The History of the Bank of Canada

This article provides a history of the Bank of Canada, and examines in detail three key events that have radically changed Canada's fiscal position.

To begin with, the article presents the historical context of the Bank of Canada and why it was created. The key dates we examine are 1934, 1938, and finally, 1974.

It is important to note, that prior to the 1930s, Canada had no reason to create a central bank. At this time, the banking system in Canada had been comprised of several large private banks, many of which issued their own currency.

The banking system was sufficient and supplied the needs of Canadians up until the Great Depression in 1929.

Bank of Canada – 1934

The great depression devastated Canada for much of the 1930's. At this time, hundreds of American banks had failed, yet none of the Canadian banks had failed during this time. However, there had been a huge strain on the Canadian economy because there was a contraction in the money supply, as much as 27%.

As a result of this contraction, people were not able to receive access to loans, businesses were not able to expand, and at the same time more people were seeking jobs. The intense competition in the labour market drove down the price of wages.

This period of high unemployment and economic instability forced many Canadians to question the cause of the great depression.

Canadian Jerry McGeer – a popular advocate on monetary reform – claimed that the policies of the Canadian banks had been responsible for the effects Canada felt due to the great depression.

One of the reasons McGeer, and a vast majority of other Canadians, had held the banks responsible for the great depression had been because of the failure of the Finance Act in 1923. The act granted upon the Department of Finance the power to advance dominion notes (i.e. cash reserves) to banks upon pledge of securities. The Finance Act was originally created in order to protect Canadians from situations similar to the great depression, by allowing the Department of Finance to control the cash reserves of the Canadian banks.

With the failure of the act, many Canadians wanted something to protect them from the great depression.

In accordance with the majority of Canadians, the Prime Minister of the day Richard Bedford Bennett called for a **Royal Commission** in 1933 in order to determine the cause of the recession.

The Royal Commission has historically been used in Canada as a major public inquiry in order to investigate the issue that is under study. In this case, it was on matters of banking and finance.

Bennett steered the Royal Commission to examine the current banking system in Canada and Bennett also wanted the Commission to consider the arguments for and against a central bank.

When Bennett had issued for a Royal Commission on the matter, he said;

The organization and working of our entire banking and monetary system [and] to consider the arguments for or against a central banking institution.

And in the summer of 1933, the Royal Commission issued its report titled The Royal Commission on Banking and Currency in Canada which examined the arguments, as well as investigating the underlying causes of the great depression.

Below is a list of the members that had been part of the Royal Commission

1. Lord Macmillian – Former Chairman of British Macmillian Commission, also a British Jurist
2. Sir Charles Addis – A reputable British International Banker
3. Sir Thomas White – Canadian Finance Minister During WW1
4. J.E. Brownlee – Prime Minister of Alberta

5. Beaudry Leman – General Manager of the Banque Canadienne Nationale

The Royal Commission recommended the creation of a Central Bank.
Not long after, Bennett followed the report's recommendation and established the Bank of Canada Act in 1934.

Bank of Canada Act – 1934

The creation of the Bank of Canada Act in 1934 proposed several key changes to the then banking policies.
Among the changes were;

- The Central bank (Bank of Canada) must keep 25% of their reserves in gold
- The Bank of Canada (BoC) had the right to ***issue notes***
- The Chartered banks had to retire their note issues (money they created)
- The BOC's mandate was to act as the banker to the government and manage public debt

- The Commercial banks had to keep at least 5% in reserves with the BOC either in the form of deposits or central bank notes
- The creation of the Bank of Canada Act ultimately led to the creation of the Bank of Canada itself in 1935 as a private central bank.

The idea of a private Central bank however, was strongly opposed by several key individuals of the 1930s.
Among them was Canada's 10th prime minister William Lyon Mackenzie King who amended the Bank of Canada Act in 1938 which led to the nationalization of the Bank of Canada.

Bank of Canada – 1938

One of the key individuals to influence King's decision to nationalize the BOC was his advisor Gerry McGeer, a major proponent for the nationalization of the central bank.
King's decision to nationalize the BoC demonstrated remarkable foresight as he understood that the key to a stable and debt-free economy was to have government control of currency and credit.
It was Mackenzie King himself who had once said,
Once a nation parts with the control of its currency and credit, it matters not who makes the nations laws. Usury, once in control, will wreck any nation. Until the control of the issue of currency and credit is restored to government and recognized as its most sacred responsibility, all talk of sovereignty of parliament and of democracy is idle and futile.

For many decades since 1938, the Bank of Canada provided near interest free loans to the Canadian government.

As a result of these loans, Canada had increasingly become prosperous and developed quite substantially, with the money created being used to build highways such as the McDonald-Cartier freeway, public transportation systems, subway lines, airports, the St. Lawrence Seaway, funding the universal healthcare system, and the Canadian Pension Plan.

The effects of King's decision would last all the way until 1974, when the Trudeau government made the decision to halt the borrowing of money from the Bank of Canada, and instead, choosing to borrow from the private banks at compounded interest.

Bank of Canada – 1974

There are two major explanations why the Trudeau government decided to stop borrowing money from the Bank of Canada, and instead choosing to borrow from the private banks.

These include:

- Popular Public Opinion by Canadians, of the Crisis in the mid-1970s
- International Basel Committee's Recommendations

In the first explanation, the public in the mid-1970s Canada was facing an oil crisis along with many of the other nations in the west.

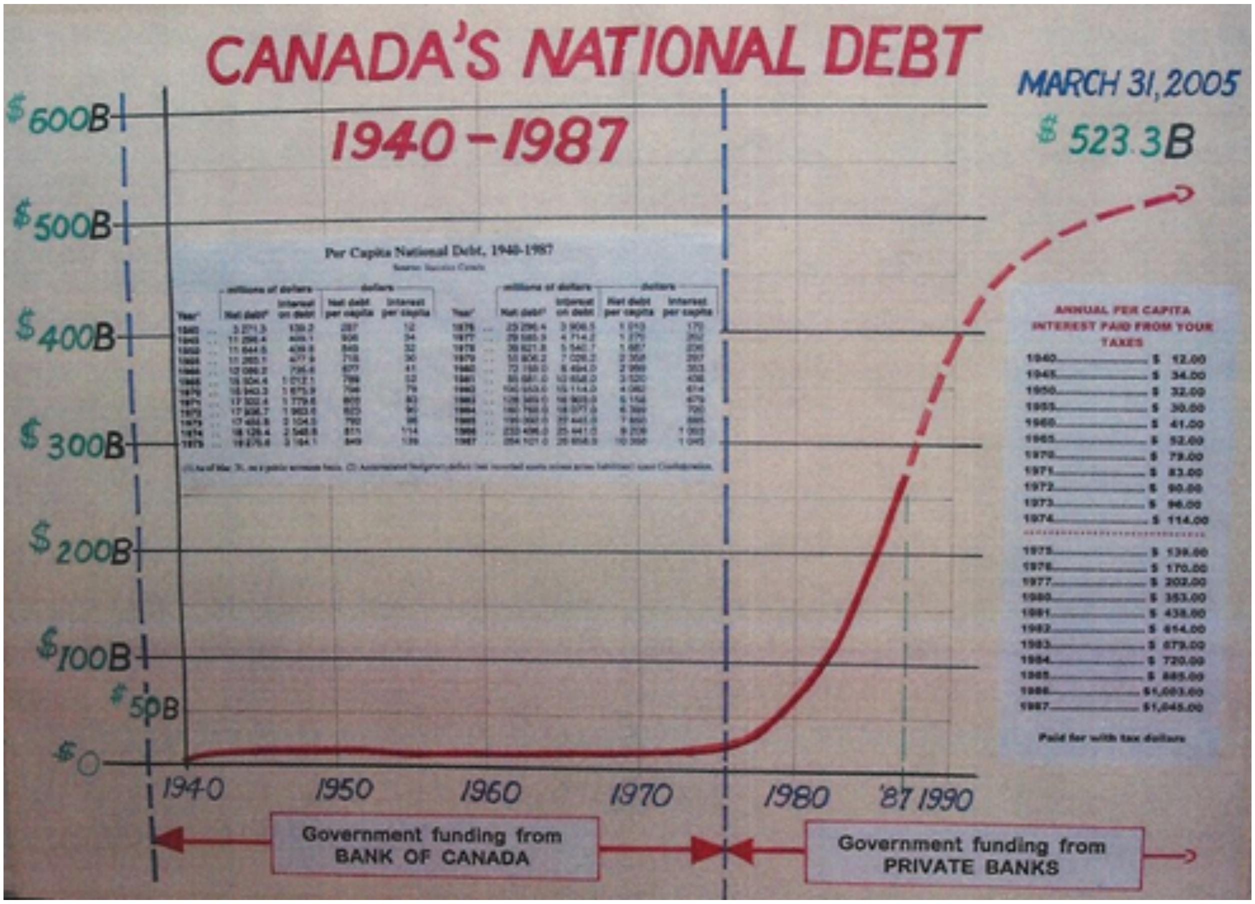
The public misattributed the economic effects of ***stagflation*** as having been created out of the Bank of Canada. This stagflation had little to do with the Bank of Canada and more to do with the rising prices of energy as well as the stagnation of wages.

In fact, the energy crisis that gripped Canada's economy had much to do with the Oil and Petroleum Exporting Countries (OPEC) oil embargo. The OPEC's oil embargo resulted in the quadrupling in the price of oil and the cost of this increase required Canadians to spend more of their income on energy. The rise in oil prices had also been accompanied by an increase in the unemployment rate as new and existing workers were seeking more jobs to pay for the increase in the price of goods. The increase in unemployment naturally drove down the cost of wages since competition in the labour market was fierce.

In addressing the second explanation, the government borrowed from private banks based on the recommendations of the Basel Committee. The Basel Committee is an international think-tank type of organization that is

composed of the central bank governors of the G-10 countries.
A prime objective of the Basel Committee had been to maintain monetary and financial stability. To achieve this goal, the Committee had **discouraged governments from borrowing money from their respective central bank and instead, encouraged governments to borrow money from the private banks.**
The Committee's rationale had been that borrowing money from the central banks would create inflationary pressures and cause the value of the currency to drop.
Previous finance minister **Paul Martin** has agreed with the Basel Committee's view of the Bank of Canada as a cause of inflation. During an interview in the **documentary movie Oh Canada: Our Bought and Sold Out Land!** Paul Martin claimed that printing interest-free money would "drive inflation through the roof".
Regardless of which explanation is used, we can see clearly that Canada's net debt rose significantly beginning in 1974.
It was at this time that the Government had borrowed from private banks. The growth of Canada's national debt is indicated below.

From the graph, one can see that after 1975, **Canadian federal debt grew for the next 12 years at more than 20 percent per year.** Currently, Canada's national debt stands over $1.1 trillion and taxpayers are forced to pay over $30 billion in interest on the debt every year.



Thus as one can see, the **private banking system has been a prime facilitator in the indebtedness** Canada is currently in.

Conclusion

It is inevitable, based on how the money system operates as indicated in Part 2 of the series, that more and more money will have to be spent to pay the interest of the net debt.

This leads to a situation where governments have less money to spend on education, infrastructure, and social programs and as a result, leads them to implement ineffective tax cuts and austerity measures in order to save money.

To address Canada’s economic health, many prominent academics have begun to speak up on the issue calling for monetary reform. We address these leaders in part 4.