CHAPTER IV

SOME ECONOMIC FEATURES OF CANADA IN RELATION TO THE FINANCIAL SYSTEM

163. We propose in this chapter to draw attention to certain salient features of the economic situation in Canada possessing a special significance from the financial point of view, and to indicate some of the problems to which they give rise, in order that we may judge how far these problems can be adequately dealt with by the existing financial institutions of Canada as we have described them.

164. Canada presents a number of prominent economic characteristics which determine the special nature of her financial problems. These characteristics are mainly:—

1. Excess production in relation to population;
2. Dependence on international trade;
3. Specialized production and local diversity;
4. Heavy cost of development;
5. The burden of debt, internal and external;
6. Relative economic instability.

165. It is important to have regard to the quantitative as well as to the qualitative aspects of these features of the Canadian economy. For it is in part their magnitude that occasions the difficulties to which they give rise. We accordingly proceed to give some descriptive and statistical details regarding them. Canada is a country with an area of 3,690,043 square miles inhabited by a population of 10,376,786, or 3 persons per square mile, according to the census of 1931.

TABLE 15

POPULATION OF CANADA BY PROVINCES, 1931[1]

Province	Population	Percentage of total	Density[2]
Prince Edward Island	88,038	0·85	40·31
Nova Scotia	512,846	4·94	24·72
New Brunswick	408,219	3·93	14·73
Quebec	2,874,255	27·70	5·49
Ontario	3,431,683	33·07	9·45
Manitoba	700,139	6·75	3·19
Saskatchewan	921,785	8·88	3·87
Alberta	731,605	7·05	2·94
British Columbia	694,263	6·69	1·98
Other territories	13,953	0·13	0·01
Total	10,376,786	100·00	3·00[3]

[1] Taken from the *Canada Year Book 1933*, p. 102 and p. 106.
[2] The density of population in 1931 (that is, the number of persons per square mile of land area) is of course affected greatly by the large northern areas included in most provinces.
[3] The figure for all Canada, when the Territories are excluded, rises to 5·20.

166. Within her borders are immense and varied natural resources. The exploitation of these resources by an active and enterprising people has led to an output of commodities of many kinds greatly in excess of the consuming power of the existing population.

167. In order to dispose of this surplus, Canada has necessarily to find markets abroad for a considerable proportion of her production. This is a feature which is common to all countries in process of development. Peoples engaged in the exploitation of natural riches must inevitably concentrate on the production and the early stages of manufacture of foodstuffs and raw materials, whilst the production of highly manufactured commodities is postponed. The latter must be imported and their cost as well as the interest and dividend charges on foreign borrowings must be provided largely by an export trade which must therefore be on a commensurate scale.

Table 16 shows the extent of the external trade of Canada.

TABLE 16

EXTERNAL TRADE OF CANADA[1]

(In millions of dollars)

Year ended March 31	Imports	Exports	Excess of exports (e) Excess of imports (i)	Total trade per capita[2]
1914	619·2	455·4	(i) 163·8	137
1919	919·7	1,268·7	(e) 349·0	252
1926	927·3	1,328·7	(e) 401·4	237
1927	1,030·9	1,267·6	(e) 236·7	237
1928	1,109·0	1,250·6	(e) 141·6	238
1929	1,265·7	1,388·9	(e) 123·2	262
1930	1,248·3	1,145·0	(i) 103·3	240
1931	906·6	817·0	(i) 89·6	164
1932	578·5	587·6	(e) 9·1	110
1933	406·3	480·7	(e) 74·4	83

[1] Taken from the *Canada Year Book 1933*, p. 517.
[2] This column is in dollars per head of population.

168. Canada is not only a country of immense area but also of great diversity of natural features. The variety of her natural resources and conditions is reflected in a corresponding variety in density of population, in racial composition and in the occupations of the people. The population by provinces and its density has been shown in Table 15.

169. The Maritime Provinces, because of their situation and physical characteristics, have been settled by people of British and French stock who find their livelihood in fishing, lumbering and mixed farming. The St. Lawrence Valley became the heart of French Canada and permitted the reproduction there of the rural life of Normandy. Later the rich resources of mine and forest and the rapidly growing population attracted capital and promoted development. Upper Canada received some of the United Empire Loyalists and numerous immigrants from the British Isles and the United States. This region of the Great Lakes, by its rich soil and temperate climate, encouraged the settlement of a large farming population which provided a domestic market for a growing industrial life. Thus central Canada has acquired to some degree the stability of economic life which arises from diversification of pursuits. Between this area and the Prairie Provinces there intervenes a barren tract of 800 miles which temporarily arrested the westerly movement of population. The offer of homesteads and the development of railways fostered the settling of these provinces

whose characteristics are sparseness of population, narrowness of occupational range and variability of return. Meantime, British Columbia had attracted the fisherman and the farmer, the miner and the lumberman and by its natural wealth induced the investment of capital. But the mountains separated British Columbia from the rest of British North America and this barrier was only surmounted at great cost.

170. In a country of such variety it is inevitable that some areas should be limited in the range of possible occupations. Table 17 shows the distribution of the important Canadian industries by provinces. The prairies have naturally specialized in spring-wheat growing. The value of agricultural products in the three Prairie Provinces ranges from 32·8 to 57·9 per cent of their total production. In Ontario and in Quebec manufactured products rank highest with 62·8 and 63·5 per cent of the total production. In New Brunswick agriculture and forestry account for 57·7 per cent of the total.

TABLE 17

PERCENTAGE OF THE VALUE OF THE NET PRODUCTION IN EACH INDUSTRY TO THE TOTAL NET PRODUCTION OF THE PROVINCE, 1930[1]

—	Prince Edward Island	Nova Scotia	New Brunswick	Quebec	Ontario	Manitoba	Saskatchewan	Alberta	British Columbia	Canada
Agriculture	76·8	22·5	29·8	19·4	20·2	32·8	57·9	46·9	12·8	23·6
Forestry	8·5	9·8	27·9	12·4	5·4	4·5	4·2	3·9	24·0	9·4
Fisheries	6·8	9·1	6·1	0·3	0·2	1·3	0·2	0·2	8·6	1·5
Trapping	.....	0·3	0·1	0·1	0·2	0·5	0·9	0·5	0·3	0·3
Mining	.....	23·6	2·8	4·6	8·2	3·8	1·8	16·6	20·4	8·7
Electric power	1·4	3·2	3·6	4·9	3·8	4·6	3·5	2·5	4·0	3·9
Construction	4·4	4·1	9·1	11·3	8·3	10·1	13·3	8·8	8·0	9·2
Custom and repair	0·9	2·4	1·6	1·8	2·6	5·5	4·5	3·8	3·0	2·7
Manufactures	6·2	25·0	19·0	45·2	51·3	37·0	13·7	16·8	18·9	40·7
Totals	100·0	100·0	100·0	100·0	100·0	100·0	100·0	100·0	100·0	100·0
Totals, manufactures, (percentages to general totals of net production)	10·3	36·1	37·5	62·8	63·5	47·6	19·9	22·0	43·9	54·8

[1] Taken from the *Canada Year Book 1933*, p. 213.

171. The cost of co-ordinating into an economic unit a country so immense in area and so diversified in character has necessarily been heavy. The dispersion of population and the specialization of the several areas have imposed on the Canadian people a serious burden in providing for the requirements of government, transportation and industry. Both physical and technical factors have made it imperative that the economic framework should be of a size which, in other countries, would have served a much larger population. The optimism natural to a new and growing society, encouraged by phases of abounding prosperity, has also led to the provision of public utilities on a scale which has in some respects anticipated the needs of a much larger community. The recent Report of the Royal Commission on Railways and Transportation in Canada has shown the unfortunate extent to which, in the particular domain of railway transportation, this process has been carried. In the following table the public debt burden of Canada is set out.

TABLE 18

DEBT OF THE DOMINION GOVERNMENT, PROVINCIAL GOVERNMENTS, MUNICIPALITIES AND CORPORATIONS, BY SELECTED YEARS, 1914-1932[1]

(In thousands of dollars)

—	1914	1919	1929	1932
	$	$	$	$
Net debt of the Dominion Government, March 31	335,996	1,574,531	2,225,505	2,375,846
Bonds guaranteed by the Dominion Government as to principal and interest, and interest only, March 31	110,000	110,000	714,208	1,000,522
Gross direct liabilities of provinces, at end of fiscal year	200,000[2]	334,472	1,031,719	1,383,382[3]
Indirect liabilities of provinces	100,000[2]	118,768	224,470	215,977[3]
Total liabilities of municipalities	376,859	493,275	1,332,510	1,600,000[3]
Corporations	1,110,000	1,118,000	1,916,796	2,097,000
	2,232,855	3,749,046	7,445,208	8,652,727

[1]Compiled by Dominion Bureau of Statistics.
[2]Estimated. [3]Subject to revision.

172. Between 1900 and 1913 the total indebtedness of the public bodies and corporations of Canada rose to over two billions of dollars. It is not sufficiently realized that it has grown by over 300 per cent since 1914. Nor is it true that the war was largely responsible for this. By 1919 the total had risen from 2 to 3.7 billions only. Moreover, the actual increase in the burden of debt since 1929 is much greater because of the fall in prices than an expansion from 7.4 to 8.6 billions of dollars would indicate.

173. Were this debt held wholly in Canada it would still bear heavily enough on the producer but the fact that much of the money came from abroad has involved the country in an external debt problem of great magnitude as well. In Table 19 we give the estimated total investment of capital in Canada by citizens of other countries for each of the years 1914, 1919, 1929 and 1931. It is clear that all the elements of the Canadian economy must, therefore, be highly efficient and its natural wealth be abundant if such a burden is to be borne and the population is to continue to enjoy the high standard of living characteristic of North America.

TABLE 19

ESTIMATED BRITISH AND FOREIGN INVESTMENTS IN CANADA[1]

(In thousands of dollars)

—	1914	1919	1929	1931
British	2,711,841	2,606,848	2,128,489	2,204,858
United States	904,455	1,800,435	3,608,521	4,107,803
Other Countries	177,729	173,493	155,409	165,217
Total	3,794,025	4,580,776	5,892,419	6,477,878

[1]The estimates for 1914 and 1919 have been specially computed; all figures for 1929 and 1931 have been taken from computations by the Dominion Bureau of Statistics.

174. A country whose economic life is dominated by such factors as have been described is bound to be subject to a considerable degree of economic instability. Weather conditions produce great variations in the yield of the farmer's crops. This is especially significant where he is dependent on one main crop of so variable a yield as wheat. (See column I of Table 20 below). Column II of Table 20 indicates a high degree of variability even over the whole range of industrial production. Not only is the range of fluctuation from year to year considerable, but instability is accentuated by the highly seasonal character of productive activity inevitable in a country situated in a northern latitude and so largely dependent on agriculture. The summer tourist visitor has, of late, tended to introduce another seasonal factor.

TABLE 20

SOME VARIABLE FACTORS IN THE CANADIAN ECONOMY

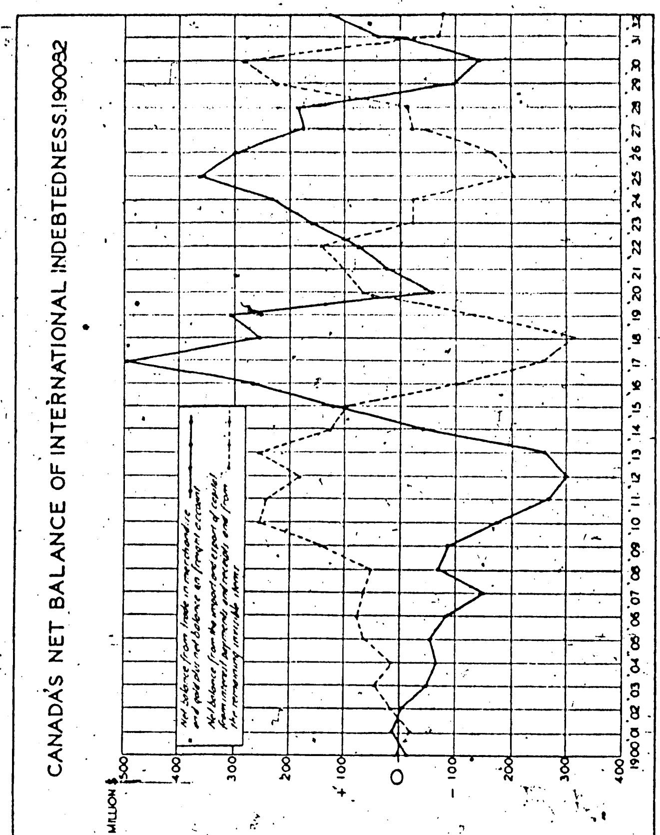
Year	I Average wheat yield in bushels per acre[1].	II Index of industrial production (1926=100)[2]	III External borrowings (in thousands of dollars)[3]
1919	10·0	65·5	82,640
1920	14·5	69·9	207,495
1921	13·0	60·4	180,297
1922	17·8	76·9	304,922
1923	21·0	83·8	196,726
1924	11·9	82·4	224,680
1925	19·0	89·7	69,590
1926	17·8	100·0	187,453
1927	21·4	105·6	266,805
1928	23·5	117·8	133,715
1929	12·1	127·4	233,580
1930	16·9	108·0	351,882
1931	12·3	90·4	[4]
1932	15·8	74·0	[4]

[1]Taken from the *Canada Year Book, 1933*, p. 241.
[2]An index computed by the Dominion Bureau of Statistics.
[3]From 1926 to date the estimates by the Dominion Bureau of Statistics have been used; for the earlier period special computations have been made.
[4]Data for these years not yet available.

175. Variability in the physical volume of agricultural production may be offset to some extent if the alterations of supply have their expected effects on prices. But Canada must sell a very large part of her products in the world market and her exports form only a part of the world supply. It may happen therefore that world price changes may accentuate the uncertainties of return arising from the vagaries of the weather. When they do so, the industries dependent on the farmers' purchasing power are also affected. All business thus becomes more speculative through the enormous importance to the Canadian economy of the prices of a few export commodities.

176. It is a direct consequence of such a situation that the prospects of profit from the investment of foreign capital in Canada vary greatly from time to time. It is much easier to sell Canadian securities abroad in some years than in others. In part this reflects the alternations of prosperity and depression which Canada shares with all countries but to a great extent it is due to the determining influence of the volume and prices of exports. The maturities of bonds may well coincide with a time when prospects of refunding are slight. As a consequence, the actual surplus available after maturities and interest obligations are met is highly variable. Column III of Table 20 gives estimates of the net amounts since 1919. There thus arise, occasionally, situations of peculiar difficulty. On the one hand individuals, corporations and governments must raise the needed revenue in Canada, and on the other hand the banking system is called upon to provide the amounts of foreign exchange demanded in the face of lessened returns from the export trade.

177. The net effect of all these factors is to produce a highly variable balance of trade. In times of heavy capital inflow more goods are bought in other countries than are sold there. When capital imports shrink, an excess of exports must be attained if debt charges are to be met. The actual variations which have been experienced in Canada since 1900 are shown in Table 21 and in the accompanying Chart.



Column I represents the net excess of imports or exports through the trade in commodities and gold and the freight charges involved. Column II represents the amount available to or owed by Canada as the net result of the movement of capital in and out of the country, of the interest charges and receipts and of the minor items in Canadian international accounts. The amounts of these two groups of items would balance were the information complete. The fact that only rough estimates are available does not however make them misleading as representations of the variations which economic instability has in fact imposed upon the economy of Canada since 1900.

TABLE 21

CANADA'S NET BALANCE OF INTERNATIONAL INDEBTEDNESS, 1900-1932[1]

(In millions of dollars)

Year	I Net balance from the trade in merchandise and gold plus net balance on freight account	II Net balance from the import and export of capital, from interest payments and receipts and from the remaining invisible items
1900	− 14	6
1901	10	− 20
1902	− 3	15
1903	− 40	45
1904	− 66	15
1905	− 54	62
1906	− 83	77
1907	−149	66
1908	− 69	52
1909	− 86	143
1910	−173	253
1911	−269	241
1912	−300	182
1913	−259	254
1914	− 40	129
1915	123	95
1916	269	−105
1917	406	−256
1918	256	−313
1919	308	−135
1920	− 69	69
1921	28	100
1922	77	144
1923	164	− 21
1924	231	− 24
1925	365	−206
1926	295	−165
1927	176	− 19
1928	184	− 10
1929	− 95	222
1930	−144	285
1931	42	− 71
1932	126	− 78

[1] A debit balance is indicated by a minus sign. From 1900 to 1913 this table is computed from information contained in *Canada's Balance of International Indebtedness 1900-1913*, by J. Viner, (Cambridge: Harvard University Press, 1924). The estimates for the period 1914-26 have been specially computed, while those for the years 1927-1932 are compiled from publications of the Dominion Bureau of Statistics.

178. A complication of another character is created by the constitution of Canada under the British North America Act of 1867 which entrusts exclusive legislative powers with reference to banking and currency, and trade and

commerce to the Dominion Parliament and at the same time confers on the provincial legislatures full legislative powers with reference to property and civil rights and direct taxation within their borders. There is thus always the possibility of divergence in financial policy between the Dominion and one or more of the provinces and among the provinces themselves. We do not conceive it to be appropriate for us to enter upon any detailed discussion of the constitutional questions thus arising.

179. The features which, because of their importance, we have selected for mention as characteristic of the economic life of Canada necessarily give rise to a number of financial problems. It is desirable that the financial system of a country so circumstanced should—

(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.

180. Certain of these requirements have been met by the high degree of development in Canada of the ordinary functions of banking. To this we have already referred in some detail. In their more general aspects, the demands of the national economy were met up to 1914 without the provision of any co-ordinating machinery by the operation of the gold standard. It is pertinent to our inquiry to examine briefly the manner in which that system operated, in order that we may be in a position to assess at their true value subsequent alterations in the financial system in their relation to the new needs that have arisen.

181. The gold standard was adopted by the United Provinces of Canada (now Ontario and Quebec) in 1853, and was continued as the standard by the Dominion of Canada at its formation in 1867. Thus, the gold standard had in 1914, been in continuous operation for sixty years. Under this standard, obligations payable in gold were redeemed in gold and there was an unhampered export and import of the metal. In terms of United States currency the gold points were somewhat less than 3/32 of 1 per cent from the parity of exchange.

182. The monetary structure as it existed in 1914 consisted of (i) the free stock of gold, (ii) the government note issue and (iii) the banking system—that is the aggregate of the individual banks. From the previous recital of the structure of the Dominion note issue, it is clear that it 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.

183. As there were then no rediscounting facilities or anything of a similar character within 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 Canada.

184. 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 made 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.

185. 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.

186. In the years from 1900 to 1913 the great expansion in Canada was financed by a heavy importation of capital. The usual economic stresses and strains involved in an adherence to the gold standard were therefore easily borne.

187. 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 to the bank 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 possession of foreign balances. As the domestic deposit did not need a reserve equal to the whole foreign balance, the bank was in a position 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 de[illegible] This procedure permitted a continuous expansion of credit to go on in Ca[illegible] 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.

188. The outbreak of war in 1914 caused a diminution of the capital flow to Canada which contributed to the crisis. Thus Canada was left with a heavy burden of fixed charges and smaller capital imports. The adjustment of its foreign exchanges became more difficult and economic stress became apparent in net exports of gold. However, the great demand for raw materials which arose out of the war needs provided a means of paying external charges and filled in the gap left in the balance of payments by the diminution of capital imports.

189. The prosecution of a war places immense financial burdens on the governments involved. The problem facing the Canadian Government at the outbreak of 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 destined 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.

190. 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 to 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.

191. As the suspension of the gold standard occurred immediately at the outbreak of the war, the whole war period was one of inconvertible paper—a necessary condition for inflation. The subsequent depreciation in the Canadian dollar reflected the wide swings in the balance of payments.

192. The significant difference between the pre-war and post-war financial structure was the addition of the Finance Act which was made permanent in 1923. The fact that this Act was made permanent several years after the end of the war was in itself noteworthy. Indeed, both in quality and in quantity the economic problems of Canada, as we have already seen, had taken on a new gravity. Not only were there the after effects of war inflation to be met, but a general expansion in production, in the volume of trade, and in the amount of internal and external borrowings, coupled with instability in the foreign exchanges, magnified the problems of the past and created fresh complications. Moreover the world of post-war finance was no longer steadied by the working of an automatic gold standard. Indeed, the gold standard was restored in a world which called for continuous direction and co-operation on the part of the various national monetary authorities.

193. When in 1926 Canada returned to the gold standard—still faced in no diminishing degree by these problems—the only additional financial mechanism with which she was equipped, as compared with pre-war days, was that of the Finance Act. We have already described in Chapter III the provisions of the Act, and the extent of the use that was made of them. We shall have occasion to refer to the Act later in another connection from the point of view of its defects. It is sufficient for the present purpose to outline the real significance of the powers and responsibilities which this Act entrusted to the Treasury Board.

194. Essentially the Act provided an instrument for increasing the credit base in Canada, that is to say, the cash reserves of the banks. The instrument was the power of the Treasury Board to make advances of Dominion notes,—i.e., of cash—to the banks against approved securities. Under an inconvertible paper standard some such mechanism was obviously necessary. Even under the restored gold standard the special post-war problems of Canada, certain of which, indeed, were also world problems, called for some additional means of influencing the credit base. The obligation assumed in 1926 to maintain the convertibility of the Canadian dollar into gold, 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.

195. 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 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.

196. We have thought it desirable in this portion of our Report to give some space to the consideration of certain aspects of the general economic situation of Canada in their relation to our main theme. Whether the facts of that situation as we see them call for other measures than those which we are competent to recommend is not for us to say. In forming our conclusions we

have concentrated on the question whether in the existing monetary and financial system of Canada the amendment of any of its features or the provision of machinery not now in existence could have a favourable effect on the general economic life of the nation.

Sir Thomas White dissents from many of the statements and conclusions contained in this chapter and expresses his views regarding the topics to which they relate in his personal addendum to our report.

CHAPTER V

THE EXISTING CANADIAN FINANCIAL SYSTEM AND THE ESTABLISHMENT OF A CENTRAL BANK

197. In the preceding chapters we have described the existing financial institutions of Canada and their methods of working; we have also delineated the outstanding features of the economic situation of Canada and indicated the nature of the financial problems to which those features give rise. It now remains to consider (1) how far the financial system of Canada, consisting of the institutions we have described, is adequately equipped to play an effective part in dealing with these problems and (2) how far the methods and actual practice of these institutions, within their existing constitution, are satisfactorily meeting the demands made upon them. These two questions are of quite distinct orders of magnitude. It is one thing to examine the adequacy of the equipment of a system; it is another thing to examine how the system with its existing equipment is working. At the same time, the efficiency of the working is necessarily related to the adequacy of the equipment.

198. If regard is had to the nature of the financial and economic problems confronting Canada, as we have briefly presented them, it is manifest that they concern the banks in a pre-eminent degree among the institutions enumerated. To a less extent, they also concern the organizations for the provision of rural credit.

199. We may say that it is only with regard to the constitution and powers of these two classes of institutions that we have had any substantial body of critical evidence and it may also be said that as regards the administration of Canada's financial institutions, as distinct from their constitution, criticism has been concerned almost exclusively with the banks, and this was no doubt natural in view of the nature of our inquiry.

200. We propose therefore in the first place in this chapter, to consider 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 economy and also in view particularly of Canada's own problems. In a succeeding chapter we shall also, though more briefly, discuss the question of the organization of rural credit. In another chapter we shall deal with the matters which have been brought to our attention affecting not the structure but the ordinary working of the banking system.

201. It has been manifest, from what we have previously written, and indeed from much of the information afforded us in the course of our hearings, that insofar as the ordinary functions of banking are concerned, the Canadian banks give 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.

202. It is nevertheless 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 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 pur-

sults of commercial banking. If we survey the cardinal monetary problems which face the Canadian people in common with all other peoples to-day, we are immediately confronted with a multitude of difficult and intricate questions: To what extent and through what organizations should the volume of credit and of currency be regulated? On what body should lie the primary responsibility 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?

203. In the great, and an increasing, majority of countries the answer to these questions has been found in the existence or the creation of a central bank. In some cases, these banks have reached their present positions of national and international importance by a long process of growth. In other cases, they have been created by acts of the national legislatures and endowed from the outset with the functions that have gradually and inevitably concentrated in the older institutions.

204. It is due to no mere accident that the existence and the functions of central banks have been the subject of much discussion in recent years and have to an increasing extent influenced the language and technique of modern banking and finance. New methods and new terms are, as a result of manifold and prudent experiment, steadily but effectively gaining acceptance. This development has repeatedly found recognition at international conferences called to consider monetary questions since the war. The International Financial Conference held at Brussels in 1920 unanimously recommended that:—

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

Again, at Genoa in 1922, the International Economic Conference resolved that:—

> "Banks, and especially banks of issue, should be free from political pressure, and should be conducted solely on lines of prudent finance. In countries where there is no central bank of issue, one should be established."

At the World Monetary and Economic Conference of 1933, resolutions, to which Canada was a party, 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 Central Banks."

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."

205. These repeated recommendations have arisen from a general sense on the part of responsible statesmen of the reality and the urgency of the tasks, both national and international, which fall to the lot of a central bank. Those tasks may conveniently be summarized here.

206. 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. These functions do not, of course, exhaust the tasks of a central bank. 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. In return for the privileges which the state confers upon it, the bank should use its store of experience in the service of the community without the desire or the need to make profit a primary consideration.

207. It is easily possible to expect either too much or too little of central bank action. A central bank is at the same time an instrument and a force. 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. Clearly these powers are of differing efficacy according to the aim of the policy. A central bank cannot be expected to influence directly the price of a particular commodity. It is even not desirable that a central bank should be specifically charged with any responsibility for the general price level of a country. There are many factors, of varying nature, which 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 well have a measure of influence. If it attempted to exercise any drastic control it would have to wield powers far beyond those which any body other than the sovereign authority would be entitled to exercise. It is manifest, however, that the regulation of the volume of credit is an important factor in influencing the level of economic activity and therefore of prices and this is one of the cardinal tasks of a central bank. In the absence of a central bank it is a task the fulfilment of which is either left to chance, or performed inadequately by other agencies. The regulation of the quantity of credit is effected by the action of the central bank on the reserves of the commercial banks. By increasing or diminishing these reserves, or by increasing the cost of securing them, there is set in motion a process of expansion or contraction through the ordinary channels of banking. A central bank is thus not a competitor with the commercial banks. Its functions are regulatory and indirect.

208. In the control over the external value of the monetary unit the action of the central bank is also of major importance. This function, indeed, is a logical outcome of that of credit regulation. Whatever additional influences may affect the level of the exchanges, such as short term capital movements, external borrowings and indebtedness, and the income from overseas investments, the long term factor of decisive importance is the credit structure of the country, and no modern state can afford to dispense with the most effective controlling instruments.

209. The services which a central bank may perform in the international sphere are even less easily dispensed with in the modern world than those which it can render within the borders of a state. Whatever changes may occur in the volume of international trade and the comparative positions of various countries, there has never been a time when external financial inter-relationships have assumed more importance than in the last decade. The need for inter-

national monetary co-operation is urgent and constant. It has found expression, not only in several international conferences, to some of which reference has been made above, but in a more permanent way in the development of the Bank for International Settlements. This body, essentially a bank for central banks, is a tangible testimony to the need which has been felt for regular and continuous interchange of views between the responsible authorities of the various national central banks.

210. The precise degree to which the level of economic activity in the world as a whole may be influenced by concerted international monetary action, may be a matter of opinion, but that a common direction in monetary policy may have an important influence in avoiding economic excesses or in stimulating revival is beyond dispute. The co-operation of central banks is beset with many difficulties; its effects are limited or distorted by many non-monetary influences; but if we wish to continue that mutual interchange of goods and services which in the past has stimulated the economic life of all parts of the world, we ought to 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.

211. Within the narrower, but no less important, sphere of intra-Imperial co-operation, we note that in the Dominions of South Africa and Australia a central bank has already become an indispensable element in the financial structure, and that, in New Zealand and India, bills are at this moment before the respective Legislatures providing for the creation of a central bank. Thus, over the greater part of the self-governing portions of the Commonwealth of British Nations there are or may shortly be in existence central financial institutions designed not only to perform important services in the national economy, but also eminently suited to be the instruments of Imperial monetary co-operation.

212. It may be of interest to refer here briefly to the history of the South African Reserve Bank and the Commonwealth Bank of Australia which, despite the relatively short time they have been in existence, have already become valued institutions.

[illegible] As the result of the Report of a Select Committee of the House of Assembly [illegible] was appointed in March, 1920, because of the grave effects of the war and post-war inflation, South Africa was the first Dominion to establish a reserve bank to regulate the issue of bank notes and the keeping of reserves with a view to securing greater stability in the monetary system of the Union of South Africa. The bank was enjoined to fix and publish a discount rate, was given the sole right of note issue and the custody of a portion of the commercial banks' cash reserves. Its powers were so defined as to ensure strength and liquidity and were later widened somewhat in order to increase the effectiveness of its control on the volume of credit.

214. There is little doubt that the Reserve Bank was of great use in helping the commercial banks to negotiate the difficult deflation period following the war. It was also of material use to the National Bank of South Africa in 1923 when that bank suffered a loss of capital and consequent impairment of its credit before being absorbed by Barclays Bank (Dominion, Colonial and Overseas). On the other hand, in 1929, when the volume of credit was expanding rapidly, the Bank exercised a salutary restrictive influence. The Bank has improved the machinery for making the proceeds of exports easily available in the Union. Its discount rate now sets the standard for the rates maintained by the commercial banks and it has been responsible for a reduction in discount and exchange rates.

215. In 1911 the Commonwealth Bank of Australia was founded by the Government in power, largely to handle the Commonwealth Government accounts and to establish a savings bank department. It is now also the banker for

several of the States. The bank was managed prudently and by its operations on behalf of the Government during and after the war it acquired considerable prestige. The note issue was transferred to it in 1920, and in 1924 the Commonwealth Bank Act was amended in order to allow the bank to function as a central bank. The savings bank department later became a separate institution. Although the bank still does some commercial business its policy is not to compete with the trading banks unless reasonable banking facilities are not otherwise forthcoming.

216. In the difficult years from 1929 onwards, the Commonwealth Bank has rendered services of inestimable value. It was instrumental in mobilizing the gold reserves of the country and their judicious employment to tide the country over a period when Australia's ability to provide and to transfer the service of her overseas debt was seriously in question. It organized an exchange pool to ensure the continued provision of external charges; the concentration in its hands of the issue and management of the Commonwealth debt and of most of the states' debt was of material advantage when the massive domestic Conversion Loan of 1931 was launched; while in taking over the control of the exchange rates since 1931 it has relieved the trading banks of a responsibility they were unwilling to shoulder and has exercised a stabilizing influence on the national economy. As a trusted and impartial adviser to the Federal Government the Bank has rendered and continues to render service of prime importance to Australia.

217. It is perhaps worth observing that in South Africa and Australia the commercial banks viewed the advent of central banking with considerable mistrust, possibly owing to a failure to appreciate the part which a central bank is designed to play, and to apprehensions as to the extent of its disturbance of the existing banking system. The first years of operation were thus rendered more difficult by the lack to some extent of co-operation on the part of the commercial banks but in recent years there has been a growing appreciation of the advantages of central banking leadership and control, and the central banks in these two countries have now obtained both the goodwill and co-operation of the commercial banks.

218. To enable it to discharge the essential functions to which we have referred above, modern experience tends to show that certain definite principles should be observed in the constitution of a central bank. Thus, in order that it may regulate credit and currency, it is essential that the central bank should hold a suitable proportion of the cash reserves of the commercial banks. It is essential for the full and satisfactory working of a central bank, that it should have the sole right of issue of legal tender notes; it is essential that the central bank, as the financial adviser of the Government, should in due course hold the various Government accounts and carry out, on behalf of the Government, all major financial transactions.

219. The functions discharged by a central bank being of such vital importance to the economic and financial life of a country, it is perhaps natural to ask whether they could not be adequately performed by some direct organ of government. 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. Certain statutory limitations have almost invariably been adopted in order to emphasize the national character of the bank. Thus, apart from the detailed provisions of the legislative act constituting a central bank, we may refer to the customary provision that the profits of the note issue should accrue, either directly or indirectly, to the state; that in most modern instances a limit is set to the profits which may be distributed to the shareholders; and lastly, that the state should have a final voice in the appointment of the Governor and Deputy-

Governor and sometimes of certain of the directors. Within this legislative framework it has been found that there are pre-eminent advantages to the state in entrusting the special and highly technical functions of a central bank to a body not subject to the vicissitudes of political life.

220. It is certainly remarkable that whereas even the smallest countries in Europe have long had, or have recently established, a central bank, there should be no corresponding institution in a country of the indisputable financial and economic importance of Canada. It is true that a large part of Canadian economic activity is of comparatively recent growth, but the explanation of the existing gap in the financial structure is not only, or indeed mainly, to be found in this fact. The explanation, we venture to think, is to be found chiefly in the excellence of the commercial banking institutions with which Canada is equipped. Their services, in all that pertains to ordinary banking, have been and remain of a quality which has tended perhaps to conceal the growing need for some further instrument to assist in dealing with the financial problems of the modern world.

221. However convinced we may be that a properly constituted central bank would be of great service to Canada, it is nevertheless right that before recommending its institution we should first ask ourselves whether there are any other means of achieving the same results with equal efficacy; whether the Canadian economy and Canada's existing financial structure are such as to provide the conditions for the successful operation of a central bank; and, if so, whether the time is opportune for the establishment of a central bank.

222. The survey we have already made in Chapters II and III of the Canadian financial system as it exists and operates to-day has shown the part played in the credit mechanism by the Finance Act of 1923. That this Act furnishes means of increasing the credit base is indisputable, but we are of opinion that the method which it embodies, regarded as part of the normal financial machinery of the country, is unsatisfactory. At a time when, under the gold standard, a deterioration in Canada's balance of payments led to an outflow of gold, it was possible for the banks to maintain their cash reserves by obtaining Dominion notes under the Finance Act. Thus, the normal consequence of the operation of the standard—without which, indeed, one of the main virtues of that standard is absent—was lacking, in that the credit base remained unchanged in Canada, and there was no incentive to take such corrective measures as financial policy could supply. Moreover, the Act does not require that any gold reserve be held by the Department of Finance against the notes issued to the banks. There is nothing in the Act to indicate that it was intended to entrust to the Department any discretionary control over the credit base although such a control is a cardinal feature in modern monetary technique. Finally, we may note that the powers of the Finance Act are entrusted to a Board which is in effect a committee of the Cabinet and are thus directly in political hands. We have already referred to the disadvantages of such an arrangement.

223. It has been represented to us from many quarters in the course of our inquiry that some further co-ordinating element is required in the Canadian banking system, and indeed the representatives of the Canadian Bankers' Association, to whose assistance we are so greatly indebted, themselves recognized the propriety of introducing some such machinery. After noting, in their memorandum, that "there exists no properly constituted body which can admit responsibility for the general supervision of credit or exchange in Canada" they go on to discuss the alternative courses of action, of which the first would be "to go back to the pre-1914 situation, by repealing the Finance Act." The conclusion of the memorandum as regards this course of action, is brief but definite: "There are obvious reasons why the first of these alternatives should not be chosen under any circumstances—but these reasons are especially strong at a time when almost the

whole world is off the gold standard; for under such circumstances our currency system would have no elasticity apart from the 15 per cent bank note issue expansion, based upon paid-up capital and reserves possible during the crop-moving period." The choice, in the view of the Association, lies between the creation of a central bank and the setting up of some other form of institution. After considering these alternatives the Association adopts the view that the need might be met by the creation of an Administrative Board, composed of experts in finance and currency and broadly representative of the business and agricultural interests of Canada, to which the functions now discharged by the Treasury Board should be entrusted.

224. That such a Board might discharge some of the central financial functions at present either not performed or dispersed through other channels, we do not doubt. On the other hand, even if its freedom from political interference could be adequately safeguarded—in itself no easy problem—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. A Board would not find it possible to establish satisfactory relations with central banks in other countries, or with the Bank for International Settlements. Its decisions—divorced in some degree as it must be from the day to day financial life of the community—would be liable to be marked by hesitation and compromise. For it must be remembered, even if it be a truism to say so, that the business of a central bank is banking, although of a very special kind, which calls not only for the highest skill, experience and integrity, but also for close and continuous contact with every important element in the financial structure.

225. Insofar as an Administrative Board attempted to overcome these difficulties it would be found, we think, that it would require powers and an organization so essentially similar to those of a central bank as to make it natural to inquire why a central bank should not from the outset have been established.

226. We have no hesitation in concluding, therefore, that, as between an Administrative Board and a central bank, the latter alternative is clearly preferable.

227. We now come to consider whether conditions exist in Canada for the successful functioning of a central bank. Here we should say at once how strongly we endorse the remarks made in a memorandum of the Canadian Bankers' Association, regarding the vital importance to such an institution of the quality of the governors and directorate. Experience, skill and integrity are required in the highest degree, and that, not only to ensure that the operations of the bank shall be wisely conducted, but also that the institution should win and maintain the confidence alike of the government, the people and the commercial banks.

228. We have no reason to suppose from our discussions with leaders in Canadian finance and industry that these qualities are lacking in Canada. On the contrary, we are convinced that there are resources of intelligence combined with experience and public spirit fully adequate to ensure the successful management of a central bank. It is true that the conduct of central banking operations requires a technique and an outlook somewhat removed from those of commercial banking; but this fact has had to be faced in every country which in recent years has established a central bank, and Canada appears to us not less well but better equipped than many other countries have been to provide the necessary administrative talent.

229. If we assume, as we believe we are entitled to do, a directorate of the necessary quality, we see no reason to regard any of the other more technical objections that have been urged as being of serious importance. It may indeed be the case that in the absence of a highly developed money market the control

of a central bank in Canada over the financial system could not be as sensitive as that which is exercised, for instance, by the Bank of England in the United Kingdom. The fact, however, that a new institution in Canada would not be able to employ all the instruments of control exercised in an older and financially more highly developed country, seems to us an inadequate reason for omitting to develop such control as could undoubtedly be achieved. The financial system and economic life of Canada are already sufficiently well developed to make the instruments of the discount rate, the purchase and sale of securities, and operations in the foreign exchange market, of sufficient importance in the hands of a well-managed central bank to give it a decisive influence on the credit situation in Canada.

230. Canada is a country with a relatively large volume of external trade and a heavy external indebtedness and is, therefore, especially interested in the international value of her currency. 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. It is no part of the functions of a central bank to monopolize the exchange markets. Here, as in the case of credit control, its function is to impart or counteract a trend as circumstances require, and this task, even from an early date, would be within the capacity of a Canadian central bank.

231. We have finally to consider the question of the opportuneness of establishing a central bank in Canada under present-day conditions.

232. So far from the time being inopportune we are of opinion that there are cogent reasons for its early establishment. The fact that the Canadian dollar is, for the time being, an inconvertible currency may, from one point of view, be regarded rather as an advantage than a disadvantage for the early operations of the bank. Obviously, the bank must work in close accord with the government in all that pertains to the external value of the country's currency, and if it were carrying out a national policy in this respect the bank must clearly have the support of the government in its foreign exchange operations. In these circumstances, the bank would be spared at the outset the risks with which it might be faced if it began its operations with a legal obligation to ensure convertibility at a time when gradually accumulated economic forces might already have weakened the strength of the currency.

233. Some reference has been made in the evidence tendered to us as to possible disturbance of the existing banking system which might be occasioned by the establishment of a central bank. We are unable to see in what respects such an institution could effect any material disturbance. On the contrary, a central bank would be expressly designed to strengthen the existing banking system. The initial transferences of assets which the establishment of the bank would require are in no way of an order sufficient to hamper the operations of the commercial banks. This is manifestly so as regards the creation of the initial reserve deposits and even the transfer of the commercial banks' note issues, if spread over a suitable period, need occasion no serious disturbance of existing banking facilities.

234. One further point on which we may add some observations relates to the cost of establishing and operating a central bank. In all that we have written above we have presupposed an organization adapted in its structure and size to the present Canadian system. Such an organization need be neither large nor expensive; its capital could be of modest dimensions so that there would be no need of large earnings in order to pay the statutory dividend. The physical organization of the bank need be neither elaborate nor widespread. Its main activities, apart from the function of distribution of currency, in which it would substitute its services for those now performed by the offices of the Receiver General, would be concentrated in a single head office. It is

true that at the outset there is a problem involved in the transfer to the central bank of the Dominion note issue, but it must be remembered that the government would be a substantial participator in the profits of the bank and in proportion as those profits grew, so the share of the government would increase. As and when the bank took over the note issues of the commercial banks, there would be a loss of income to the latter, but this can scarcely be conceived as an expense to Canada, but must rather be regarded as a transfer of income within the existing financial system. The only expenses not previously incurred would be those of the physical equipment and the salaries of the staff of the bank and these, given the scale of operations, can scarcely be regarded as of major importance in a country like Canada.

235. We are now in a position to sum up our general views on the question of a central banking institution for Canada. We should perhaps sound 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. 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.

236. On the other hand, its positive services would, we believe, be very considerable; it would substitute for the present undeveloped and anomalous system a more rational and unified control over the credit structure; it would provide a suitable instrument for the execution of a national policy in regard to the external value of the currency; it would be increasingly a source of skilled financial advice for the Dominion and possibly for the Provincial Governments; and, finally, it would provide a central body which could maintain relations with similar institutions in other countries, which find at present no counterpart in Canada with which to maintain contact.

237. We include in the appendix a suggested scheme for the constitution of a Central Bank for Canada.

238. 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. They state their views on these questions in individual personal memoranda attached to our Report.

CHAPTER VI

AGRICULTURAL CREDIT

230. In an earlier chapter, reference has been made to the various facilities that have been provided in Canada to extend short, intermediate and long-term credit to those engaged in agriculture. As the establishment of the Canadian Farm Loan Board in 1929 has made reasonable provision for long term credit, it now remains to consider the adequacy of the facilities for short or intermediate credit.

240. As already indicated, efforts have been made to provide short term credit mainly through the medium of the following provincial organizations: in Ontario by the Agricultural Development Board, in Alberta by the Provincial Treasurer, and in Manitoba through the establishment of rural credit societies. In Quebec requirements of this nature are met to some degree by facilities provided by the Caisses Populaires. The enterprise of the Dominion Agricultural Credit Company Limited will also be recalled.

241. The history of these efforts is of value in a study of the credit problems of agriculture in Canada for two reasons. In the first place, the fact that the provincial governments decided to engage in these experiments may well be taken as indicating the necessity of agricultural credit at lower rates of interest than prudent banking practice might seem to warrant, particularly in certain areas where agricultural production is attended by certain hazards or requires loans of a length which militates against the affording of credit by commercial banks.

242. Secondly, the experience gained in the successes and failures that have followed the operations of these organizations in the various Provinces will be of valuable assistance in any subsequent attempts that may be made to meet the p[illegible]n.

243. Whatever view may be taken of the necessity in more normal times for some provision for this type of credit in addition to such as is provided by the banks, undoubtedly the very great decline in prices of all agricultural products during the past three years and the attendant loss of farm income, have made the problem of agricultural credit a very acute and difficult one. Particularly is this true of the Prairie Provinces. Various estimates have been made of the effect of the shrinkage of purchasing power due to short crops and falling prices. In a memorandum prepared by a committee representing the Governments of the three Provinces, it is estimated that the annual gross revenue from agriculture in these Provinces fell from $843,153,000 in 1928 to $273,738,000 in 1932, representing a loss of 67½ per cent in farm income.

244. In the memorandum filed on behalf of the United Farmers of Ontario, an estimate made by the Dominion Bureau of Statistics of the values of field crops in Canada was given as follows:—

1928	$1,125,003,000
1932	416,586,000

The following is an extract from the evidence submitted on behalf of the United Farmers of Ontario as to the problem of short term credit in Ontario—

> "Generally speaking, within the last two years the banks have ceased to function in regard to Canadian agriculture. Agriculture is taken to be an activity, or an industry that is not worthy of credit, and from the banking point of view I am not blaming them."

245. At various sittings of the Commission, evidence was adduced both by individual farmers and by representatives of farm organizations to show that as a result of this declining revenue the maintenance and operating costs of farms cannot be met, farm debts have considerably increased, taxes are unpaid, farm equipment has seriously deteriorated, and a large percentage of farmers are unable to obtain new credit to meet the operating costs incidental to putting in and harvesting the crop. This evidence was confirmed by representatives of the banks, particularly in Regina, where it was agreed that a large proportion of farmers could not carry on their operations without some form of credit, that the credit could not be supplied by the banks and that a serious problem therefore existed which had to be met if agriculture was to be revived. The indebtedness of many farmers appears to be such that even a substantial rise of agricultural prices would not be sufficient to warrant the extension of new credit through ordinary commercial channels. A memorandum on rural credit submitted to us by the Canadian Bankers' Association referred to the matter of intermediate credit in the following terms:—

> "Assuming that the need for credit in this form is clearly a matter of sufficient national importance to warrant some action being taken by the authorities, consideration should be given to the creation of an institution financed on the public credit and to the placing upon it of the responsibility for meeting all legitimate demands."

246. Several suggestions have been made as to the most suitable facilities for providing this form of credit. The committee representing the Governments of the Prairie Provinces has suggested the extension of the existing Rural Credit Societies of Alberta by appropriate legislation of the Dominion Government; the Canadian Bankers' Association has suggested the formation of a Dominion Intermediate Credit Corporation with capital partly subscribed by each province in which it was asked to operate; while a suggestion, which has much to commend it, has been made that the scope of the Canadian Farm Loan Board might be extended to enable it to make short or intermediate term loans.

247. The material placed before us on this subject in the course of our inquiry is not sufficient to enable us to make a specific recommendation as to the precise form which such an organization might take. But we are satisfied that the need is a real one. We therefore recommend that 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.

CHAPTER VII

MISCELLANEOUS QUESTIONS OF BANKING PRACTICE

248. Having considered in the preceding chapters how far it is desirable to make any additions to or changes in the existing financial equipment of Canada, we now pass to the consideration of a series of topics raised in the course of our inquiry with regard to the working of the chartered banks under the present system. These topics, which relate to the ordinary administration of the banks, are of a different order of magnitude from such questions as that of the institution of a central bank, but from the amount of evidence which we heard regarding them, it is manifest that some of them at least are matters of much concern to considerable numbers of the banks' customers.

(a) Rate of Interest on Loans: Bank Act Section 91 (1)

249. Subsection 1 of Section 91 of the Bank Act provides as follows:—

> "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."

Much controversy has centred round this enactment both as regards its precise effect and as regards its expediency. The public have read it as a prohibition against the charging by the banks of interest or discount in excess of seven per cent on loans and this would appear to have been the intention of Parliament. While seven per cent has since first May last become the recognized rate for loans to farmers in the West, it is the case that the banks have been in the practice of stipulating for eight per cent or a higher rate where they thought that the risk warranted such charges. They appear to have thought that they were justified in doing so by the decision of the Privy Council in McHugh vs. *Union Bank of Canada* [1913] A.C. 299. In that case their Lordships no doubt refused to allow past settled transactions in which eight per cent had been paid to be opened up. This was because of the well-known legal principle that money paid under error in law is not recoverable. But the 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 opinion of their Lordships as expressed by Lord Moulton (at p. 316) was "that the express provisions of the first portion of this clause rendered it ultra vires on the part of the bank to insert in the chattel mortgage of May 28, 1907, the stipulation that interest should be payable at the rate of eight per cent and that therefore that stipulation is inoperative." An illegitimate charge is not rendered legitimate by reason of the fact that if it has actually been paid it may be irrecoverable.

250. The banks appear to have 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 is legitimate and by acting on this view have laid themselves open to the allegation that they have been evading the law.

251. As regards the future we are of opinion that the choice lies between either repealing the subsection altogether or so recasting it as to put it beyond doubt that it is illegal to stipulate for more than seven per cent interest or discount; if the latter course is adopted a penalty for contravention should be imposed.

252. On the one hand, in support of the retention of the provision, it has been argued that the purpose which Parliament had in view in originally enacting the subsection still subsists; that the banks should not make loans involving such risks as to warrant the charging of more than seven per cent; that higher rates than seven per cent constitute a burden too heavy for agricultural activities to bear; that although competition exists in the services extended by the various banks it is not manifest in the rates of interest demanded from borrowing customers, particularly from those engaged in agricultural pursuits and that in consequence Parliament was justified in enacting a maximum rate of interest. On the other hand, in support of the repeal of the provision, it has been argued that there are circumstances in which, if regard be had to the risk and to the cost of providing credit, a charge in excess of seven per cent is warranted; that the enforcement of a rigid maximum loan rate of seven per cent would so restrict business as to necessitate the closing of a large number of small branches, especially in newly-settled districts, and thus deprive many communities of banking services except at the expense and inconvenience of long journeys; that a charge of, say, one per cent in excess of seven per cent is a small matter to the customer, representing only two and a half dollars on a loan of five hundred dollars for six months while to the banks it may make cumulatively the difference between being able to carry on a branch in a particular district or closing it down; that in 1854 all usury statutes were repealed in Great Britain and the principle of restricting rates of interest abandoned, as being ineffective and inexpedient in the public interest; that if the banks were unable to lend at rates over seven per cent where such charges were justifiable in view of the risk, many borrowers, owing to the banks' inability to accommodate them would be driven to money-lenders not under the same restriction; that to deprive borrowers, who are willing to pay more than seven per cent where such charges are justifiable, of the opportunity of obtaining loans from the banks would restrict their freedom and often prevent them from engaging in profitable enterprise.

253. We have carefully weighed these considerations but unfortunately have not been able to reach agreement as to the recommendation which we should make. Four of us (The Chairman, Sir Charles Addis, Sir Thomas White and Mr. Beaudry Leman) are of opinion that a statutory maximum rate of interest is nowadays anomalous and an undesirable interference with freedom of contract, and that the provision of the Bank Act limiting the rate of interest to seven per cent, whatever justification it may originally have had, ought now to be repealed. Mr. Brownlee is of opinion that the statutory maximum still serves a useful purpose, that adequate reasons for repealing the section have not been adduced and that it ought to be retained. The result is that by a majority, we recommend the repeal of the provision in question.

(b) Discrepancy between Periods of Loans and Farmers' Requirements.

254. The discrepancy between the currency of loans and the period of the farming operations which the loans are intended to finance was represented to us as being a source of inconvenience and irritation to the borrowers, and complaint was also made of the practice of compounding interest, thus increasing the interest charges. It is acknowledged that the common practice of the Canadian banks has been to take notes maturing in three or four months, although repayment was not expected before six to twelve months. In justification of this procedure, the banks have emphasized that it was necessary to ascertain from time to time that their position had not been prejudiced by acts of the borrower, inasmuch as farmers' notes were almost invariably unsecured.

255. With regard to the compounding of interest, the banks argued that it has been their general practice to discount notes, and that this custom is world wide and not peculiar to Canada; that if only simple interest is collected at

maturity of a loan represented by a series of bills discounted and renewed from time to time this amounts merely to a reduction in the rate, and a small one at that; that actually it is more expensive for a borrower to discount a long term note than to discount short term notes and obtain renewals thereof, interest being compounded.

256. It would seem reasonable to expect that the banks catering for the needs of a farming community whose normal operations require six, nine or twelve months' credit facilities, should endeavour to accommodate their practice to the legitimate requirements of their customers. But it must be recognized that, having regard to the diversity of the requirements of borrowers in different industries and different localities, it would be well-nigh impossible to place a statutory obligation upon the banks to lend upon terms of repayment at a date likely to coincide with the realization of the venture for which the money was borrowed. Matters of this kind can better be adjusted through mutual good-will, with such moral suasion as may be exerted through some central authority duly qualified to exercise a regulating influence. We may add that in our view the banks would be well advised in the case of satisfactory customers to endeavour to meet their wishes and convenience in this matter.

(c) Charges for (i) Operating Accounts; (ii) Collecting Cheques.

257. (i) Subsection 4 of Section 91 of the Bank Act reads as follows:—

> "No bank shall directly or indirectly charge or receive any sum whatsoever for the keeping of any account unless such charge is made by express agreement between the bank and the customer."

Representations were received to the effect that charges had been made by banks without the express agreement of the customer. One instance only of irregular practice was brought to our notice where the letter intimating the intention to make a charge did not explain that this could only be done by agreement. It is acknowledged by the Canadian Bankers' Association that if requirements of the statute are inadvertently overlooked by some branch manager, the customer is entitled to obtain a refund of any charge made. The wording of the provision of the Bank Act appears to be clear, and its purpose unmistakable. We were assured that the case brought to our notice was entirely exceptional and that steps would be taken to see that there was no recurrence of it. The reasonableness of the banks making by agreement charges for services rendered in administering active accounts, when the customer offers no collateral or compensating advantage to the bank, has been recognized by the Bank Act, and rightly so. Any other mode of procedure would result in the shifting of the costs of performing certain services from one class of customers to another class.

258. (ii) Some complaint was made to us regarding charges for collecting cheques. A bank however cannot undertake the encashment or collection of cheques, whether drawn upon its own branches or those of other banks, without incurring expense for postage, stationery, clerical work and the maintenance of clearing houses and messenger services. Moreover, it is the custom in Canadian banking to give credit in the books of the bank at the date of deposit of all cheques, whether these are drawn on the bank's own branches or on branches of other banks. Responsible customers thus obtain immediate use of the funds represented by these cheques although in the case of those drawn upon branches at distant points several days may elapse before the bank itself receives the funds which it has put at the disposal of its customers. When charges for the encashment of such cheques are waived it is tantamount to making advances to the depositors without any interest charge.

259. Many customers in Canada are granted what are known as "par privileges," whereby a bank agrees without charge to accept cheques drawn on its branches and to encash at its various branches the cheques issued by a customer. In such cases the bank at present receives compensation by requiring the customer to maintain substantial non-interest-bearing deposits proportionate to the number of cheques deposited or encashed.

260. The advantages of extending par privileges to all customers of all banks is widely recognized in other countries. It facilitates trade and, by encouraging the use of cheques, economizes the use of currency. It also eliminates the trouble and irritation involved in a multitude of minor charges. For these reasons the Canadian banks might well consider whether it would not be in their interests and in the interests of the country to extend general par privileges and to recoup the consequent expense by extension of the custom of making charges by agreement for carrying active accounts and by restriction of the use as chequeing accounts of savings deposits upon which interest is paid. It should be understood, however, that this change would involve the postponement of credit-dating to correspond with the time necessary to encash the cheque.

(d) *Rates of Interest on Loans to Provincial Governments, Municipalities and School Boards.*

261. In this connection it has been represented that too great a spread exists 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. The question of the spread between rates paid and received by banks has been under discussion in a great many countries and for a very long time. A number of considerations have been submitted to us in explanation.

262. The rates on loans are based on the interest paid on deposits, plus the cost of operation, plus the cost of the risk involved. All three elements must be taken into account, hence the difference between one region and another, and between one customer or class of customers and another.

263. The purpose of the Finance Act is to increase or decrease, as conditions develop, the cash reserves of the banks or the currency needed to carry on the business of the country. It was not designed as a lending agency for the benefit of the banks.

264. The Dominion notes advanced to the banks represent a small proportion of the loans made by them as evidenced by the figures submitted to us. The average ratio of advances under the Finance Act to the total loans of the banks were:—

In 1926	0·74 per cent	
" 1927	0·84 " "	
" 1928	2·28 " "	
" 1929	3·32 " "	
" 1930	1·04 " "	
" 1931	0·49 " "	
" 1932	1·77 " "	
" 1933	3·32 " "	(up to date)

265. The funds obtained under the Finance Act should not be segregated from the banks' entire volume of loans. If the banks were to lend to Governments or other public bodies at the rate paid on deposits, or at the rate charged by the Government for advances under the Finance Act, without the necessary additional charge, it would be tantamount either to placing upon the banks a large share of the burden of carrying on the public and social functions which the various communities decide they are entitled to, or else to shifting this burden onto other borrowers. If, on the other hand, the Government were to issue

Dominion notes to finance the requirements of Provincial Governments, Municipalities and School Boards, it would engage in a dangerous policy. In this respect it should be noted that, in accordance with the return of the chartered banks to the Government for the month of July, the advances of the Canadian chartered banks to Provincial and Municipal Governments amounted to $152,-511,000.

(e) *Investment Business and the Banks.*

266. The Investment Bankers and representatives of a number of Boards of Trade have strongly urged upon us that banks should be prohibited by statute from dealing in securities, save as regards purchases and sales for the banks' own portfolios. It has been suggested that the banks should be restrained from selling securities directly to the public and also from tendering for new issues, either individually or as members of syndicates, and from acting as agents in connection with issues made by Governments, Municipalities and other public bodies. There is apparently no exception taken to the banks acting as agents, through their numerous branches, for the distribution of securities, receiving a commission for such services, or to their sharing commissions with the bond dealers when purchasing orders are received from clients; provided n both cases that the source of supply of the securities sold to the public be he issuing body or the investment bankers.

267. In answer to these representations, it is pointed out by the banks that lealing in securities is a recognized normal activity of banks throughout the vorld, and that in Canada the right of a bank to conduct such operations was established in 1876; that the revision of the Bank Act of 1890 and subsequent evisions (including that of 1923, subsection (1) (*c*) of section 75) authorized bank to "deal in, discount and lend money and make advances upon the ecurity of, and take as collateral security for any loan made by it, bills of xchange, promissory notes and other negotiable securities, or the stock, bonds, lebentures and obligations of municipal and other corporations, whether secured by mortgage or otherwise, or Dominion, Provincial, British, foreign and other ublic securities," and under subsection (1) (*d*) to "engage in and carry on uch business generally as appertains to the business of banking." "Banking usines" was defined in 1918 in Great Britain by the Board of Trade after onsul with the Treasury as follows:—

> "'Banking business' means receiving money on current account or on deposit; accepting bills of exchange; making, discounting, buying, selling, collecting or dealing in bills of exchange, promissory notes and drafts whether negotiable or not, buying, selling or collecting coupons; buying or selling foreign exchange by cable transfer or otherwise; issuing for subscription or purchase or underwriting the issue of loans, shares or securities;......."

268. The banks have drawn attention to the valuable aid rendered to the Dominion Government in floating its loans during the Great War and to the ssistance given in the marketing of a large volume of public securities in the ost-War period, including the National Service and 4 per cent Loans of 1931 nd 1932. They have also drawn our attention to the fact that, when securities sued by public bodies run into many millions of dollars, their participation necessary if firm bids are called for, and their assistance is always valuable ensure wide and prompt distribution of the securities. It is manifestly in e public interest that Provincial Governments and Municipalities and other iblic bodies should obtain as high a price as possible for their issues and this n be better secured by active competition among bodies financially capable making good their tenders. There seems to us no justification for legislative

interference with the practice which ensures keen competition and close tendering, and it follows that if the banks become, in whole or in part, the purchasers of such issues, they ought to be allowed to distribute them through their branches. From the point of view of the public, it has been pointed out that the banks have hundreds of branches in small and remote communities where the investment houses do not have, and cannot maintain, offices.

269. While there is no doubt of the banks' right to deal in securities we could not fail to be impressed by evidence of abuses. It may be true that the volume of industrial or other securities sponsored and distributed by the banks may have been small in comparison with that of the governmental and municipal issues sold by them, but we, nevertheless, strongly urge upon the Canadian banks the advisability of refraining from dealing in, or distributing for their own account, any but the highest class securities available in the country, and more particularly those issued by Governments, municipalities and other public or semi-public bodies.

270. As regards trading in stocks we do not consider that the banks should act otherwise than as agents for their customers to place such orders as they may receive through the regularly constituted channels provided by the brokers and investment bankers.

(*f*) *Section 88 of the Bank Act*

271. The question of the desirability of the retention of this much discussed section was among the topics raised before us. On the other hand we were urged to extend its provisions to certain additional items, namely silver foxes, fox pelts and fertilizers. The section is anomalous inasmuch as it contravenes the general principle of law that a borrower cannot pledge articles which he retains in his own possession. This principle affords a safeguard to creditors and is of importance in a trading community. We recognize that the section was introduced to meet the conditions of a developing country lacking accumulations of working capital and we are not satisfied that its utility is spent, although the time may come when the advantage of retaining it may well be questioned. We do not advise the repeal of the section but we do not think that it should be further enlarged.

(*g*) *Alleged Subordination of Eastern and Western Interests to those of the Central area*

272. 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 to the effect that, under such a centralized system, applications for loans from Eastern and Western communities or business interests had to be passed upon by head office officials who were not sufficiently conversant with Eastern or Western conditions and who might be inclined to favour enterprises near at hand.

273. The banks have been most emphatic in denying these charges, and have submitted that their boards were as far as possible representative of the entire country, or at least of such parts of the country as provided a sufficient volume of business. The banks submit that for administrative purposes the branches are grouped into districts, generally by provinces, under the charge of a supervisor with authority to deal with all credits up to, say, $25,000. At certain points, where banks have committees of directors, the limit is still larger. We received evidence to the effect that, in the case of one bank having its head office in Montreal, out of thousands of loans made in the three Prairie Provinces 99·64 per cent were granted before reference to head office; whilst another bank reported

that 82·32 per cent of its loans in Alberta had been dealt with by the branch managers directly, that 16·47 per cent had been referred to the Calgary superintendent, leaving 1·21 per cent for approval by the Assistant General Manager in Winnipeg, and out of this 1·21 per cent only ·005 per cent had been submitted to head office.

274. The banks state that they desire to have on their boards leading business men from the districts where banking operations are on a sufficiently large scale, but that they must also take into account the distribution of their shareholders. It must always be borne in mind that it is permissible to establish a bank in any province or region of Canada under the Bank Act by the provision of the moderate capital of $500,000.

275. We do not see how this sentiment could be allayed by any form of legislation, but in view of the fact, which appears from a statement submitted by the Canadian Bankers' Association, that out of a total of 170 directors of all the chartered banks in Canada only two reside in the Provinces of Alberta and Saskatchewan, we commend to the attention of the shareholders of the Canadian banks that they should, in their own interest, consider the advisability of providing not only a fair but a generous proportion of directors from the eastern and western sections of the country and of further extending their local committees for the purpose of allaying any regional feeling of discrimination. Goodwill between the banks and the public in all parts of Canada is essential to the proper functioning of the banking system as well as to the promotion of national unity.

(h) *Bank Directorates*

276. Attention has been directed at several of our hearings to the fact that many bank directors are also directors of other corporations and it has been suggested that in consequence such corporations are specially favoured in the credit policy of the banks to the detriment of individual customers engaged in agricultural and the primary industries generally, as well as of traders with comparatively small credit requirements. It is also urged that such directors in voting as members of their boards upon credits to companies of which they are also directors occupy a position in which their interest would be in conflict with their duty to the shareholders of their banks.

277. As to the first of these suggestions it is to be observed that no evidence has been adduced before us showing that there has been such discrimination in banking policy and that as banks are engaged in nation-wide business they naturally desire to have upon their boards men engaged in large enterprises, who are thus in a position to bring to their respective banks profitable business in the form of deposits, loans and exchange.

278. In addition to this important consideration boards of directors are mainly concerned with the policy of their banks rather than with the day to day routine administration. Moreover as the field of banking is coextensive with the entire economic activities of the Dominion it is necessary that members of Boards of Directors should be men of affairs, actively engaged in business enterprise or having at least wide knowledge of commercial and financial conditions. It would seem unwise therefore to restrict membership in bank directorates to those who are not directors of other corporations. It must be left to the sense of propriety of directors not to place themselves in a position where their interests may conflict with their duty or which may justifiably attract unfavourable comment.

279. We agree, however, that directors should not vote or be present at meetings of their boards when credits to themselves or any firms or corporations of which they are partners or directors are under consideration, and we are informed that most of the banks have by-laws to this effect, which in practice are strictly obeyed. We suggest that all banks should have such a by-law.

(i) *Bank Profits*

280. Some allusion was made at our hearings to the amount of profits earned and the dividends paid to shareholders by the banks. It does not seem necessary to discuss this question in great detail as the figures presented to us giving the record of earnings and dividends over the last ten years indicate clearly what the position is.

281. The average paid-up capital, reserve and undivided profits, constituting the shareholders' investment, was $268,158,153 during the years 1923 to 1932 inclusive, made up as follows:—

Average paid-up capital	$123,605,663
Average reserve fund	137,370,735
Average undivided profits	7,181,755
	$268,158,153

282. It should be noted that the reserve funds have been constituted, in part, from cash received from shareholders as premiums on capital stock issues. Of the present reserve funds, 42 per cent has been derived in this manner, 34 per cent has been made up from profits accumulated throughout the respective periods of the banks' lives and 24 per cent was added in connection with the purchase of assets of other banks.

283. The average net annual profit available for dividends, 1923 to 1932, was $17,064,957, which is the equivalent of 6·36 per cent on the average shareholders' investment. The dividends paid averaged $15,919,384, which is equal to 5·93 per cent of the average shareholders' investment.

284. Since 1930 all bonus dividends have been discontinued by the Canadian chartered banks and the regular dividends have been decreased by 4 per cent per annum in the case of four banks, 3 per cent in the case of another, and 2 per cent in the case of three other banks.

285. In coming to any conclusion as to whether or not the returns to Canadian bank shareholders have been reasonable, having regard to the earnings which might be secured upon capital invested in other enterprises or in Governmental, municipal or high grade industrial securities, note must be taken of the double liability which attaches to the shareholder's participation and also to the desirability that there should, from time to time, be a ready flow of money available for bank capital.

(j) *The Decennial Revision*

286. On the one hand it has been suggested that the banks' charters should be rendered perpetual and that the banks should not be subjected to the recurrence every ten years of the disturbing process of revision of the Bank Act. On the other hand it has been suggested that revision should take place at shorter intervals. No adequate reason has been adduced before us for altering the existing practice.

(k) *The Statutory Returns*

287. We have received both from Mr. Coats, the Dominion Statistician, and from a committee under the chairmanship of Professor Jackson, suggestions as to the improvement of the various statistical returns which the banks are required to make. This is a matter of detail and largely non-controversial, and in our view is more appropriate for consideration by the Department of Finance, preliminary to the inquiry before the Standing Committee on Banking and Commerce to which the revision of the Bank Act will doubtless be referred by Parliament.

(l) *Banks and Insurance Business*

288. We heard some evidence on behalf of insurance agents to the effect that the banks were engaging in or influencing insurance business and so invading their sphere. The Bank Act is quite explicit on the subject. Section 75 (3) provides that:—

> "No agent or manager of any bank shall act as agent for any insurance company or for any person in the placing of insurance, nor shall any bank exercise pressure upon any borrower to place insurance for the security of such bank in any particular insurance agency . . . ."

289. The suggestion made was that the provisions of the statute were indirectly evaded. The Bankers' Association assured us that the banks took all steps to prevent the infringement of the statute by their agents or managers and that if any case of non-observance of the statute were reported it would be duly dealt with. From the public point of view there is the further protection of the Provincial legislation regarding the licensing of those engaging in insurance business. We do not think that any additional statutory protection need be accorded to the insurance agents other than the Bank Act and the Provincial legislation already afford.

(m) *Restriction of Deposits by Married Women*

290. At Montreal a special point affecting the rights of married women in the Province of Quebec was brought to our notice by the Canadian Alliance for Women's Votes. Section 95 of the Bank Act which authorizes a bank to receive deposits from, and to repay deposits to, persons under legal disability provides in the third subsection as follows:—

> "If the person making any such deposit could not, under the law of the Province where the deposit is made, deposit and withdraw money in and from a bank without this section, the total amount to be received from such person on deposit shall not at any time exceed the sum of two thousand dollars."

291. As, under the law of the Province of Quebec, a married woman could not, apart from section 95, deposit or withdraw money without her husband's consent, the effect of the subsection just quoted is that in this Province a married woman cannot without her husband's consent deposit more than $2,000 in a bank. Apparently under the Dominion Post Office legislation a married woman is under no disability as regards the amount which she may deposit in the Post Office Savings Department, and may make deposits up to the limit of $5,000 which applies generally. We were asked to recommend that in the case of married women in the Province of Quebec the limitation on deposits in the banks to $2,000 should be removed and an unlimited right of deposit conferred, without the requirement of the husband's consent. We think that this is a reasonable request and we recommend that section 95 (3) be amended accordingly.

CHAPTER VIII

CONCLUSION

292. We have now considered all the matters brought to our notice with which we can usefully deal within the scope of this Report. As we indicated at the outset, some of the topics discussed before us are not in our opinion appropriate for legislative treatment in the revision of the Bank Act, and on such topics we have confined ourselves to comment and advice, confident that what we have said will receive due consideration. Our operative recommendations are consequently few in number.

293. 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.

294. 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.

295. These are our two recommendations with regard to the improvement of the Canadian financial structure.

296. Our recommendations with regard to the existing administration and practice of the Canadian chartered banks will be found in Chapter VII under the appropriate headings.

297. On certain topics Mr. Brownlee desires to add some further observations and these will be found in an Addendum attached to our Report.

298. In addition to the tables printed in preceding chapters, we have also printed in the appendix a number of other tables and statements which seemed to us likely to be useful to those who are interested in our subject.

299. We cannot conclude our task without expressing our indebtedness to all those who by their evidence or their written communications have been at such pains to lend us assistance. Among many useful contributions which we have received we may be allowed to refer, on account of its representative character, to the brief submitted by the Canadian Chamber of Commerce. In reaching our conclusions we trust that we have given due weight to all the representations laid before us. It may not be out of place to express here our high appreciation of the courtesy with which we were received, indeed welcomed, by the Governments of the Provinces and of the ready help which they extended to us in our investigations.

300. To our secretaries Mr. Roberts and Mr. Plumptre, who have discharged their arduous duties under circumstances of unusual difficulty and pressure, we owe no ordinary gratitude for their unfailing devotion to duty and their resourceful assistance.

MACMILLAN,
Chairman.

C. S. ADDIS.

W. T. WHITE.*

J. E. BROWNLEE.

BEAUDRY LEMAN.*

B. J. ROBERTS,
Secretary.

A. F. W. PLUMPTRE,
Assistant Secretary.

OTTAWA, 27th September, 1933.

* Subject to dissent on certain matters as set out in his memorandum attached.

ADDENDUM

By SIR THOMAS WHITE

PARAGRAPHS 141 TO 148, INCLUSIVE, CHAPTER III OF THE FOREGOING REPORT

BANK DEPOSITS

I regard the treatment of this subject in the above-mentioned paragraphs of the Report as incomplete by reason of omission to emphasize the fundamental economic factors affecting the aggregate of bank deposits from time to time.

The two major causes of variation in the volume of deposits are bank loans and purchases of securities by the banks. Bank loans come into existence through the initiative of borrowers who believe they can employ profitably the funds obtained. Bank loans, therefore, and with them the aggregate of bank deposits, increase in periods of active demand for commodities and of rising prices. Conversely, both diminish in periods of declining demand and falling prices. In both cases the volume of agricultural production due to good or bad harvests plays a most important part. Another factor is confidence, or lack of confidence, in the financial stability of the nation. Security purchases by the banks on the other hand are made on the initiative of the banks themselves. Subject to the maintenance by the banks of the level of security holdings considered necessary as part of their secondary reserves, further purchases of securities will be made from surplus cash reserves only if good loans are not available, since such loans result in more profitable employment of funds. To maintain normal cash reserves, banks, if their security holdings exceed the minimum deemed essential, will sell securities rather than restrict good loans.

The influence of the economic factors above named is well shown in official statistics relating to both demand and notice deposits by the Canadian public during the past twenty years. On 30th June, 1914, demand deposits by the Canadian public totalled in round figures three hundred and fifty-five million dollars. By 1920, due to the War and early post-War activity—a period of rising commodity prices and rapidly expanding national production—the aggregate had reached six hundred and fifty-nine millions. In the same period and due to the same causes notice deposits rose from six hundred and sixty-three millions to twelve hundred and forty-three millions and in 1921 to thirteen hundred and eight millions. In the post-war period 1920-1925, inclusive, owing to the sharp decline in world commodity prices, the volume of demand deposits by the Canadian public fell from the maximum of six hundred and fifty-nine millions mentioned above to four hundred and ninety-five millions, while the aggregate of notice deposits diminished from thirteen hundred millions in 1921 to twelve hundred and fifty-three millions in 1925. The succeeding period 1926 to 1929 was featured by a vast economic and financial expansion in Canada, caused by bountiful harvests and good prices, the great volume of borrowings in the United States by Canadian Governments, municipalities and private corporations and the concurrent influx of American capital seeking permanent investment in Canadian industrial enterprise. It was also featured by an unprecedented wave of stock speculation which swept both Canada and the United States. The resultant effect of all these factors is clearly shown in the expanding volume of Canadian bank deposits. Demand deposits increased from four hundred and ninety-five millions in 1925 to six hundred and seventy millions in 1929 and notice deposits from thirteen hundred and twenty-eight millions in 1926 to fourteen hundred and sixty-six millions in 1929. Then came both in Canada and the United States the culmination of this period of over-borrowing and over-expansion of credit and the "boom" collapsed in the autumn of 1929. There followed inevitably the period of severe depression which has lasted to the present time although there has been a certain degree of recovery during the past year. In this period, characterized as it has been by a disastrous fall in the price level of commodities in all markets of the world and a practical cessation of Canadian borrowing abroad except for the purpose of renewing maturing loans, we find as we should expect a marked decline in the amount of Canadian bank deposits. The aggregate of demand deposits fell from six hundred and seventy millions in 1929 to four hundred and eighty-eight millions in 1932. On 30th June, 1933, they showed an increase to five hundred and thirty-five millions—one of the evidences of recovery above noted. Following a like course, notice deposits decreased from fourteen hundred and sixty-six millions in 1929 to thirteen hundred and seventy-three millions in 1932 and increased during the succeeding year to thirteen hundred and eighty-six millions.

It is to be observed that during the entire period 1914-1933 covered by this review the cash reserves of Canadian banks were maintained on a percentage ratio to deposit liabilities in keeping with the standard practice of banks of the leading commercial and financial nations of the world.

As bearing also upon this subject it may be observed that while deposits are a medium of exchange as stated in the Report, their economic importance depends largely upon the velocity with which they are turned over. Dormant deposits represent potential but unused buying power. It is interesting to note that, taking [illegible]6 as a base, the velocity of Canadian bank deposits (expressed as a ratio of [illegible]orted bank debits to total deposits) fell from a peak in October, 1929, of 153 per cent to 94 per cent in October, 1932, while the total volume of bank credit in Canada (loans plus security holdings) in the same period fell only from approximately 141 per cent to 118 per cent.

I feel justified in dealing with this subject in some detail because of the possibility of misunderstanding on the part of readers of the Report as to the respective degrees of influence exerted by fundamental economic factors and by banking technique upon the volume of Canadian bank deposits.

W. T. WHITE.

OTTAWA, October 3, 1933.

MEMORANDUM OF DISSENT

By SIR THOMAS WHITE

THE FINANCE ACTS, 1914 AND 1923

I respectfully dissent from many of the statements and conclusions contained in Chapter IV 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 respectively. The paragraphs of the Report dealing with these matters are numbered 188 to 195 inclusive. In paragraph 190 it is correctly stated "that the Dominion Government did not attempt to use the Dominion note issue to any extent as an agency of inflation." The further statement that the Finance Act "may be said to have been the efficient agent which made effective the policy of inflation which Canada, in common with all belligerent countries, followed" requires qualification. It is true that there was credit inflation arising from the volume of Dominion borrowings for war purposes, through issues of bonds subscribed by the Canadian public. But there was on the part of the Government no "policy of inflation." Credit inflation automatically and inevitably occurred owing to the need of financing the Government's own war expenditures in Canada and of providing the British Government with the necessary funds to pay for the vast amount of foodstuffs, munitions and other products purchased in Canada and required by Britain and her allies in the prosecution of the war. In respect of these advances to the British Government aggregating more than twelve hundred million dollars it is to be observed that conversely that Government made advances in sterling in London to the Canadian Government to meet the expenditures of the latter in maintaining the Canadian forces abroad. On balance at the end of the war the British Government owed the Canadian Government two hundred and twenty million dollars which was duly paid.

In connection with this subject of credit inflation it may be pointed out also that the prices of munitions, wheat and certain other commodities were fixed at high levels (in conformity with those prevailing in the United States) and that, owing to war demand, general prices in Canada were continuously forced upward and national production greatly expanded. In these conditions and having regard to the suspension of the gold standard in all the great nations of the world except the United States, the Finance Act instead of being an instrument promoting a policy of credit inflation served with the highest efficiency the purpose of providing in conjunction with the note issues of the banks adequate currency facilities for the financing of the rapidly mounting volume of Canadian agricultural, industrial and commercial production and trade. It is my belief that no central bank in the world during the war period functioned more smoothly or was capable of being utilized more promptly or with greater immediate effect in serving the purposes of national and business finance than the Canadian Finance Act of 1914. It is also my view that during the period in question and in the very trying period of so-called reconstruction 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. The advantage of that system to the Government of Canada, in making its issues of bonds to the Canadian public and of having immediately available through the agency of the Canadian Bankers' Association the facilities afforded by the chartered banks with their thousands of branches throughout the Dominion needs only to be mentioned to be realized and appreciated. And in my opinion the same high degree of efficiency has been maintained by the Canadian financial system down to the present time. Of this statement we have at least partial proof in the stability of that system during the unprecedented world depression of the past four years.

In paragraph 191 of the Report reference is made to the depreciation in the value of the Canadian dollar following the conclusion of the war. This depreciation was not of course confined to Canada but was common to the currencies of all nations engaged in the war except the United States, whose participation was for a less lengthy period than that of the other great nations. During this immediate post-war period the Canadian dollar stood at a higher gold exchange value than that of the currency of Britain or of any other Dominion of the Empire and much higher than that of any of the currencies of the Continental belligerent nations. One of the reasons for this strength in Canadian exchange was that Canada had come through the war without having incurred a net indebtedness either to Great Britain, the United States or any other nation. Canada's war debt was owed almost exclusively to the Canadian public who had subscribed the various issues of securities made by the Government to meet war expenditures. The Finance Act was in no wise responsible for the fall in the Canadian dollar in the immediate post-war period.

I also respectfully take exception to the statements contained in paragraph 195 relating to the administration of the Finance Act of 1923 in the period following the resumption of the gold standard by Canada in 1926. One of these statements is as follows: "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." With respect to this suggestion, it need only be pointed out 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. The following tables show the comparative rates from 1926 to 1930:—

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

Even if the suggestion 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. The 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 such as for example to enable issues of Treasury Bills, or of long term securities to be made at low interest yield rates for temporary or refunding purposes. 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. In Canada whether a Central Bank is established or the Finance Act is retained the rediscount rate in the one case and the rate on advances in the other will be bound to be affected by the need of the Government to obtain short or long term money as cheaply as possible and to provide funds at a reasonable rate to aid the financing of the movement of the Western wheat crop. These in my opinion

have been the two main factors affecting the rates charged for advances under the Finance Act from 1926 down to the present time.

It is possible, as stated in this paragraph, that "rates on advances under the Finance Act were not used as an instrument of credit expansion and contraction." The rates of rediscount quoted above show that in the result (no matter what the intention) the rates charged by the Treasury Board were kept fairly uniform with those of the Bank of England and of the Federal Reserve Bank of New York which presumably were employed (partially at least) as "instruments of credit expansion and contraction." It must be borne in mind, however, 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 or contraction. An examination of the borrowings of Canadian banks under the Finance Act shows such a slight percentage (1 to 3%) of the aggregate of such borrowings to the total volume of Canadian bank credits including security-holdings 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. Such an increase in rate could not, having regard to public opinion, have been put in effect by any reserve institution that might have existed in Canada at the time. There is another aspect of the matter. It is implied that the officials of a Central Bank, had there been one in Canada at the time, would have wisely discerned that expansion or contraction of credit was needed and would have acted accordingly. This inference finds no warrant in the action taken from time to time throughout the Federal Reserve System of the United States where conditions during the period in question were similar to those which prevailed in Canada. The fact is that "the light of contemporary conditions" mentioned in the paragraph referred to seems to shine clearly only in a subsequent period when the conditions have themselves become a matter of history. The 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. 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) is not in my view well-founded. We can all see more clearly in retrospect. The real check upon undue expansion of the currency issued under the Finance Act is 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 twofold reason for this policy: firstly because they do not desire to continue to pay interest any longer than necessary and secondly because they do not care to incur or to show in their returns heavy indebtedness in respect of advances under the Act. Although it may be technically correct that "the Finance Act did not provide Canada with the organization needed to undertake the tasks which the maintenance of the restored gold standard implied," the fact is that in conjunction with the policy followed by the banks the Canadian monetary system worked quite as efficiently as the Central Bank systems of nations economically similar to Canada.

It was suggested during the course of our hearings that political influence might possibly affect unfavourably the administration of the Finance Act because the Treasury Board which authorizes advances and fixes rates of interest payable thereon is composed of members of the Government. With regard to this I have only to say that if by "political influence" is meant partisan or improper influence not a shred of evidence has been adduced before the Commission in support of such a suggestion. The fact is that authorization of advances under the Act is 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. I have no hesitation in asserting that the administration of the Finance Acts under all Governments has been wholly free from any such influence. If, however, it should be deemed expedient by Parliament to limit the aggregate amount which may be borrowed by the banks under the provisions of the Finance Act or make the Governor General in Council instead of the Treasury Board immediately responsible for fixing such aggregate from time to time and the rates of interest to be charged upon advances, legislation to that end may of course be readily enacted. Should it be the opinion of the Minister of Finance that he requires additional expert assistance to that available in his Department he might appoint as a permanent member of his staff an outstanding economist whose special duty it would be to continuously study the economic and banking situation in Canada. Such an official together with the Deputy Minister of Finance (himself a distinguished economist) and the Inspector General of Banks would constitute a most competent Departmental Committee to advise the Minister and the Treasury Board upon all applications for advances by the banks. Personally, if any change is made in the existing mode of procedure, I would prefer such a permanent Departmental Advisory Committee to an independent Board created for the purpose of control and regulation of credit through the administration of the Act. It may be of interest to the public to know that since the enactment of the Finance Act in 1914 the Dominion Government has received a total revenue, by way of interest charged the banks upon advances, of $22,782,602, with practically no additional cost to the Department of Finance.

The Establishment of a Central Bank

Upon this most important question which involves consideration of structural change in Canada's monetary system I regret to find myself in disagreement with a majority of the members of the Commission. With my colleague, Mr. Leman, I dissent from their recommendation that "a Central Bank for Canada be forthwith established." The terms of our dissent are to be found in paragraph 238 of the Report and are as follows:—

> 238. 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.

As Mr. Leman has in his memorandum set out the main grounds of our dissent I shall only make some general observations upon the subject in issue and call attention to certain features of the constitution of the proposed bank which I regard as open to criticism. I do not say that at no time in the future will a Central Bank be needed as an integral part of Canada's monetary system. It may well be that in the course of the evolution of that system such an institution may be found necessary and established. Even if I believed however (which I do not) that a Central Bank could now perform useful functions as a part of our monetary system, I would still entertain the view that the present is not a suitable time for its establishment. My reason for this conviction is that, without regard to the financial disturbance which would undoubtedly be caused by such a fundamental alteration in the structure of our monetary system, an institution of this kind would hamper rather than help the Government of the day in dealing with the manifold and complex financial problems with which it is confronted. A Central Bank, newly established, entrusted immediately with the ownership of the entire cash reserves of Canadian banks, and administered by a necessarily untried and independent Board of Directors clothed with the power of controlling currency, credit and security issues and charged with the

conduct of negotiations respecting our external public finance, could, I think, be only an impediment to the Government in this trying period, when direct unfettered Governmental action is manifestly required. I recall that the Union Government, of which I was a member in the reconstruction period following the Armistice—a period very similar to this—declined to consider favourably the establishment of a Central Bank for the reason I have expressed. Some of the financial problems to which I have alluded are the refunding of our outstanding loans, the flotation of new issues, whether in Canada or elsewhere, the sale of Treasury Bills, the management of an Exchange Stabilization Fund (should that hazardous experiment be tried) and such questions as reducing unemployment and raising the domestic price level through monetary action. In the solution of all these problems it is my belief that the existing banking system of Canada supplemented by the provisions of the Finance Act, affords the Government a much more efficient instrument than that system controlled and regulated by a newly-created Central Bank independent, in theory at least, even of the Government of the day. There are many signs of business recovery in Canada to-day. Structural alteration in our monetary system could hardly fail to retard, temporarily at least, such recovery.

I wholly agree with the view of the Canadian delegation and the other delegations of the Empire in formally stating, after the adjournment of the recent World Monetary and Economic Conference that "the ultimate aim of monetary policy should be the restoration of a satisfactory international gold standard." My conviction is that as the main trouble in the world to-day is debt—national, international, corporate and private—that none of the nations, no matter how self-contained they may suppose themselves to be, can possibly achieve recovery unless a reduced gold content of their various currencies is established (or has, as in the case of France, been established) and the leading nations are thus enabled to return to a gold standard which they can severally maintain. Such a return would mean the immediate stabilization of exchange, the end of the ruinous contest in depreciation in currencies, increase in volume of international trade and a reduction of debt obligations in terms of gold (without any change in their nominal value), to manageable proportions.

The international co-operation necessary to accomplish this desired end can I think be achieved only by direct negotiations of Governments with Governments. I have no confidence that international conferences of Central Bank officials, no matter how eminent they may be, whose respective Governments may overrule their decisions at any moment, can bring about the restoration of gold as the universal medium of exchange and so promote world recovery. With respect to some of the specific reasons put forward by a majority of the Commission in favour of the immediate establishment of a Central Bank for Canada, I summarize my observations as follows:—

(1) The fact that Central Banks have been created by numerous other countries is not a valid argument for the establishment of such an institution in Canada. In the case of most of these countries the exchange value of their currencies is lower than that of Canada and their national credit not nearly so high. Notwithstanding the existence of their Central Banks, conditions within their areas are not nearly so good as those prevailing in Canada. The question so far as Canada is concerned, must be considered in the light of our own situation and circumstances. A disturbing feature of the financial statements of several of the Central Banks established since the war is the unduly high ratio of floating Governmental debt to the aggregate of assets against which currency may be issued. In these cases the facilities afforded Governments of easy financing obviates the immediate necessity of balancing their annual budgets and leads to the invalidation of their credit and a continuous depreciation in the exchange

value of the currencies of their respective countries. The resulting loss of confidence makes it difficult or impossible for such countries to refund maturing issues at lower yield rates of interest.

(2) Expressions of opinion by international conferences no longer, I am sorry to be obliged to say, carry weight with the public in any part of the world. History records no more tragic futilities than the deliberations and resolutions of these all too numerous gatherings from the Treaty of Versailles to the present day.

(3) I respectfully dissent 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. I believe that any action they might take towards this end would be nugatory so far as concerned its purpose but fraught with grave potentialities for causing business disturbance through its indirect effects. My view is also that no Board of Directors, no matter how eminent its personnel, would be wise enough to be entrusted with such a duty.

(4) I do 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 for International Settlements as being of sufficient importance to warrant the expense of establishing and operating a Central Bank in Canada.

Now as to certain features of the constitution or "set-up" of the proposed Central Bank as recommended by the majority of the Commission:

(1) The proposed "set-up" apparently contemplates that vacancies caused by the retirement of directors in rotation should be filled by vote of the shareholders. If this is the case there would undoubtedly be active canvassing of shareholders for proxies to be voted on behalf of candidates seeking election to positions of such prestige and emolument. Vacancies in the directorate occurring from time to time should in my view be filled by the Governor-General in Council.

(2) The provision authorizing the Bank to become the banker for Provincial Governments (in which is implied a measure of control over the conduct of their financial operations and expenditures) is in my opinion unwise and likely to lead to undesirable friction between Provincial Governments which 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 and issue their securities as at present under their sovereign authority to "borrow money on the sole credit of the Province" (Section 91, B.N.A. Act).

(3) I join with my colleague, Mr. 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. He has pointed out the grave risk involved in relying to too great an extent upon the stability of such exchange and to the necessity for maintaining a 25 per cent gold reserve in Canada. I desire to express the view that on no account should the Board of a Central Bank, (upon whose wisdom in making investments the integrity of the Canadian currency would depend), be empowered to reduce the gold reserves of the Bank in Canada to a point below 25 per cent of its liabilities. By possibility, under such a power as is proposed of carrying foreign exchange as cash reserves, Canada might be stripped of all her gold reserves and sustain a very heavy loss in replenishing such reserves or in realizing such exchange, as did many Central and other banks when Britain and United States departed from the gold standard.

I earnestly trust that a Central Bank for Canada (if one is established) shall not be entrusted with the management of an Exchange Equalization or Stabilization Fund. The risk of loss to the Government in the operations of such a fund, no matter how skilful its management, must necessarily be very great in a period when the range of fluctuations in the relative value of world currencies cannot be foreseen not only by reason of the incalculable economic factors involved but also by reason of the uncertain and undeterminable factor of the constantly changing policy of foreign governments in respect of their currencies. It is also my view that a Central Bank for Canada should not be empowered, except with the approval of Parliament, to enter into agreements with other central banks which would undoubtedly, on account of their greater experience and wide sources of information, possess decided advantage in the negotiation of such agreements.

There is one observation which I feel I should make in concluding this Memorandum. The determination of the question of the advisability of the establishment of a Central Bank for Canada lies with the Government and Parliament of Canada. There may be considerations of policy relating to the promotion of intra-Imperial and international trade which may materially influence that determination of which the members of our Commission have and can have no immediate knowledge. We are not legislators. We make our recommendations and set out the reasons therefor upon the evidence adduced before us and having regard to our individual views of existing conditions in the hope that our Report may be of assistance to the Government and Parliament in dealing with the many important and perplexing questions which have formed the subject of our deliberations as Commissioners. It is with this conception of our duty and in this hope that all the members of the Commission have conscientiously and diligently applied themselves to the task assigned to them under the terms of our reference.

W. T. WHITE

OTTAWA, October 3, 1933.

MEMORANDUM

By HON. J. E. BROWNLEE

I have signed the Report of the Commission, without reservation other than my dissent from the recommendation of the majority of the Commissioners with reference to rates of interest on loans, Bank Act, section 91 (1) as stated in paragraph 253. I desire, however, to add some observations with respect to certain topics referred to in Chapter VII; to express my dissent from one recommendation with respect to the suggested constitution of a central bank as set out in Appendix I and to express briefly my views on one subject not considered in the Report.

1. Chapter VII

(a) *Rates of Interest on Loans to Provincial Governments, Municipalities and School Boards.*

While I do not dissent from the observations of the Commission on this topic, I feel consideration should be given to the complaint freely expressed to the Commission in Western Canada of the discrimination between the rates of interest charged on loans to Provincial Governments, Municipalities and School Boards in the Western Provinces, as contrasted with rates on similar loans in Eastern Canada. The evidence is clear that the rates on such loans are from ¼ to ½ per cent higher in Western than in Eastern Canada. The reason given by the banks is that rates of interest must bear a relationship to the risks involved. It has also been suggested that the relative value placed on the bonds of the Western as compared with the Eastern Provinces by the investing public is a factor to be taken into consideration. On the other hand, it is clear from the evidence of the representatives of the Western subsection of the Canadian Bankers' Association in Winnipeg, that the Provinces in Western Canada may now be regarded as settled communities; that, despite adverse crop condi[illegible] in some areas, no losses have been sustained by the banks on loans of [illegible] nature and that the number of defaults by municipalities on their public obligations has not been large in contrast to other parts of Canada. It can hardly be argued that the cost of operation with respect to such loans is higher than in the Eastern Provinces. I think it may be argued that the attitude of the investor in public bonds is influenced in no small measure by the lead given by large loaning bodies such as the chartered banks. This is a matter, of course, that cannot be dealt with by legislation, but I desire to express my conviction that a very constructive step would be taken not only in removing the sense of unfairness that undoubtedly exists but also in assisting the general economic development of the West to the benefit of all Canada, if the banks could give a lead in expressing their confidence in the security and stability of the Western Provinces by placing the rates of interest on loans to public bodies on a basis uniform with those in other Provinces.

(b) *Bank Profits.*

Our Report on this topic has of necessity been based largely on data supplied by the banks. Any other information available to us has not disclosed that the banks have paid excessive dividends to their shareholders. It may be argued, however, that figures based on a ten-year average of earnings of all the banks compared with an average over a similar period of the investment of the shareholders may not be the most accurate method of approach. The

publication annually of a dividend rate based on the original par value of shares has no doubt been the cause of any existing feeling that excessive dividends have been paid. I therefore suggest that the Department of Finance or the Inspector-General might compile a more complete analysis of the earnings of typical banks for the benefit of the Standing Committee on Banking and Commerce for the purpose of more fully allaying any public apprehension.

(c) *Bank Directorates.*

I desire to add a brief comment to our Report on this topic. Although protest was voiced at several of our hearings against the extent to which bank directors are directors of other corporations, no practical suggestion was offered as to how any limitation might be effected. I have been unable to see how, by legislation, Parliament could differentiate between corporations so as to say that bank directors should not be directors of a certain class. In any event, the formation of a central bank to exercise the purposes proposed in our Report would do much to allay a very considerable amount of public apprehension on this subject.

2. Suggested Constitution of a Canadian Central Bank

In Appendix I it is suggested (a) that the capital of the central bank should be $5,000,000 offered for public subscription, and (b) that the first Governor, Deputy Governors and Directors should be appointed by the Governor General in Council, and that future appointments of the Governor and Deputy Governors should be subject to the approval of the Governor General in Council. This implies that future appointments of Directors and chief executive officers should be made by the shareholders subject to the approval aforesaid.

I dissent from this suggestion and recommend that the capital be subscribed by the Government of Canada, and that all directors and executive officers be appointed by that Government, each appointment to be for a fixed number of years.

The source of capital is in itself of little significance. The control of the bank is of great significance. The election of directors by private shareholders means private control, and notwithstanding the limitation of the rate of dividends, this control might place earning capacity as a first consideration. The only reason advanced in favour of private, as against national, control is the fear of political influence. I am not impressed by this argument. I believe the selection of directors and executive officials by a Government would be as wise as that of a body of shareholders, the majority of whom might vote by proxy. It is admitted that the State must ultimately retain sovereignty in matters affecting currency. Emphasis is placed upon the necessity of close accord between the bank and the Government in all that pertains to the external value of the country's currency. The primary purposes of a central bank are, in paragraph 206 of the Report, defined to be the regulation of the currency in the best interests of the State, and by wise and timely co-operation with similar institutions in other countries to mitigate as far as possible fluctuations in the general level of economic activity.

In times of stress the policies of the State must prevail, whatever may be the constitution of such a bank. In normal times I am of the opinion that the function of the Governor, Deputy Governors and Board in carrying on all the functions of such a bank would not suffer as a result of appointment by the Government. It is suggested, in the plan in the Appendix that the Government should exercise partial authority in the selection of the executive officers of the bank. In my judgment it should exercise full authority.

3. Exchange

As stated in our Introductory Chapter, our terms of reference are very wide and might be deemed to include many topics of public interest. We decided "to take a more moderate view of the duty entrusted to us and have considered it rather to be our task to enter upon the field of these large topics only insofar as they affect and are affected by the more specific subject of our study, namely, the banking and currency systems of Canada." The fact that our inquiry was carried on at a time of rapid changes in the exchange value of the Canadian dollar in relation to the American dollar and the British pound sterling, and the uncertainty as to what further changes may result from policies adopted or about to be adopted in other countries, makes it inadvisable to attempt, for example, to express any opinion on such a subject as a Canadian policy of exchange, which otherwise I would have personally desired to consider. I feel it my duty, however, to comment briefly on certain representations made at our hearings on a subject which I feel is within the view we have taken of our task.

4. Interest Rates

At our hearings in every province of Canada the feeling was expressed by witnesses representing Provincial Governments, municipal bodies as well as many branches of industry in Canada, that interest rates were high and should be lowered. It is not my purpose to express any opinion as to whether interest rates on loans are high in comparison with the present interest rates on deposits. I do suggest that interest rates on deposits should be further reduced in order that reduced rates of interest on loans might result. The following extract appears in the Report of the Committee on Monetary and Financial Questions to the Imperial Economic Conference at Ottawa in 1932:—

> "In the monetary sphere the primary line of action towards a rise in prices should be the creation and maintenance, within the limits of sound finance of such conditions as will assist in the revival of enterprise and trade. Among these conditions are low rates of interest and an abundance of short term money."

It would seem clear there is no dearth of money in Canada awaiting investment, but it is suggested there is no demand for loans. I do not consider th[illegible] comprehensive reply. While admitting that, under present conditions, t[illegible]s little private initiative in expanding industrial activity, and that recovery in general business is largely dependent on the psychology of the people, there is nevertheless a wide field in which lower interest rates would prove a benefit. Lowering of interest rates on deposits would lead to a lowering of rates on the higher grade of bonds, both public and private, by leading depositors to seek more remunerative fields of investment and thus facilitate the refunding operations at lower rates of interest of both governmental authorities and industrial bodies. Annual carrying charges would thus be reduced. It should result in a reduction of rates on current loans, thus relieving the burden of all governmental authorities, Dominion, Provincial and Municipal. It should result in a general reduction of rates of interest that should permeate every phase of industrial and private enterprise and should thus result in some decided stimulus to a revival of business.

J. E. BROWNLEE.

Ottawa,
September 28, 1933.

MEMORANDUM OF DISSENT

By Mr. BEAUDRY LEMAN

In formulating the reasons for my dissent from certain arguments and conclusions embodied in our Report, I am deeply conscious of two main disabilities. It will undoubtedly be considered presumptuous that I should express opinions at variance with those of my colleagues, and particularly of the eminent and experienced gentlemen from Great Britain, who have been requested to study our Canadian financial problems and to advise the Dominion Government in regard to their solution. Furthermore, it is but natural to expect that my observations will be interpreted as having been influenced by my connection with banking affairs.

Notwithstanding the embarrassing situation in which I unwillingly have been placed, I must, in the discharge of the duty thrust upon me, state my conviction that:—

(1) The time is inopportune for organizing a central bank in Canada because: (*a*) In a time of great economic difficulties the authority of Governmental bodies carries more force if exercised directly and in co-operation with the financial institutions of a country. The division of forces, incidental to the establishment of another expensive mechanism, will not bring to the Canadian monetary and financial system additional wealth or capital, but will divest the State of some of the powers it now exercises, and will diminish the strength of the existing institutions. (*b*) It is difficult to conceive how and to what extent, under present conditions, a monetary system can be placed beyond political influence. In Great Britain, the Government, and not the Bank of England, provided the funds to establish and operate the "equalization fund" in which some seventeen hundred millions of dollars are now involved; in the United States the provisions of the statutes governing the activities of the Federal Reserve Banks have been profoundly altered, this year, to conform with the policies and exigencies of the Government of the United States; in France, only last year, Parliament voted some ninety millions of dollars to guarantee the losses sustained by the Bank of France in pursuance of the instructions issued by the Government of France to the effect that credit balances were not to be withdrawn from Great Britain; these instances of what is happening in the wealthiest and most powerful countries in the world, each provided with a central bank, should offer sufficient evidence as to what must inevitably happen in countries of lesser financial importance. (*c*) In the realm of monetary and financial policies the world is presently in a state of flux, and therefore it behooves Canada to proceed cautiously and to await developments which might well necessitate fundamental changes in regard not only to the superstructure but to the very foundations of a central bank.

(2) Under existing conditions, the Parliament of Canada should not proceed to enact legislation establishing a central bank, because: (*a*) Under the British North America Act of 1867 this Dominion was organized as a federation of provinces on the basis of a decentralization of legislative powers, as set forth in paragraph No. 178 of our Report. Matters of banking and currency on the one hand, and of property and civil rights on the other hand, are interpenetrating and overlapping. I disclaim any qualification whatsoever to even discuss these intricate constitutional problems, but do strongly urge that they be carefully studied and defined before Canada embarks on a long voyage over an uncharted route. (*b*) Regardless of the constitutional aspects of the question,

if a central bank is to be a co-ordinating agency in this country it would seem indispensable to ascertain beforehand that such an institution would be assured of the goodwill and co-operation of each and every one of the Provinces of Canada. Before a central bank can hope to speak with one voice on behalf of Canada, it would seem desirable that it should have authority to express the views not only of the Dominion Government but also those of all the Provinces.

(3) Certain features of the suggested constitution of a central bank for Canada, should one be established ultimately, appear unacceptable and do not afford sufficient safeguards in regard to currency and monetary matters: *(a)* In addition to minor objections to a number of clauses, notably to clause No. 8, which fails to differentiate 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, I do take strong exception to clause No. 13, which states that: "The bank should maintain a proportion of 25 per cent in gold and foreign exchange against its outstanding note issue and sight liabilities." This clause makes no provision for the holding by the bank of a minimum amount of gold, or of a minimum percentage of gold against liabilities, nor does it even provide that the foreign exchange held by the bank should be convertible into gold. It will be argued that the Governors and Directors of the central bank would exercise their authority with prudence, skill and discretion, and that, in practice, sufficient gold would be held in reserve; and that a judicious choice would be made of the foreign exchange held by the central bank. The clause appears all the more surprising at a time when no one can have forgotten what befell the sterling, French franc and United States dollar exchange. Shall the currency of Canada be exposed to the uncertainties which might arise from possible errors of judgment on the part of the central bank? Can we be so sanguine as to hope that those who will guide the central bank and determine its policies will be men of such calibre that they will be at all times above human frailty, and will outclass in ability and foresight the bankers now at the head of the oldest and most powerful central banking institutions in the world? *(b)* Paragraph No. 207 of our Report acknowledges that the State "must necessarily retain ultimate sovereignty in matters affecting the currency," and I find it difficult to reconcile this fundamental consideration with the power proposed to be given to the central bank under clause No. 13. Surely the Parliament of Canada would not confer upon any organization, much less one privately owned, the right, implied in this clause, to strip this country bare of every ounce or dollar of gold and ship it abroad, holding in exchange, as the sole backing of the currency of Canada and as the bulk of its cash reserves, a claim on some inconvertible outside or foreign currency. The mere suggestion that such a situation might develop would be more than enough to wreck the credit standing of this country and undermine the confidence which long years of faithful and sound banking have brought to Canadian institutions, both public and private.

(4) Sufficient stress has not been laid upon the factors of national recovery, far more dependable and permanent than the temporary advantages of export trade of raw-materials or foodstuffs. Outside markets for our surplus specialized production of certain commodities should unquestionably be sought, but it should always be borne in mind that world markets are unreliable and a source of constantly recurring disappointments. Rightly or wrongly, but as a matter of fact, the countries of the world are economically becoming more and more nationalistic. Are we to await the belated results of international conferences between bankers, that may or may not, in the near or remote future, restore international exchanges and trade, or shall we endeavour to build up as rapidly and as soundly as possible our own domestic market? Paragraphs Nos. 243 and 244 should be read and studied in the light of the effect that world prices have had on the value of field crops.

(5) Measures calculated to develop intra-Imperial co-operation or Imperial monetary co-operation, as set forth in paragraph No. 211, should not be developed beyond the scope of providing ample facilities for the interchange of goods and services, unless the people of Canada understand and decide, 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.

(6) The criticism will doubtless be offered that the foregoing observations are limited to reservations of a negative nature and do not contain suggestions of a constructive character. It should, however, be borne in mind that the Government of Canada sought recommendations from a group of men, formed into a commission, and not from its individual members.

Respectfully submitted,

BEAUDRY LEMAN.

OTTAWA,
September 27, 1933.