as to them seems advisable. Notice of declaration of every dividend shall be published in *The Canada Gazette.*

9. The Executive Committee of the Board shall meet at least once every week and in addition special meetings may be called by the Governor.

10. Two members of the Executive Committee shall constitute a quorum.

11. The Executive Committee shall determine the duties and responsibilities of the officers and employees of the Bank, and shall make rules governing the conduct of the staff.

12. The Executive Committee shall determine what officers or employees of the Bank shall be bonded, and all matters relating thereto.

13. The common seal of the Bank shall remain in the Bank in the custody of the Secretary, who shall affix it to all documents requiring the seal of the Bank and such documents shall then be signed by the Governor and the Secretary of the Bank. Every document so signed to which the seal is affixed shall be reported to the next meeting of the Board or the Executive Committee.

14. The form of the Annual Statement of Accounts shall be substantially that of Schedule C to the Bank of Canada Act, supplemented by a Profit and Loss Account appropriating the net profits of the Bank.

15. A Staff Pension Fund shall be established as from March 12, 1936, and subject to Section 15 of the Bank of Canada Act, the Civil Service Superannuation Act. Revised Statutes of Canada (1927) Chapter 24 shall be the rules of the said Fund except as herinafter provided:

1. *Interpretation*—Section 2 of the Civil Service Superannuation Act shall not apply but in its stead the following shall form part of this By-law:

(*a*) Wherever the following terms appear in the Civil Service Superannuation Act they shall be read for the purposes of this by-law as given hereunder:

(1) "child" includes a step-child and an adopted child;

(2) "civil servant" shall read and mean "member of the Bank's permanent staff";

(3) "civil service" shall read and mean "service of the Bank";

(4) "consolidated revenue fund" shall read and mean "Pension Fund of the Bank";

(5) "contributor" shall read and mean "a contributor under this by-law to the Bank's Pension Fund";

(6) "dependent" of a contributor means and includes the father, mother, brother, sister and child of a contributor who is at the date of death of the contributor dependent upon the contributor for support;

(7) "head of department," "deputy head" and "Minister" shall read and mean "Governor of the Bank";

(8) "Governor in Council" shall read and mean "Board of Directors";

(9) "misconduct" means any act which, in the opinion of the Board of Directors, is wilful disobedience of the provisions of any statute or of any rule of the Bank the breach of which involves dismissal from the service of the Bank, or malversation in office or abandonment of office;

(10) "permanent officer, clerk or employee" shall read and mean "a member of the permanent staff of the Bank including the Governor, Deputy Governor and Assistant Deputy Governor";

(11) "permanent staff" for the purpose of this by-law shall consist of the Governor, Deputy Governor, Assistant Deputy Governor and of all officers, clerks and employees whose appointment to the permanent staff of the Bank of Canada has been confirmed by the Board of Directors or Executive Committee of the Board.

(12) "salary" means the regular salary paid in respect of a contributor's service, together with the value of living and residential allowances but does not include allowance or payment for overtime or other extra allowance or pay or any gratuity;

(13) "service" for the purpose of computation of any allowance or benefit under this by-law shall mean any period of service in the permanent staff of the Bank of Canada, and shall include service as defined in Section 15, subsection 4 (ii) of the Bank of Canada Act;

(14) "superannuation allowance" shall read and mean "pension";

(15) "superannuated" shall read and mean "pensioned" and any of the tenses of the word "superannuate" shall read as the tenses of the word "pension";

(16) "Treasury Board" shall read and mean "Staff Committee of the Bank."

(*b*) Wherever the context requires, for the purposes of this by-law, the word "Act" in the Civil Service Superannuation Act shall read "Staff Pension Fund By-law of the Bank of Canada."

2. Section 3 of the Civil Service Superannuation Act shall not apply.

3. Section 4 of Part I of the Civil Service Superannuation Act shall not apply but in its stead the following shall form part of this by-law:

   4 (1) Every member of the permanent staff of the Bank shall, upon appointment, by deduction from his salary contribute five per cent of such salary to the Pension Fund of the Bank unless exempted by the Board of Directors, and every member of the permanent staff of Bank on the date this by-law becomes effective shall, unless exempted by the Board of Directors, contribute to the Pension Fund of the Bank as from March 12, 1936, or from the date of his appointment whichever be the later date, but no such contribution shall be made in respect of a period of service in excess of thirty-five (35) years; provided, however, that the Board of Directors may postpone the operation of this section in the case of contributors making an election pursuant to section 15, subsection 4 of the Bank of Canada Act.

   4 (2) In the case of a contributor who is in receipt of a salary in excess of $15,000 per annum no contribution shall be made to the Pension Fund of the Bank from that portion of the salary which is in excess of $15,000 per annum and the said excess shall be excluded from any computation which is made for the purpose of establishing a payment or benefit.

4. Section 5 (*a*) (ii) of the Civil Service Superannuation Act shall not apply but in its stead the following shall form part of this by-law:

   5 (*a*) (ii) Who before attaining the age of sixty-five years becomes disabled or otherwise incapable of performing the duties of his office an annual retiring allowance equal to the pension to which he would have been entitled if he had attained the age of sixty-five years at the date of such disability, or

5. Section 6, subsection 2 of the Civil Service Superannuation Act shall not apply.

6. The following paragraphs shall be added to section 6 of Part I of the Act for the purpose of this by-law:

   6 (5) In computing the pension to be granted to any contributor who waives a right or benefit in the Civil Service Superannuation Fund under the provisions of section 15 (4) (ii) of the Bank of Canada Act, and if such right or benefit has been governed by sections

16 and 21 of the Civil Service Superannuation Act, the average salary shall be based upon the salary received by the contributory during the last five years of his service.

6 (6) In the case of any person who becomes a contributor to the Pension Fund of the Bank, not being a person who at the date of his appointment was employed by the Civil Service of Canada and who upon appointment to the permanent staff surrendered or forfeited prospective pension rights or benefits, such addition shall be made to his period of service for the purpose of computing any benefit or allowance under this by-law as the Board of Directors may in the circumstances deem fair and reasonable, not, however, exceeding ten years.

6 (7) (*a*) Notwithstanding anything to the contrary in this by-law contained, if the service of a Governor, Deputy Governor or Assistant Deputy Governor is not less than five years and if his service is terminated for any reason other than death, and from September 12, 1938, or the date of his appointment whichever is the later, he has by deduction from his salary contributed five per cent of his salary to the Pension Fund of the Bank in addition to the five per cent required by section 4 of this by-law, he shall receive a pension computed at the rate of one-fiftieth of the average salary received during his period of service, multiplied by the number of years of his service, not, however, exceeding thirty-five years; provided that if the service has exceeded a period of ten years, such computation shall be based upon the average salary received during the last ten years of service; and provided further that no contribution shall be made in respect of a period of service in excess of thirty-five years.

(*b*) In the case of a Governor, Deputy Governor or Assistant Deputy Governor who is in receipt of a salary in excess of $15,000 per annum, no contribution shall be made to the Pension Fund of the Bank from that portion of salary which is in excess of $15,000 per annum, and the said excess shall be excluded from any computation which is made for the purpose of establishing a payment or benefit.

(*c*) If the service of a Governor, Deputy Governor or Assistant Deputy Governor is terminated by death no allowance or benefit granted to his widow or

other dependents shall be determined by the provisions of section 6, subsection 7 (*a*) of this by-law.

7. Section 7, subsection 1 of the Civil Service Superannuation Act shall not apply but in its stead the following shall form part of this by-law:

   7 (1) If a contributor becomes disabled or otherwise incapable of performing the duties of his office and if he is ineligible by reason of age or length of service for a pension under this by-law the Board of Directors may grant him a gratuity not exceeding one month's pay for each year of service; or, if he leaves the service of the Bank for any reason other than misconduct, a gratuity not exceeding the amount of his contributions made under this by-law without interest. In the case of a contributor who has elected to join the Pension Fund of the Bank pursuant to section 15, subsection 4 (ii) of the Bank of Canada Act, his contributions shall be taken to include the amount contributed by him during his period of service in the Civil Service.

8. The words ". . . . . and no superannuation or retiring allowance shall be granted unless the Treasury Board, on the advice of the Civil Service Commission, reports in addition that the granting of such allowance will be in the public interest: Provided that the latter report shall not be required if the contributor has attained the age of sixty-five years" in section 9, subsection 1, Part I, of the Act shall not apply.

9. Section 11 of Part I of the Civil Service Superannuation Act shall not apply, but in its stead the following shall form part of this by-law:—

   (11) The Board shall make such regulations as may be deemed necessary to give effect to the provisions of this by-law, and in case of any confusion of meaning arising out of differences existing in the conditions of service in the Bank and conditions of service in the Civil Service, or otherwise, the Board of Directors shall on recommendation of the Staff Committee, determine and decide what is fair and reasonable in the circumstances.

10. Sections 13 and 14 of Part I of the Act shall not apply.

11. Part II, Part III, Part IV and Part V of the Act shall not apply.

NOTE ON THE SOURCES

The most valuable source materials for the history of the development of the central banking idea in Canada have been found in the *Proceedings of the Select Standing Committee on Banking and Commerce of the House of Commons,* and the Debates of both the House of Commons and the Senate, particularly from 1923 to 1938. The chapters in this study dealing with the historical development of the Bank of Canada are based principally on the materials found in these sources.

The *Proceedings* of the Royal Commission on Banking and Currency in 1933, comprising seven volumes of over thirty-five hundred mimeographed foolscap pages, is a mine of information concerning the views of individual Canadians and representative organizations and groups throughout the country concerning the need for a central bank, its structure, and field of operations.

The Report of the Royal Commission on Banking and Currency in Canada, 1933, is an interesting and illuminating document which presents a history and discussion of the working of the existing banking system, together with recommendations for the revision of the Bank Act and the establishment of a central bank, incorporating, moreover, the dissenting opinions on the main recommendations of the Report.

The subsequent debates in the House of Commons in 1934, 1935, 1936, and 1938 on the structure, functions, and operations of the Bank provided useful material.

The Bank of Canada has been in operation for a period of slightly more than four years; therefore relatively little has been written on the operations of the Bank. However, much can be learned from an analysis of the weekly, monthly, and annual reports of the Bank.

The library of the *Financial Post,* Toronto, possesses a file of newspaper clippings, press dispatches, articles by contributors to the *Financial Post,* and other financial papers relative to the various features of the central bank. Much useful material was gleaned from this file.

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