The Depression

"No glory in being head of a bank"

LAVOY, ALBERTA, WAS NO BANKER'S PARADISE IN THE DEPRESSION. A DECADE before, when it opened, the Lavoy branch might have offered an ambitious young banker a promising first managership. The Royal Bank opened more branches – a neat one hundred – in 1919 than in any other year in its history. Lavoy, a grain-elevator stop 130 kilometres east of Edmonton on the Canadian National, was one of them. For the hardy Ukrainian immigrants who had settled around it, Lavoy was similarly a land of promise. But by 1931, Lavoy was a financial ghost town.

For Sam Halton, the manager in Lavoy since 1930, life in the branch was dreary and depressing. With $30,000 in bad debts on the books, customers seldom darkened his door. From ten in the morning, when the branch opened, until the three-o'clock closing, Halton and his junior, Norm Stewart, marked time. Only on Saturdays and during the crop-moving season did the pulse of business quicken slightly. Loan demand was moribund, and the dead hand of the Depression lay on deposits. On many days, Halton balanced the books long before closing time, knowing that there would be no more business that day.

The real banking day began when the branch closed, and Halton and Stewart headed out of town in the manager's Chevy. "We buy a lot of gasoline for our managers," General Manager Morris Wilson told the Royal Commission on Banking and Currency two years later.[1] Lavoy was no exception. Halton would bump along the back roads, pulling into the yards of farmers who owed money to the Royal Bank. Stewart vividly recalled the nervous encounters that followed. Against a backdrop of rural poverty – "apple boxes for furniture," he remembered – Halton engaged in broken half-Ukrainian, half-English conversations that touched on everything but the farmer's financial

Sam and Dorothy Halton stand proudly in front of their new Chevy, shortly after Halton took up the Lavoy managership in 1930. Drought crippled Lavoy.

condition. "How are the kids?" "Does the crop look any better this year?" Despite his suspicion that there were small caches of money buried behind the shed or under the floorboards, Halton could not bring himself to demand any form of payment. There seemed little point in seizing cattle or tractors, as Section 88 of the Bank Act allowed him to do. The Depression made them virtually unsaleable, and Sam Halton was too humane a man to force the issue. Back at the branch each evening, he would duly enter a cryptic report of his visit – such as "we appear to have his goodwill" – in his loans ledger.

Neither Lavoy nor Halton were to remain long in the Royal Bank fold. When Sam had returned from the First World War, he had hurried to take up the tellership the Union Bank of Canada offered him in Pincher Creek. British-born, he had first "gone banking" in 1913. Banking offered him a future in his new country. In 1925, the Royal–Union merger gave him a new employer.[2] His daughter remembers him as a man who was "born to bank," but the Depression crushed Sam Halton's enthusiasm for his profession. In the 1920s, banking had given him prestige and a sense of purpose in small prairie towns; now he found himself vilified, a creditor rather than a giver of credit. Prairie managers were, for instance, instructed to scrape the gold letters that advertised the size of the bank's assets off their branch windows. What had provided customers with an assurance of stability in the 1920s, now smacked of excess and bred distrust. Sam's brother, Matthew, had opted for a career in the fledgling broadcasting industry, and would soon win fame as a foreign correspondent for the CBC. Sam must have reflected on the irony of this; by the mid-1930s the airwaves of Alberta were crackling with condemnations of the banks and of the eastern "big shots" who ran them.

Despite the radio talk of bank profits, however, Lavoy made a meagre profit of $1,256 in 1931, and in May of the next year head office instructed Halton to close the branch. He was posted to nearby Holden, and then to Edmonton, but his zest for banking was gone. In 1935, the Calgary supervisor concluded that "there did not appear to be much future for him in banking" and requested his resignation. With a retirement allowance of a year's salary in his pocket, Halton joined an oil company. He never relished the work, and died two years later, a broken man. For Norm Stewart, the future was rosier. He was transferred to Bellevue when Lavoy closed and went

Lavoy, Alberta, branch, opened 1919, closed 1932.

on to help pioneer the bank's stake in the oil patch in the 1950s.[3]

Sam Halton's agonies were largely a private matter, poignant to his family but unremembered elsewhere. It was left to another Royal Banker to give Canadians their most enduring literary remembrance of the "dirty thirties." Like Halton, Sinclair Ross came to the Royal Bank as a result of the 1925 Union Bank merger. He began as a junior in Abbey, Saskatchewan, in 1924 and served across rural Saskatchewan through the Depression. By day he was a banker, but in the evenings he became a writer. In 1941, his first novel, *As for Me and My House*, appeared.[4] It is not about banking; it is instead an evocation of the emotional desolation of small-town prairie life in the grip of drought and depression. If prairie towns had central figures, they were invariably ministers, bank managers, or station and elevator agents. Ross chose the local minister. He called his town Horizon; it could have been Halton's Lavoy, or Eyebrow, or Didsbury, or any one of the hundreds of towns where the Royal Bank had positioned itself to help build the West. In each of these communities, the Depression tested not only men's bank balances but also their souls.

The Depression was not just a Prairie phenomenon. It reached, for instance, thousands of kilometres east into the office of the prime minister. In 1930, R. B. Bennett, former Royal Bank director and solicitor and still-prominent shareholder, had vanquished Mackenzie King and the Liberals with promises of protectionism and special relief from the hard times that had engulfed the country. If the banks thought that they had a friend in Ottawa, they were quickly disabused of the notion. From his caucus, constituents, and Canadians at large, Bennett had daily reminders that something was amiss in the world of Canadian banking. "It is idle to expect any member of Parliament or Canadian citizen for that matter," he bluntly told the president of the CBA in 1933, "to justify some of the acts of the banks in driving customers to the wall who are unable to liquidate their liabilities under existing circumstances."[5] When a Saskatchewan MP told the prime minister that the Royal Bank manager in Borden was "simply taking the shirts off the backs of the people" by exercising his Section 88 prerogatives, Bennett warned the bank's head office that such incidents fed political radicalism – "the nourishment upon which the Woodsworth faction feeds."[6] When, in 1933, J. S. Woodsworth and his allies established the Co-operative Commonwealth Federation – the forerunner of today's NDP – they gave prominence in their manifesto to a demand for the nationalization of banks. Morris Wilson was obliged to acknowledge that "certain managers did go too far" and instructed his prairie supervisors not to give "justifiable cause for complaint."[7] Clearly, not every Royal Banker had the sensitivity of a

Sam Halton. Loan collectors and inspectors sent out by regional offices often descended on small-town branches intent on shaking out loan payments that the local manager knew were unshakable. The old trusting bond between manager and townsfolk was thus broken, and bad blood was left in its place.

The credibility of Canadian banking sagged elsewhere as well; loans were written off in downtown Toronto, managers presided over dormant branches in Cape Breton, and even at head office the hard times reverberated – staff defalcations jumped dramatically. As commodity prices tumbled and protectionism strangled world trade, the international system began to falter. In Cuba, political turmoil complicated the situation. As President Machado's reformist zeal succumbed to political corruption, nationalist ferment grew in Cuba. Foreign banks offered an inviting symbol of the island's woes; in 1931 a "heavy bomb" blew the doors off the bank's Havana main branch.[8] A year later, the staff at São Paulo branch in Brazil were caught behind the barricades when the state rose in insurrection.[9] The Spanish Civil War engulfed Barcelona branch in 1936; the bank pulled out all but two of the Canadians on staff, leaving the manager, H. L. Gagnon, to live out three hellish years of dive-bombing and street fighting. When asked what had sustained him through the ordeal, the Nova Scotia-born Gagnon replied: "Sam Slick's formula: human nature and soft sawder – we worked wonders."[10]

Despite all the trauma inflicted on its customers and staff by the Depression, Canadian banking survived. Unlike the United States, where banks fell like bowling pins, there was not a single bank failure in Canada's Depression. The American banking system, dominated by small regional banks, was obliged to take a "holiday," to close down completely in early 1933 and to endure a dose of stiff reform in the Glass–Steagall Act. Canada's "big banks" survived because they were big; they wobbled but they did not topple. The system entered the 1930s broad and stable enough to absorb even the most brutal of regional reverses – but only just. Yet, as the system creaked from Lavoy to Havana in the early 1930s, Canadian bankers were astute enough to know that change was in the wind, that the time had come for a little of Sam Slick's "soft sawder" to be applied to the national banking system. They were reluctant converts, the Royal Bank being perhaps a little less reluctant than others. There was grudging recognition that the time for the central bank that Edson Pease had proposed in 1918 had finally come. Slowly, but only slowly, it came to be realized that the banks were not in a position to manage the monetary system, that a central bank was needed for this, and that without a central bank, the banking system, for reasons of sheer survival, would always sharply restrict credit in tough times. Their own survival would come first.

When Bennett created a Royal Commission on Banking and Currency in July 1933, the bankers' first instinct was to have CBA president J. A. McLeod of the Bank of Nova Scotia present a historical sketch of Canadian banking to remind the commissioners that Canadian banking was "extremely strong and singularly flexible."[11] Even in the face of its severest test, Canadian banking instinctively stuck to the gradualism that had served it so well since the first Bank Act was passed in 1870. But, if they had only tinkered with the act in earlier revisions, bankers were soon obliged by a sceptical public in the 1930s to make some major structural renovations.

The Royal Bank of 1939 showed the ravages of the Depression. It had shed over two hundred branches and seen its staff decline from 8,784 to 7,016. Its assets, having peaked in 1929 at a billion dollars, sagged as low as $729 million in 1933 and only recovered the billion mark in 1939. By decade's end, the Royal Bank was still Canada's largest bank, but its primacy had been eclipsed by the Bank of Montreal in the years from 1932 to 1935. Similarly, profits slid from their 1929 high of $7.1 million and languished between $3 and $4 million through the decade. An 8 per cent dividend was maintained – reasonable, but lower than the 12-per-cent-plus-2-per-cent bonus that prevailed in the "roaring twenties." The bank's statistical shifts in the decade were hardly out of keeping with the national trends in banking. What was fundamentally different by 1939 was the relationship of all the Canadian banks with the country's fledgling central bank. By 1935, the private banking system found itself working in partnership with an independent and active central bank in the setting of national credit, rather than with a passive and directionless Finance Act. The gold standard was really dead and the banks' power to issue their own notes was fast expiring. The Bank of Canada now set the conditions of the money market, and the federal government was experimenting with ways to use the banking system to stimulate the economy into recovery.

For the Royal Bank, as for many others, the first hint of depression had come with the news of drought in the West in the summer of 1929. Managers in Saskatchewan and Alberta began reporting that loans made for spring seeding were in jeopardy as the parched soil destroyed crops. The stock-market crash of October created a whirlwind of rumours about the Royal in the east. The Toronto tabloid *Hush* began spreading the rumour that a prominent Toronto client, the brokerage firm of Solloway Mills & Co., was guilty of "bucketing" –

Stock Market Tips

Cartoon by C. Fleming

BEWARE OF THE BULL
A risky support on a narrow margin.

Belated advice: A cartoon in the Royal Bank Magazine *of May 1930* speculating in marginal stocks – and that the bank was suffering heavy losses as a result. Morris Wilson in Montreal quickly moved to squelch such rumours by assuring his managers that "not one dollar has been lost by the bank through stock loans during the recent panic."[12]

In its public pronouncements the bank had initially sought to portray the economic downturn as simply "a breathing spell in the long-term trend of expansion and constructive development" of Canada. Throughout the 1920s, the bank had championed an economic strategy for Canada based on aggressive trade and vigorous exploitation of natural resources. Bank presidents traditionally played the role of national confidence-boosters. Every year Sir Herbert Holt had used his annual-meeting address to extol the latest increases in mineral, forest, and farm production. For him, this "nationalism" entailed an open-immigration policy and open access to the American market. The events of 1929 and the onset of protectionism undermined this whole outlook. None the less, the bank persisted in viewing the hard times as an aberration, a moderate recession, as Holt told the shareholders, brought on by the speculative enthusiasm of the late 1920s. "Prudence and conservatism" were the order of the day. Again and again in the early Depression, bank officers called for the nation to return to what they perceived as the fundamentals of national economic life: a balanced budget, reduced taxes, and orderly marketing. Wasteful competition between the CPR and the CNR must, for instance, be eradicated by the creation of one railway. Above all else, Canada must begin with the "exorcising of the spirit of extreme nationalism" in trade. Well into the Depression, the Royal Bank remained committed to these "corrective forces."[13]

A more anxious mood prevailed in the bank's executive offices. Behind closed doors along the walnut-panelled corridors of 360 St. James, a handful of the Royal Bank's most senior men wrestled with matters that struck at the very heart of the bank. The thick, red carpets outside their doors muffled any report of their conversations long before they might have reached the street below. The fact was that what *Hush* gossiped about and what Prime Minister Bennett suspected was true: the Royal Bank technically tottered on the brink of insolvency throughout 1932-33. If there was a miracle for the Royal Bank in the Depression, it was that the knowledge of its precarious financial state in the early 1930s never became known outside 360 St. James. The mortal blow to confidence that public disclosure might have brought was never landed.

Bankers had no inside track on understanding the Depression. Like other Canadians, they had experienced nothing that would have prepared them for its severity and persistence. There had been other economic slumps – like that of 1913-14 – which had etched themselves into the Canadian psyche, but the Great Depression quickly pushed aside all that had gone before. It rolled unevenly across the country, hitting first the regions most exposed to slumping commodity markets and then creeping into the more protected industrial heartland of central Canada. Nobody knew where it would end, how deeply it would erode the national economy. The decline was at its worst from 1929 to the spring of 1933. Unemployment peaked at 32 per cent in the bleak winter of 1932-33. The gross national product contracted by an astounding one-third. The price of wheat plunged 53 per cent in 1933 alone. Auto production dropped 75 per cent in the same years. Base-metal mining slumped, leaving the boom towns of the "roaring twenties" virtual ghost towns. Only gold sparkled; precious metals seemed an elixir for insecurity. Immigration, the traditional feedstock of Canadian growth, dried up. With demand moribund, the cost of living shrunk by 23 per cent by 1933 as deflation took its toll.[14]

Two forces unleashed by the Depression pushed the bank toward the brink: a dangerous accumulation of bad debts and the stifling effects of tight money across the country. Drought and plummeting prices for Canada's export commodities provided the first jolt. The problems of western farmers contending with a faltering wheat economy were just the most visible symptom. In the east, for instance, the mammoth pulp-and-paper industry that Holt and Gundy had built up vigorously in the 1920s suddenly found itself facing slumping prices, huge overcapacity, and a surly mood of protectionism in its principal market, the United States. And the bills were coming due, as companies like Holt's Canada Power and Paper struggled to service a mountain of funded debt.

Declining commodity demand placed the Royal Bank in global double jeopardy. The crown jewel of its international system, Cuba, lived and died on the fortunes of sugar. The sugar crash of 1920 had already dragged the bank deeper into Cuban sugar than any bank would have ever normally tolerated. The so-called "sugar-estate accounts" represented the bank's actual operation of sugar mills that had collapsed and been taken over by the bank. Thus, for both the bank and for Cuba itself, sugar was the be all and end all; and, in the early 1930s, the end again seemed near. As the world's largest producer, Cuba had to have access to the American market. From a peak of 4.1 million tons in 1929, American imports of Cuban sugar fell to 1.6 million tons in 1933. Sugar producers desperately sought to control the market. Agreements such as the Chadbourne Plan of 1931 tried to dispose of huge surpluses and rationalize the market. Despite such quotas, the Cuban sugar industry was in contraction and creditors looked on with alarm. The bank's Havana main branch bore the brunt of the austerity. Lending, which had peaked at $43 million in 1926, had shrunk to $5.2 million a decade later. In 1932, this key branch actually reported an operating loss. Similar contractions took place in Brazilian coffee, Grenadian cocoa, Antiguan cotton, and many other Caribbean and Latin American commodities which the bank had traditionally financed. Only in Cuba, however, was the risk of catastrophic proportion.

The Depression brought other unpleasant international repercussions. Throughout the 1920s, the bank had tried to establish itself in Germany, lending to German banks through its New York, London, and Paris offices. The recuperating German economy seemed like a natural new frontier for the bank, but hyper-inflation and growing social instability soon obliged the now-cautious Canadians to apply the brakes. By 1930, the bank was still owed $9.4 million by German banks such as the Dresdner and Deutsche. A year later the German debtors began defaulting. "Unfortunately," Paris office reported, "the problems to be faced proved to be far beyond the most pessimistic anticipations."[15] Late in 1931, all Germany's creditor banks signed a Standstill Agreement, which effectively froze the country's foreign obligations and placed its creditors on an equal-preference footing. Although there was perpetual talk of better times, Norman Hart, the Paris manager, grimly acknowledged that the German debt situation had become a political one. The better times that Germany was to get in the 1930s were not the kind that saw debts to foreign bankers settled. As late as 1952, the Royal Bank was still grappling with the Standstill Agreement.[16]

The Depression thus exposed the bank's over-indulgence in the financing of Canadian merger mania, in Cuban sugar and in German reconstruction in the 1920s. What had seemed normal lending decisions in the "roaring twenties" became abnormal liabilities in the "dirty thirties." It also triggered a liquidity crisis that jeopardized the bank's stability. As the national economy soured, head office instinctively tried to minimize the bank's exposure to liabilities by adopting tight money policies. From a 1929 high of $640.5 million, loans were reduced a dramatic 40 per cent to $384.6 million by 1933. This was partially the result of a natural falling away of loan demand, but it was also the outcome of hard-nosed lending policies. Even though deposits in the same 1929-33 period fell only 22 per cent, the bank strained to make provision for its liabilities. New loans were vigorously scrutinized, old loans vigilantly policed, and interest rates boosted above the usual 7 per cent. With no central bank regulating the nation's appetite for credit, the banks were the sole masters of their fiscal fate. Thus, whatever the social and economic cost of squeezing the availability of credit, banks saw preserving their solvency as their first duty.

It was this duty that provoked the political outcry. When Prime Minister Bennett complained in late 1932 that Peace River District farmers were, for instance, being charged 9 per cent interest,* Morris Wilson acknowledged the fact, defending his managers by citing the burden of increased taxation: "In the very nature of things they, like other business people, attempt to pass these increased charges on to the public."[17] Branches could also be closed, but this, too, brought political outrage. There was always the bank's rest account if the bad-debt situation became precarious, but any resort to the rest account would be viewed as a desperate measure by the public, a final, frantic grab at the life raft. Through the early Depression, the Royal Bank thus enforced a regime of tight credit to protect its solvency. Few realized that this banking orthodoxy seriously deflated the national economy by denying it capital to grow. The bankers' concern was survival: to protect the stability of the bank by limiting its exposure. Without a central bank to ensure adequate liquidity, there was no other way – as Pease had earlier realized.

But, no degree of tight money or corporate austerity could get around the Royal Bank's over-exposure to certain cyclical types of credit dispensed in the late 1920s. In January 1932, the bank's accountants broke the bad news. In a codicil to their annual report on the bank's financial condition, Peat, Marwick, Mitchell and Price, Waterhouse warned the directors that they found the condition of "certain loans...unsatisfactory." In Cuba, interest on $33.7 million in loans to the sugar companies had fallen into arrears. The accountants called on the directors to materially increase the reserves set aside for these loans. Closer to home, there were $23 million in questionable loans on the Canadian books "where the securities held as collateral, on the basis of quoted market values at November 30, 1931, were insufficient to cover the amount of the loan, or for other reasons the loan appeared unsatisfactory."[18] The day of reckoning had arrived.

The mortal danger of nearly $60 million in doubtful loans was heightened by a fresh gust of rumours about the personal precariousness of Herbert Holt. Rumours are a banker's nemesis, and work to dissolve the public's trust in a financial institution. By the early 1930s,

* Banks could charge whatever interest they liked on loans, but the Bank Act only allowed them to legally recover 7 per cent.

Holt's name had become synonymous with that of the bank and with that of St. James Street corporate capitalism. If the banking community construed the Royal Bank in terms of Pease, Neill, and now Morris Wilson, the man on the street thought of Holt when he thought of the bank. Pease had brought Holt to the board in 1905 and to its presidency three years later because his status as a captain of industry gave substance to the bank's drive for national prominence. The Depression, however, torpedoed Holt's ship of capitalism. Not only did the pulp-and-paper industry, which Holt and his Toronto partner, Harry Gundy, had so vigorously promoted in the late 1920s, collapse into debt and idleness, but the public came to associate Sir Herbert with the problems of "big business" in Canada.

In the previous decade, counting Holt's corporate directorships had become a national pastime. These ranged from his personal hold on Montreal Light, Heat and Power to his presence in the boardrooms of companies as influential as Canadian Pacific and Sun Life. He was "Mr. Capitalism" in many a Canadian mind. Most assumed that he was Canada's richest man. This he was not; his power consisted of control, not extent of wealth. Throughout the 1930s, Holt, for instance, held only 4,217 of the over 350,000 shares in the bank.[19] None the less, as Canadians reached the conclusion that their market economy had faltered in the early Depression, delivering them into unemployment and uncertainty, they drew a bead on Holt. The unchecked speculation and interlocked power of corporate titans like Holt was the root of Canada's misery, they decided. "Large, taciturn, surrounded by the traditional insignia of the very biggest business," the *Canadian Forum*, the small but outspoken voice of Canadian radicalism, noted in 1934, "he has become for many the fearful embodiment of reaction."[20] And it was not just for the man on the street that Holt became the shibboleth of greed. In 1932, W. E. J. Luther, the president of the Montreal Stock Exchange, became distraught over his own losses in Holt stocks and attempted to assassinate Holt. Thinking he had succeeded, Luther went home and killed himself. Holt was only grazed and soon recovered. Luckily, the story never came to light in the press.*

Holt's precipitous decline in public esteem soon had implications for the bank. The Winnipeg supervisor had, for instance, reported that one North End client had closed out her account: "she had been told by a financial friend...that the bank was unsafe and that the Holt interests owed us $250,000,000. The gossip is rife amongst all classes here, but withdrawals in the main are by wage earners and professional

* The Toronto tabloid *Hush* alone covered the story. It alleged (without evidence) that Holt's bodyguard had in fact gunned Luther down as he attempted to shoot Holt, and later took his body to his Oka home, where a suicide was staged.

people."[21] The Regina supervisor complained that "false statements respecting this bank are matters of discussion in barber shops and women's social functions."[22] The New Glasgow, Nova Scotia, manager, E. G. MacMinn, reported that local shareholders of the bank were being panicked into selling their stock by the woes of Holt's Canada Power and Paper. To make matters worse, just two months before the auditors' report was received, the prominent Montreal brokerage house of McDougall & Cowans, a frequent recipient of Royal call loans, went spectacularly bankrupt. To cover its liabilities, the bank collected the cash value of Percy Cowans's personal insurance policies.[23] In Toronto, the bank participated in a hasty reorganization of the debt-laden Wood, Gundy & Company.

There was, however, no way to cover all the rumours. Fortunately for the bank, the public did not even have an inkling that another pillar of the Montreal Anglo business community was dangerously near the financial rocks. Thomas B. Macaulay, president of the redoubtable Sun Life Assurance Company, had relied on the bank for call loans to support Macaulay Securities, a private holding company. By October 1931, Macaulay Securities was $10 million in debt and not meeting its payments. Two million of this was owed to the Royal Bank. By the spring, Morris Wilson concluded that the situation was "highly unsatisfactory" and could not "be allowed to continue."[24] Unfortunately, continue it did – for many years.

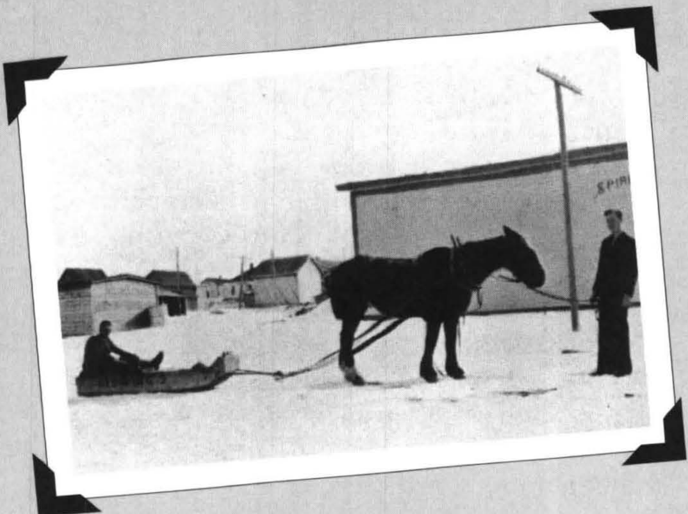
By February 1932, the directors knew that something had to be done to alleviate the debt load, but their options were very limited. Among the $23 million in questionable domestic loans were the businesses of some of Canada's premier financiers: T. B. Macaulay, Harry Gundy, and, indirectly, Herbert Holt. Any attempt to force liquidation of these accounts would provoke a major crisis of confidence in Canadian business. Who in the bank, after all, would have the temerity to demand repayment of a $2.9-million loan to the Consolidated Investment Corporation, a 1929 Holt holding-company creation? But more worrisome was the knowledge that much of the marketable assets supporting these loans were in fact Royal Bank stock. Any forced liquidation of these accounts would have the effect of flushing a huge volume of the bank's stock onto an already depressed market; from a 1929 high of $298, Royal Bank stock had slipped to a low of $120 in 1932. An investor panic would undoubtedly follow any mass sell-off of Royal stock. From the outset, therefore, secrecy was imperative – even the whisper of a rumour might create a crisis.[25]

The crisis was managed by a team of bank directors working with

(continued on p. 260)

GOOD MEN AND BAD DEBTS

The Saskatchewan "Outlawed" Loans Book



ROYAL BANK'S ARCHIVE IN MONTREAL contains shelf after shelf of neatly filed documents, millions of them, reaching as far back as 1818. This is the stuff of history. No one document in this vast collection makes history come alive more than the "Saskatchewan District Register of Written-Off Debts" from the Depression. An "outlawed" debt was one which the bank resigned any hope of ever recovering. A debt first fell into arrears and was later "outlawed." Most of these Saskatchewan loans were Section 88 loans, made to farmers to support their annual crop, and they were secured by chattel mortgages on possessions, but never on land. When a loan became non-performing, the branch manager began tracking it on the back of the loan sheet. The record over time presents a heart-wrenching piece of history. This is the tale of one such loan.

On May 28, 1929, Charles W., a farmer, contracted a $282.50 loan at Sedley branch. The loan was for spring seeding and was due on September 4. Drought hit the area that summer, and Charles W. failed to meet his obligation. The bank did not press for repayment. The loan was labelled a "carry-over." A year later, on November 29, 1930, he managed a small payment, and then fell into complete arrears. Two years later, on December 29, 1932, head office wrote off a total of $408.73 in principal and accumulated interest. The manager's notes complete the sad tale.

Jan. 5, 1933: "a married man aged 43...secured by chattel mortgage covering twelve horses, three cattle, McCormick tractor, Chevrolet truck and a Star car. The horses and cattle could not be located and the tractor, truck and car were brought in...by the bank...in poor condition... stored." The truck and car were then sold for $10 and the tractor offered for $50. Charles W. moved to Hudson Bay Junction "and has been out of employment for some time and is in very poor condition."

Feb. 15, 1934: Tractor sold for $65. "No further security held...debtor...reported to be worthless." The bank thus recovered $64.77 after costs from Charles W.

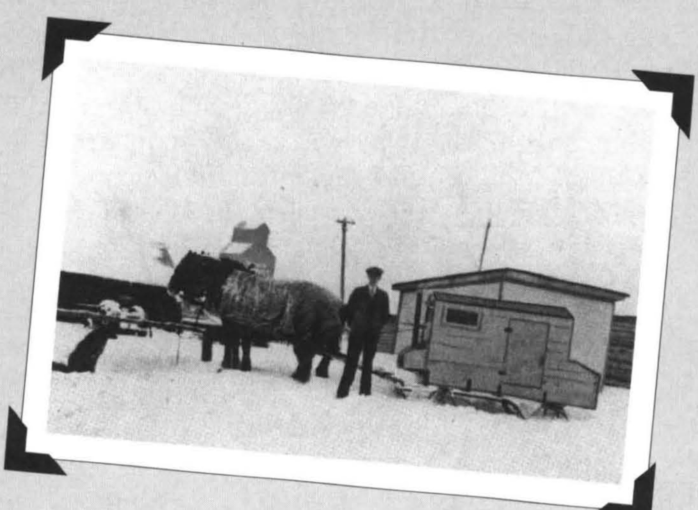
March 19, 1935: Charles W. has "partial employment doing odd jobs...on Relief...very little likelihood of W. ever improving his position to such an extent as would permit of him looking after his old obligations."

March 12, 1937: "Recovery of the account seems hopeless."

Jan. 4, 1944: "This man is now the Village scavenger...should be contacted from time to time."

Feb. 4, 1947: "We have been authorized by the supervisor to accept $300 in settlement... payable in monthly instalments of $10."

Feb. 4, 1948: "This claim is outlawed and we are inclined to think W. has no intention of arranging a settlement."



The Depression brought out Westerners' resourcefulness. In 1933, J. M. Windsor, the manager in Spirit River, Alberta, took these pictures of improvised winter transportation.

General Manager Wilson and his four assistant general managers – S. G. Dobson, C. C. Pineo, S. R. Noble, and G. W. Mackimmie. Only three directors – Holt, A. J. Brown, and G. H. Duggan – appear to have been actively involved: Holt because he had so much at stake, Brown because he was the bank's indispensable corporate counsel, and Duggan, chairman of the Dominion Engineering Works and a director since 1916, probably because of his intimate ties with Montreal business. The group immediately recognized the need for secrecy. The auditors' codicil was not printed in the annual report, but it was appended to the annual statement sent to the minister of finance in Ottawa, who was required by the Bank Act to receive each bank's annual statement. Prime Minister Bennett, who acted as his own finance minister, thus knew of the bank's predicament and later confided that the issue "gave me more concern than any other single matter that I had to deal with during my term of office as Prime Minister."[26]

Throughout the spring of 1932, the team at head office groped for a means of extricating the bank from its predicament. The Bank Act prohibited a bank from purchasing or dealing in its own stock. This therefore precluded any direct bail-out, whereby the bank might relieve its debtors by taking over their holdings of bank stock. Some arm's-length arrangement was therefore necessary.

In April, inquiries were made of F. T. Walker, the New York agent, about establishing an American shell corporation "to act as nominee to hold shares of the bank for account of customers and/or correspondents."[27] This bore no fruit, and all the while, the economic situation continued to blacken. By most indexes, the Depression hit bottom in the winter of 1932-33. At this darkest hour, a solution was found. The architect was probably Albert Brown, the director drawn from the Montreal law firm of Brown, Montgomery and McMichael and a master of corporate law. A holding company, Islemont Securities Corporation, was established in December, using $5 million of the "private resources" of Holt, Duggan, and Brown. Islemont then turned to the bank for a loan of $7,993,780,[28] which it secured with $8 million of its own twenty-year collateral trust bonds. Thus, Islemont itself became "one of the largest debtors of the Bank." With this capital, Islemont then bought large blocks of Royal Bank shares from the bank's beleaguered debtors, thereby easing their indebtedness. Morris Wilson later noted that Islemont bought these shares "at a time when such a purchase would not normally have been considered; and paid for them about $4,000,000 in excess of their then market value."[29]

Islemont's immediate effect was to loosen the corset of debt around several of the bank's most prominent debtors. The tactic was quickly mimicked to relieve the pain of debt elsewhere in the bank's portfolio. Exchequer Securities, for instance, was formed "to take over loans and securities of Wood Gundy & Co." totalling $8.3 million.[30] The Islemont companies were given a cubbyhole office in 360 St. James and had a lawyer from Brown's firm as their titular president. Islemont's long-term strategy was to gradually retire its debt by selling its holdings of Royal Bank stock onto what was hoped to be an improving market. The plan worked. While the Islemont loan stayed on the bank's books until well after the Second World War, by 1946, for instance, the principal was down to just under $3 million.[31]

Islemont Securities was the creation of perilous times. Given Albert Brown's canny sense of corporate legal affairs, it broke no law. Behind all the secrecy, it was in fact an early example of debt restructuring. In late 1934, two years after Islemont's creation, Morris Wilson prepared a secret affidavit in which he outlined his view of the Islemont affair. The debt crisis of 1932, he wrote, threatened "most serious repercussions" for the bank. Holt, Brown, and Duggan acted out of altruism, and senior management was beholden to them for their secret intervention. From the outset, management felt an "obligation...to collaborate by all available means" to help Holt, Brown, and Duggan "withdraw their capital from that company [Islemont] without loss." To assist this, management agreed to waive or "materially reduce" interest on Islemont's loan. Wilson and his four assistant general managers duly signed the affidavit and consigned it to the secret file of Islemont documents, which was quickly stored in the president's vault. Islemont remained the Royal Bank's best-kept secret. Prime Minister Bennett clearly knew about it, and there was a good deal of scuttlebutt "on the street" about it, but public confidence in the bank was never fundamentally shaken. It is probably no coincidence that, in 1934, the Bank Act was revised to prohibit a bank director from voting approval of any loan to a concern in which he held an interest.

While Islemont quietly stood guard over the bank's troubled corporate loans, the Cuban debt problem and the accumulating losses from normal Canadian operations continued to exert pressure. Early in the Depression these had been accommodated out of the bank's inner reserve, an undisclosed contingency fund built up out of operating profits. But this tactic had two unfortunate outcomes: it depleted the inner reserves dangerously, and it gave the public the impression that the bank had bottomless pockets. By the summer of 1933, the bank was on the leanest possible financial diet; salaries had been cut by 5 per cent, the dividend had been cut, the 2 per cent bonus to shareholders had been stopped, and branches had been closed. Bank accountants were prophesying – rightly – the worst annual profit in ten years.

The news from Cuba was even worse. President Machado had been toppled and had fled the country, coming briefly to Montreal. In his wake, labour unrest and rural insurgency engulfed Cuba. This time the United States did not intervene; the Platt Amendment would be repealed in 1934. In September, for instance, a mob of five hundred, carrying red flags and clubs, laid siege to the bank's Palmira sugar mill near Cienfuegos.[32] As the Machado regime crumbled, there was sporadic violence in Havana. When a bomb exploded near a branch, "one of our tellers got so excited that he took a revolver of the bank's and went out to the back and finished himself off."[33] News that the bank's Havana supervisor was reduced to pleading with the British ambassador for protection of foreign property convinced head office that the end was near in Cuba, and faint rumours that a strongman, Colonel Fulgencio Batista, was beginning to restore order did little to reverse the pessimism. Facing a possible Cuban fiasco and accumulated Canadian losses, the bank finally turned to its $35-million rest account – the proud symbol of the bank's solidity, the fruit of careful husbandry since the days of Edson Pease.

The Royal Bank was not alone in feeling the pinch of the Depression. In September 1933, Prime Minister Bennett told the president of the Bank of Montreal that he was "very anxious that the banks take

Many Canadians were unsure exactly which bank Herbert Holt headed. On this crude counterfeit $5 bill, Holt is mistakenly portrayed (see signature) as the president of the Bank of Montreal. Holt's successor as president, Morris Wilson, enjoyed less notoriety. After attending the Coronation in London in 1937, Wilson went on to Paris, where (opposite) he met with H. L. Gagnon (left) and Paris manager E. G. Groning (centre). The bank magazine noted that Gagnon had temporarily escaped "the tragic conditions" under which he had been managing the Barcelona branch.

some definite action in connection with appropriation of reserves for unforeseen demands."[34] By December 1933, a "standing committee" of the Royal Bank board – consisting of five Montreal directors – recommended that $15 million be drawn out of the rest account to reimburse the inner reserves for "appropriations made therefrom during the past few years of disturbed business conditions and consequent abnormal depreciation in values, and to provide for future contingencies."[35] The transfer from the rest account was not an act of desperation. During the course of the Depression, six of Canada's nine banks reduced their reserves. Since the shareholders would have to be informed, the transfer could not be hidden from the public. From the outset, it was presented as "conservative and constructive" banking. Wilson was quick to point out that financial results for 1933 showed a distinct improvement over 1932; profits were up from $3.9 million to $4.4 million, and assets were again on the rise. The uncertain Cuban situation made it prudent, however, "to make liberal allowance for contingencies." Equally important, depletion of the published reserves would counter the public impression that the bank had a deep well of undisclosed profits – its inner reserves – that it had built up "through excessive profits during good times."[36] With a revision of the Bank Act looming in 1934, the bank had no wish to appear falsely as a "fat cat," untouched by the Depression.

In advance of the January 1934 annual meeting, Wilson carefully briefed his managers on the transfer. The announcement should be "treated in a very matter of course way," so as not to arouse undue comment.[37] After decades of assuring its customers that its rest equalled its paid-up capital, the bank was now letting its rest slip well below its $35-million capital. The annual meeting brought no adverse comment; it was, after all, still a small, cozy affair, commanded by the proxies held by the directors. The inspector general of banks in Ottawa heard isolated criticism: a disgruntled former Royal Banker demanded to know "just how much was written off the books from the year 1933."[38] The financial press was unperturbed; the ability to write off bad debts was a sign of Canadian banking's stability. "They have faced what some might call the worst and faced it successfully," the *Monetary Times* noted. "It was necessary to make certain write-offs and they have done so...Canadians will continue to regard the banking structure of the country as one of its bulwarks."[39] Privately, Morris Wilson sensed that a crucial challenge had been met: "We can now hope for better things."[40]

And things did get better. In January 1935, the bank's auditors quietly reported that "the improvement in the status of some of the larger loans is quite marked and the Cuban situation has changed for

An aged-but-still-jovial Herbert Holt arrives at 360 St. James in his limousine, c.1934.

the better owing to the increase in the price of sugar over that of last year."[41] Even Macaulay Securities began to whittle down its debt. A more positive tone crept into the annual meetings of the late decade. Profits – still depressed by weak commercial demand and low interest rates – stabilized around $3.5 to $4 million annually. More encouraging was the steady growth in deposits from a nadir of $600 million in 1933 to $911 million in 1939.

With this slow improvement came a sense that change was now inevitable, both for the Royal Bank and for banking in general. The Depression had severely dented the credibility of Canadian banking and probably the deepest dent had been provoked by the unsavoury perception the public held of the Royal Bank's president, Sir Herbert Holt. "I do not see why I should be picked out and the Royal Bank is being made the devil in the piece," Holt lashed out in 1934.[42] Morris Wilson knew why. Holt's octopus-like reach in the Canadian economy meant that an early reputation as a "builder" could easily be turned inside out in hard times. Not just to the narrow readership of *Hush* or the *Canadian Forum*, Holt was a convenient target for discontent. He had restructured the pulp-and-paper industry to the point of monopoly and overcapacity. His grip on Montreal's public utilities was felt every time a utility bill was dropped in a mailbox. And, although Wilson tried his best to deny them, the country was awash with rumours that Holt was hanging by a financial thread – a thread tied to the bank. While Islemont remained a hermetic secret, most in the financial know suspected that Holt had somehow been "bailed out" by his friends. Even R. B. Bennett was quick to make the allegation. When a Calgary constituent complained that the bank was taking legal action against her to recover a $6,100 loan, Bennett asked general manager Dobson to "think of the losses that the Bank has experienced through some of the 'pirates of finance' and 'captains of industry' and then remember the toil and suffering which that woman has passed."[43] To friend and foe of the bank alike, it was clear that Holt had to go.

By 1934, Holt's health was deteriorating. Now well into his seventies, the reclusive millionaire appeared gaunt and haggard in the few photos that the press managed to take of him. Holt increasingly pleaded poor health in his attempts to shun public scrutiny. When the Commons Committee on Banking and Commerce called him to Ottawa to give evidence in the spring of 1934, Wilson obtained an opinion from the dean of the McGill medical school, saying that he was "absolutely and irrevocably opposed to his going up"; the limitations on the president's heart had reached "an extreme degree" and he had suffered brain "spasms."[44] The committee obliged Holt by travelling to Montreal. There was little to hold Holt in the president's office. His $25,000 salary had been cut 10 per cent in token resistance to the Depression; he collected another $4,000 in director's fees, and then paid taxes on the lot. "I cannot imagine anybody but a bank in Canada being able to secure a man of his ability for the average rate of $14,000 a year," Wilson told the Commons committee. That's what MPs earned, a politician gibed. "Yes," Wilson retorted, "but there is honour and glory there and there is no glory in being the head of a bank."[45]

If he could not find glory, Holt was determined to find the sun. One of the few bright spots for the Canadian economy in the Depression had been gold mining; precious metals assuaged troubled investors. Canada's gold king was Harry Oakes, the irascible millionaire proprietor of Kirkland Lake's Lake Shore Gold Mines, a solid bank client since the 1920s. Like his friend Holt, Oakes was eager to escape the Depression limelight, and he fled his Niagara Falls home in the early

1930s for the Bahamas, where the Royal had been active since 1908. Holt followed.* During 1934, the finishing touches were put on Holt's splendid mansion on the outskirts of Nassau. At the annual meeting in January 1935, shareholders learned that, for the first time since 1914, Holt would not preside over their assembly. He was wintering in the Bahamas. More surprising was the news that, after twenty-six years, Holt was no longer the bank's president. A month earlier, Holt had told the board that the time was "opportune" for him to step down. In true Royal Bank tradition, Holt said that he had "always been a strong believer in appointing younger men" and that the new president, Morris Wilson, was "the outstanding banker in Canada." Holt would remain in the new – and completely titular – position of chairman. As president and managing director, Wilson would run the show, backed up by General Manager Sydney Dobson.[46]

Holt's departure was a watershed. For the first time in its history, the bank had as its president a banker born and bred. The tradition of an outsider president, begun by Kenny in Halifax, had died, and the Royal Bank would from now on groom its own presidents. Banking had become too involved, too professional, to entrust its leadership to amateur, part-time presidents, especially if their personal business adventures might drag their banks down. In Wilson and Dobson, the bank now had two Nova Scotia "bank boys" at its helm. They had both pursued remarkably similar paths, Wilson's starting in Lunenburg in 1897 and Dobson's in Sydney in 1900. Both had been trained under the redoubtable Martin Dickie in Truro. Both had been posted to Vancouver. Both had been called to head office young to serve as the bank's chief inspector. They were not captains of industry; they were trained practitioners of banking. They had worked long, long hours to get where they were, and neither had lost the "natural kindliness or friendliness" of a Maritimer.[47] "I am just one of the 'common herd,'" Wilson told one of his managers in 1937. "I recall that Abraham Lincoln once said that God must like the common man because he made so many of them."[48]

In a jocular salute to Wilson, the *Canadian Banker* noted that, in 1934, "he finally escaped from all worry by being appointed President." Certainly, Wilson had been instrumental behind the scenes in orchestrating the Islemont rescue on behalf of his predecessor. Barring a catastrophic relapse into deep depression, after 1934 the bank could rest assured that its internal affairs had been shored up. For Wilson, the worry was to lie in rebuilding the bank's external credibility. From 1934

* Sir Frederick Williams-Taylor, general manager of the Bank of Montreal until 1929, also frequented the Bahamas but was by no means a friend of Holt's.

When Morris Wilson became president of the bank in 1934, he was the first "professional" banker to head a bank in Canada. Another Maritime "bank boy," Wilson was toasted (with coffee) by the staff of Wolfville branch when the news reached them.

to the onset of war, Canadian banking lived with constant challenge and change. Public antagonism and an economy starved of credit led to a royal commission on banking and, ultimately, the creation of a central bank. Eager to pump purchasing power into a still-faltering economy, Ottawa followed these initiatives with schemes to enlist the banks in financing home and farm improvement. Impatient with piecemeal reform, the West exploded in protest and embraced populist schemes for radical economic reform of the banks. The CCF call for bank nationalization and Social Credit assaults on eastern "big shots" – like Holt – shook the pillars of Canadian banking. These were to be Morris Wilson's worries, and they had found their roots in the early Depression.

As the economy collapsed around them, Ottawa and the bankers had clung to their orthodoxies. They did so in no coherent fashion, indulging in piecemeal renovation, but never pursuing coordinated action in the face of economic hardship.[49] Amid this chaos, government and the banks tried to shore up the economy in *ad hoc* ways. In 1931, the banks had helped Ottawa raise $180 million in a National Service Loan, a campaign modelled on the wartime victory loans. As the price of wheat spiralled downward, the western wheat pools found it increasingly difficult to arrange forward financing of the annual crop. Initially, the three Prairie governments enhanced their guarantees of these loans to the banks. When wheat fell further, Ottawa stepped in and, under the 1931 Unemployment and Farm Relief Act, furnished its own guarantee. Thus, the Canadian financial system's fundamental obligation to move the crop to world markets was maintained.[50]

In the east, other obligations were also met in *ad hoc* ways. When the giant Beauharnois power project on the St. Lawrence near Montreal faltered in 1931, the Royal Bank joined the Commerce and Bank of Montreal in providing advances to the beleaguered project. Once again, Prime Minister Bennett intervened, providing a federal guarantee to the banks. Despite the fact that it was bathed in political controversy, Beauharnois was reorganized and completed without the banks ever having to draw on Ottawa's guarantee – "without it having cost the country one cent," as Wilson told Bennett in 1934.[51] (Coincidentally, Beauharnois fell under the sway of Holt's Montreal Light, Heat and Power.) Similarly, the bank took a \$12.2-million share of a \$60-million loan to Canadian Pacific in 1933 to rescue it from defaulting on a series of short-term obligations that could not be refinanced on troubled Wall Street. This too was backed by a federal guarantee.[52] The loan was successfully retired in 1936 when the CPR returned to the bond market. When Price Brothers Paper defaulted on its loans, the bank became embroiled in a longer and less-fruitful attempt to reorganize the company with British press barons Beaverbrook and Rothermere.[53]

Ad hocery was by no means capable of solving the fundamental malaise that had been brought on by the Depression – the chronic deflation of the economy. In the wake of the "crash," risk aversion and tight credit became the bywords of Canadian banking. In 1929, the Royal Bank had \$640.5 million in loans on its books. It would not regain that level of lending again until 1948; lending bottomed out in 1937 at \$338.4 million. Canadian bankers continued to see themselves as the nation's lender of last resort. "Cheap money" was reckless money, money that would simply rekindle the fires of speculation and thereby endanger the solvency of the banks. In 1933, the banks shaved a per cent off their loan rate for farmers and municipalities to 7 per cent, a decrease soon echoed by a fall in the savings rate to 1½ per cent.[54] Even then, the vigilance of most managers in assessing potential borrowers' collateral and prospects tended to militate against any quick flush of cash reserves into the banking system. In 1932, Ottawa had tried to inject some credit by *obliging* the banks – under the 1914 Finance Act – to borrow \$35 million in Dominion notes from Ottawa at 3 per cent. The banks then lent a similar amount back to the government at 4 per cent. Under the Finance Act, this was the limit of monetary expansion and it had little or no impact on credit conditions.

The banks' tight credit policies soon inflicted grievous damage on their public credibility. However natural a policy of limiting dangerous exposure to loss in lending seemed to the banks, the borrowing public saw tight credit as slow strangulation. In August 1931, for instance, the branch manager in Plenty, Saskatchewan, reported that his clients were seething over the bank's "conservative loaning policy." At one meeting, an eavesdropping branch manager reported that a speaker called Scarlet of Saskatoon made "some very damaging remarks about our institution and...stated that the Royal Bank of Canada was no doubt head of the Capitalist System in Canada and for this reason it was difficult to obtain credit."[55] The Canadian Bankers' Association responded to such assaults by sending B. K. Sandwell, a former McGill economics professor and now editor of *Saturday Night*, on a western swing to suggest "propaganda" that might be directed against "socialistic" criticism.[56] Back east, however, there was a growing recognition that "propaganda" was not the answer to Canada's credit woes.

As early as 1931, Prime Minister Bennett had asked the CBA to consider "some form of central bank"; such an organization would make dealing with the U.S. Federal Reserve easier. Sensing the opposition, Bennett conceded that such an "institution would have to be owned by the banks."[57] The bankers balked. A central bank might regulate national credit, but it would undoubtedly fall under the thrall of politicians. If political appointees governed national credit, Canadian banking would be at the mercy of the least populist whim. "This is quite contradictory as it is impossible," Holt complained, "as in the case of the railways, to do away with politics if the directors are to be appointed by whatever government may be in power at the time."[58] Whatever its shortcomings, bankers argued, the present system at least ensured stability.

A few lonely bankers were beginning to think otherwise. Within the Royal Bank, there was the memory of Edson Pease's ill-starred campaign for a central bank in 1918. Pease had argued that "supplementary banking facilities" might ease the problems of post-war adjustment. Pease left apostles. Most prominent among them was Randolph Noble, assistant general manager since 1922. Another Fredericton "bank boy," Noble oversaw the bank's foreign branches. In Montreal, he had become a self-taught economist, taking evening courses at McGill from Leacock. Through his colleague Graham Towers, he fell in with a group of academic free-thinkers, notably McGill law professor Frank Scott. Together, they questioned the *status quo*. What if, Noble suggested, the private banks were relieved of their duty on the nation's financial front line by a central bank? Would a central bank have eased the financial pain of the Depression? Would it have helped to stimulate the national economy? Avoid the Islemont predicament? Put credit in farmers' pockets? Such ponderings did not ingratiate Noble with his superiors;

at a board meeting a prominent Montreal director – probably the arch-conservative A. J. Brown – once openly berated him for consorting with a "radical" like Scott. Noble learned to segregate his daytime banking and his nighttime philosophizing.

The social and economic disintegration of the Depression prompted Noble and Towers to question the received wisdom of their profession. As the bank's chief inspector since 1929, Towers daily saw the financial carnage of a nation starved of credit. Noble concluded that this credit strangulation was not a cure but a perpetuator of the Depression; he would later write of the "misguided financial policies" pursued by governments caught in the grip of the Depression. "The Canadian experience shows," he wrote, "that so long as bank reserves were deficient, deposits steadily declined and liquidation proceeded apace."[59] Noble began to sense that monetary expansion, not contraction, was the way out of the Depression. The unveiling of the Roosevelt New Deal – "Roosevelt magic," he called it – in 1933 seemed a move in this direction; Noble visited New York to share ideas with "New Dealers" such as Dean Acheson and a circle of secret Roosevelt admirers on Wall Street, including several J. P. Morgan partners. The ideas of John Maynard Keynes, the English economist who advocated the forced injection of purchasing power into a lagging economy by government, began to attract Noble and Towers.[60] "I think Mr. Keynes is right," Noble wrote to a prominent Toronto businessman in 1934, "when he says in his *Treatise on Money*...'Booms and slumps are simply the expression of the results of an oscillation of the terms of credit about their equilibrium position.' Monetary management must devote itself to maintaining the equilibrium position and when this becomes possible it will be the greatest single thing that has ever been done for the good of mankind. It will eliminate the agony of depressions and the stupid waste of resources and effort always connected with them."[61] In 1937, Noble joined Keynes in contributing an essay to a book on the monetary experience of the Depression.

Closer to home, Noble piqued the curiosity of Prime Minister Bennett, another New Brunswick boy grappling with the meaning of the Depression. "I was the centre of all the propaganda for an inflationary policy from the beginning of 1930," Noble wrote to a leading American economist. "Without assistance from anyone, I sold the idea to the Prime Minister of compelling the banks to borrow under the Finance Act, although I wanted him to make it fifty million dollars, not thirty-five."[62] Noble's musings found little resonance in senior management at 360 St. James; the bank economists proved a more receptive audience. In May 1933, Donald Marvin, the chief economist, praised the Roosevelt New Deal as being of "utmost importance in restoring prosperity." In particular, Marvin pointed to the powers given to the Federal Reserve to bolster commercial bank credit.[63] Then good news came from Ottawa. The Bank Act was slated for its decennial revision in 1933, but, rather than face an onslaught of protest and half-baked reform, the government moved to postpone the revision for a year. In the interim, a royal commission on banking and currency would perform a "complete and detailed examination" of the act *and* study "the advisability of establishing in Canada a central banking institution." Headed by the British jurist Lord Macmillan, the commission set out in early August on a brutal schedule of coast-to-coast hearings, returning to Ottawa to present its report in September. Canadian banking would never be the same again.

High River, Alberta, lives up to its name in a 1932 flood.

In city after city, the Canadian banking system was found wanting. Never was the fatal gap between the banks' insistence on their solvency and the public's need of credit more apparent. A spontaneous coalition of farmers, labour, and political agitators pummelled the banks, and the temperature rose as the commission moved westward. "The farmer was educated to do his business on credit," the president of the United Farmers of Alberta complained. Now he could not get that credit. There was "no intelligent or systematic regulation of the volume of purchasing power...we are faced with the tragic paradox of our times – a lack of financial means to distribute to our people the goods and services which can be provided in superabundance."[64] There was no credit because there was no competition in banking: "Here was a fine machine for concentrating control in a few hands," one Alberta farmer MP claimed.[65] Eastern reformers joined the chorus: in Toronto, the League for Social Reconstruction – the brains trust of the CCF – called for the "complete social control of the machinery of finance."[66] This would begin with an end to "the very low salaries paid to junior workers in the commercial banks."

In an effort coordinated by the CBA, the banks defended themselves as best they could. If Westerners could not get credit, it was because Section 88 loans, secured by chattels, made no sense in falling commodity markets. Even in the best of times, a crop in the ground was a precarious security. "The only thing is that loaning money on anything covered by a chattel security to a farmer," the Royal Bank supervisor in Regina noted, "is like loaning on a watch in the other man's pocket."[67] In Winnipeg, the banks argued that their western loans outweighed their deposits by $106 million in 1932. Morris Wilson told the commissioners that 99.6 per cent of Royal Bank loans were approved on the spot in the West, not in the East. Banking profits, Wilson added, were not lavish: in 1932, 42.3 per cent of Canada's 3,263 branches lost money. But this was all a rear-guard action; the bankers were defending a system that virtually everybody agreed was in need of fixing.

It fell to Morris Wilson, as a progressive industry leader, to concede defeat – grudgingly – on behalf of the banking community. The heads of the chartered banks each presented briefs on aspects of banking to the commission, but Wilson addressed the crucial questions of bank control of national credit, the banks' note-issuing privilege, and the effectiveness of bank directorates. Canadian bankers, he maintained, believed that the 1914 Finance Act still provided an adequate means of creating excess credit. Furthermore, the profits they garnered from circulating their own notes helped to pay the cost of running a national branch system. While banks' boards were "representative of the entire country," they oversaw a marvellously decentralized credit system that distributed credit efficiently around the nation. A state-appointed central bank would dismantle this entire arrangement. It would demand a monopoly on note issue and would appropriate the right of divining the volume of credit in the economy. Wilson did his best to stress the dangers involved. The "moral force" of its advice would initially be weak; its "prestige must inevitably be the product of slow growth." Unlike the commercial banks, it would lack the network of sensors into the community that the branches provided. Its officers must be "men of the very highest calibre," not political hirelings.

Wilson proceeded to outline his views on how a central bank *might* operate. Canada had never had a short-term money market, a place where the placing of money bills established the going rate of credit. The commercial banks had maintained reserves in New York and London so that they could play these markets. A Canadian central bank might, however, control domestic credit in four ways: moral suasion (i.e., the influence of a top-notch staff); the purchase of bonds on the open market; intervention in the foreign-exchange markets; and the use of open-market operations to establish a bank rate for credit. Use of these mechanisms, Wilson concluded, would "necessarily be somewhat crude" and it would be "visionary" to suggest that even a very capable central bank could enforce its will by these methods.[68] Despite this, Wilson made it clear that the fledgling central bank would have the support of the commercial banks.

In its report, the Macmillan Commission was quick to praise the achievement of the private banks – "admirable evidence of security, efficiency and convenience" – but was equally quick to prescribe a central bank.[69] Facing both an election and immense public unpopularity, Prime Minister Bennett acted quickly. "No purely profit-making institution operating in a competitive system," Finance Minister Edgar Rhodes told the Commons, "can afford to place social interests before its own in regard to credit policy." National credit would now be set impartially. This was "but another stage in the natural evolution of our banking system" – "Canada's coming of age financially."[70] The central bank would be empowered to regulate internal credit and foreign exchange, and would also give the government impartial financial advice and use monetary action to mitigate economic fluctuations. The commercial banks would surrender their right to issue notes and the gold reserves that anchored these notes to the central bank. Ottawa would now guarantee the Dominion's note circulation and assume the risks attendant on national credit creation. Within five years, the medley of distinctive private banknotes would disappear from Canadian wallets to be replaced by a uniform national currency. On March 11, 1935, the Bank of Canada opened for business. The bank was one of Bennett's few lasting achievements. When Mackenzie King swept back to power later in the year, he embraced the central bank and promised to bring it completely under national control. This King completed by 1938.

The Royal Bank lost more than its notes and gold to the Bank of Canada. Throughout the commission hearings, Wilson had made much of the need for a high-calibre staff for the new central bank. As its head, the bank's governor would also have to be free of any political taint. Once the Bank of Canada Act was passed in July 1934, Bennett turned his thoughts to the task of finding a governor. His thoughts naturally turned to the Royal Bank, a bank he had been intimately involved with for four decades. Despite frosty exchanges with Morris Wilson over Depression banking, Bennett was still close to him. Bennett also knew that the bank had a tradition of promoting men young, of testing their ability. The Royal Bank had always been quick to the frontier. A central bank was a new kind of frontier and, one senses, Wilson wanted one of his own at its edge. In 1924, C. S. Tompkins had left the bank to become the inspector general of banks. Now Graham Towers would follow him to Ottawa. At thirty-six, Towers was young, dashing, and already committed to the idea of central banking. After several meetings with the prime minister, Towers accepted the post on September 6. His $14,000 bank salary more than doubled; so did his challenge – not only to make the bank work but to build its credibility.* Six years later, his friend "Ran" Noble would follow him to Ottawa.[71]

The Depression had a few bruises left for the bank. Despite the creation of the Bank of Canada, the Bank Act still had to be revised. Through the spring of 1934, Wilson was obliged to hear yet again the litany of faults laid before the banks by their parliamentary critics. The charge was led by C. G. "Chubby" Power, a Quebec Liberal, and G. G. Coote, an Alberta United Farmer. Together they dragged out issues as disparate as interlocking directorates and the mechanics of bank mergers. Power persistently quizzed Wilson on the bank's support of the Holt–Gundy paper companies in the 1920s. He often got dangerously near the truth. "I have never," Holt declared, "borrowed a cent from a bank in my life."[72] If Holt had not, then his holding companies had. To some degree, Wilson was aided by the fact that the chairman

* In September 1936, Ogema, Saskatchewan, branch hired seventeen-year-old Gerald Bouey as a junior. After taking leaves for military service and university, Bouey left the bank in 1947 and eventually joined the research staff of the Bank of Canada. In 1973, he became the Bank's fourth governor.

"He's the man to photograph," Montague Norman, Governor of the Bank of England told the press when Graham Towers arrived in London just days after leaving the Royal Bank to become Governor of the Bank of Canada in 1934.

of the Commons committee was R. B. Hanson, Charlie Neill's brother-in-law.[73] The revised act was duly passed, sanctioning the end of the banks' note-issuing privilege.

The Depression brought the final curtain down on the banks' direct personal relationship with politicians. The banks were soon caught in a scrum of pressure groups. They could no longer count on their informal confabs with the finance minister to make sure that their views were understood in the capital; Canadian finance was now too complex for such intimacy. By the end of the decade, bankers found themselves using paid lobbyists, radio "propaganda," and advocacy programs to preserve their stake in Canadian society. Much of this public-relations effort was administered in Alberta. Just as the battle was subsiding in Ottawa and the new landscape of Canadian banking was taking form, the West exploded in regional protest. If Chubby Power had demanded a reformed banking system, Alberta's Social Credit movement wanted a *different* banking system. If the League for Social Reconstruction attacked the banks on the basis of class, Social Credit attacked on the basis of *region*. It was a root-and-branch challenge that did not lend itself to compromise.

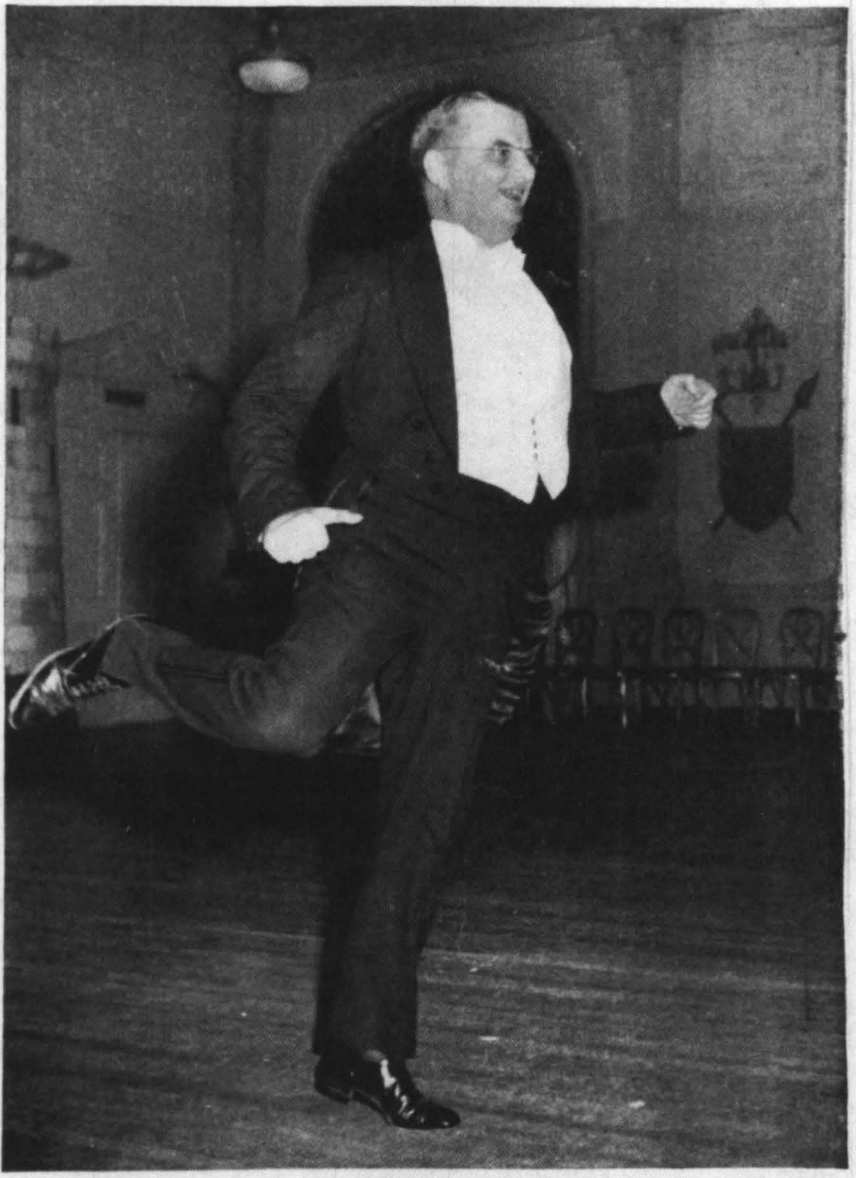
Banks were but one obvious target for western political alienation. Even as Lord Macmillan and the Bank Act committee deliberated, Westerners were abandoning another form of what they saw as eastern control of their lives – traditional politics. In the summer of 1933, a farmer-worker coalition had come together in Regina to form the CCF, which, among other things, promised to nationalize the banks. Randolph Noble's Montreal friend Frank Scott helped to write their ringing manifesto. The startling prospect of socialized banking was somewhat blunted by the fact that the CCF failed to win office anywhere in Canada in the Depression; Saskatchewan would finally elect a "socialist" government in 1944. The threat from Alberta Social Credit was far more immediate.

The landslide victory of William "Bible Bill" Aberhart at the Alberta polls in August 1935 reverberated down Bay and St. James streets. Social Credit fanned smouldering western discontent into a raging brushfire of protest. A high-school teacher and hot-gospeller from Calgary with a flair for stump rhetoric, Aberhart played on Westerners' belief that their destinies were controlled by "fifty big shots" in the east. Fields went unplanted because the financiers would not risk their capital on the "little guy." There was more profit to be made in speculation. There was also enough gossip in the daily press to make Herbert Holt one of the biggest of the "big shots." Since eastern bankers were clearly in "cahoots" with eastern politicians, Aberhart told Albertans, then the time had come to break the manacles of outside control.

Aberhart embellished his populism with theory. In 1923, the Commons committee revising the Bank Act had given short shrift to an English monetary theorist, C. H. Douglas, who believed that the way to stimulate a faltering economy was to inject purchasing power – "social credit" – into it. Adequate purchasing power was a right of all citizens; its absence was the result of the manipulations of financiers. Douglas's rejection in the 1920s paved the way for Aberhart's triumph in the Depression. Social Credit, he claimed, would restore the purchasing power of Albertans by seizing control of the banking system and then using it to distribute a "prosperity certificate" to every citizen. The danger of inflation never entered Aberhart's rhetoric. The eastern press promptly attached the label "funny money" to the certificates.

From Lavoy to Calgary, Albertans believed in Social Credit because it made sense of the topsy-turvy Depression world; it restored their sense of self-worth by seeming to give them control over their personal destinies. Above all else, Social Credit promised to banish debt. Aberhart made brilliant use of his Sunday radio Bible show to

St. George's Society Ball CONTINUED



JAUNTY STEP is performed by S. Randolph Noble, the head of Canada's Industrial Development Bank, who likes to be called "the Keynes of Canada."

High-stepping banker: Life *magazine published this photo of S. R. Noble at the 1949 Montreal St. George's Ball.*

reach the grass roots. The eastern banks were horrified. Ironically, some aspects of Social Credit were theoretically moving in the same general direction as men like Noble, Roosevelt, and Keynes – it sought to restore economic health by injecting purchasing power into the economy. It was on the question of *how* this was to be done that Aberhart and Keynes differed. Rather than controlling the levers of credit creation through a central bank, Social Credit would simply print money. The result, as bankers saw, would be rampant inflation and monetary chaos. Would the certificates be secured by reserves? Would they have any value outside the province? More worrisome for the bankers was Aberhart's implicit threat to provincialize the banking system, to trespass on Ottawa's monopoly over bank regulation. Lurking in the background was the grotesque fear that the province might default on its debt.

In 1936, "Bible Bill" made his initial move. The Social Credit Measures Act – "to bring about the equation of consumption to production" – introduced the prosperity certificates, and the Provincial Loans Refunding Act capped interest payable on the provincial debt.[74] Sensing the challenge to national banking, the CBA executive council decided to take "every effort...to prevent the spread of a desire for this type of legislation into other provinces."[75] Assured that the prosperity certificates were worthless as circulating currency, the bankers focused on the more potent threat of debt adjustment. Alberta's attempt to limit interest on municipal bonds at 3 per cent, even on existing debt, seemed to tamper with the central tenet of creditor-debtor relations. In January 1936, Wilson used the bank's annual meeting to transmit his alarm: "Almost all the important relationships in life are based on the sanctity of contracts." Aberhart seemed oblivious to this.

In the face of Aberhart's threats, the banks sensed that they had an ally in Ottawa; they could find protection in the federal government's clearly defined monopoly over national banking. Ottawa could simply knock down Aberhart's acts by disallowing them. Not yet, cautioned the banks' Edmonton legal advisor, H. R. Milner. Disallowance would "be playing into Aberhart's hands. It would give him a grievance and spread the present insanity."[76] Instead, the banks decided to fight fire with fire.

From the outset, the banks had greatly underestimated Aberhart's psychic appeal to debt-ridden Albertans. A little common sense, they thought, would make Albertans see the error of their ways. In 1935, the banks had sponsored a special issue of *Saturday Night* on "The Banks and the Average Man." The banking industry's old friend Stephen Leacock then took up the torch. In the fall of 1936, Sydney Dobson of the Royal Bank, soon to be CBA president, secured

Next YEAR'S HOLIDAY

● This can be you a year from now. Impossible? Not at all—if you start saving for it now.

Saving money can be thrilling if you save for such a purpose, and a real holiday is well worth saving for.

To Help You SAVE

The Family Budget Book, published by The Royal Bank of Canada will help you to save. It contains sample budgets for your guidance, and a section for each month's accounts. Thousands of householders use this handy Budget Book each year. A copy is yours for the asking at your nearest branch.

By the way . . .

A home of your own; a new car; an education for your child—these also are objectives that will give new life to your savings programme, help you in your natural desire to get ahead in the world.

Don't worry if your savings are small. Saving regularly is the important thing.

You will find it's as easy to save as to spend—when you save for a *purpose*.

P.S.—*Don't forget . . . the one who gets the bargains is the one with ready cash.*

THE ROYAL BANK OF CANADA

OVER 600 BRANCHES IN ALL PARTS OF CANADA

The Depression changed bank advertising. The old ideal of saving remained, but "consumerism" now sometimes became the objective. The 1938 ad above emphasized short-term saving and was designed to counter the notion that bankers were "coldblooded, impersonal 'money-changers'." (Opposite) brochures for the Home Improvement Loan Plan of the late Depression. Note the prominence given to the federal government's guarantee of the plan.


WHAT
CAN
BE
DONE TO
IMPROVE
YOUR
HOME?
HOME IMPROVEMENT PLAN
HIP
NATIONAL EMPLOYMENT COMMISSION


NATIONAL
EMPLOYMENT COMMISSION
HOME
IMPROVEMENT
PLAN
HOME IMPROVEMENT PLAN
HIP
NATIONAL EMPLOYMENT COMMISSION
A NATION-WIDE CO-OPERATIVE EFFORT
Under the authority of the Dominion Government

a princely $10,000 from CBA members to finance a western speaking tour by Leacock. The Port Arthur-to-Victoria tour was arranged at arm's length by the bank's advertising agent, Cockfield Brown, although Leacock must have had no doubt about who was footing the bill. "I spoke," Leacock reported, "on literary, humorous and college stuff, and on Social Credit." In Vancouver, Aberhart actually showed up at one of Leacock's lampoonings.[77]

The CBA complemented Leacock's tour by hiring a publicity director, Vernon Knowles of the *Winnipeg Tribune*, to carry the banks' case to the West. Knowles, in turn, hired a lobbyist in Edmonton to sniff out political intelligence. Later in 1937, Knowles attempted to put "some plain facts" before Albertans in six radio lectures on banking broadcast from Edmonton. James Muir, the Royal Bank's ambitious assistant general manager, was the "star."[78] Eastern wit and preachy broadcasts hardly put a dint in Aberhart's popularity. Social Credit back-benchers continued their pressure for a real assertion of provincial control over the banks. Fearing the worst, the bank began drawing up contingency plans to withdraw from the province. If Aberhart tampered with bank powers, Albertan clients would be served from "shadow branches" in British Columbia and Saskatchewan.[79]

By August, the banks' lobbyist in Edmonton reported that Aberhart was "floundering wildly." His attorney-general had advised him that any action against the banks would be ruled *ultra vires* by the courts. Fearful of losing his credibility, the premier plunged ahead and staged what amounted to a *coup d'état* against the Canadian banking system. The so-called "August Acts" asserted provincial power over bank credit policy, promised Albertans interest-free loans for homes, and set up an Alberta Credit House. The banks were forbidden to challenge the legislation in provincial courts, bank employees would have to be licensed by the province, and, to prevent adverse press comment, press liberty was limited to ensure "accurate news." When the provincial Tory leader portrayed the legislation as an assault on civil rights, he was labelled a "bankers' toady." A libel suit followed. So did Ottawa's massive disallowance of the whole package as *ultra vires*. Canadian banking would not become balkanized like its American counterpart.

Having won his defeat, Aberhart would continue to pound the banks. As the banks' lobbyist reported in 1938, "It now appears that Alberta will, for some time to come, be a hunting ground for every type of political adventurer."[80] But Social Credit reverted to a role of vociferous regional protest, and the nation again turned to Ottawa and the *national* banks for a solution to its economic ills. Neither possessed Aberhart's flair for the dramatic. They did, however, share the belief, vaguely realized by Aberhart and now championed by Keynes and his apostles, that the Depression might be banished by the injection of purchasing power into the economy. The power of money grew with its velocity. If the banks entered the "dirty thirties" trapped in a deflationary role, the creation of a central bank allowed them to entertain ideas of credit expansion at the end of the decade.

At first, the experiments were small and hesitant. R. B. Bennett's ignominious ejection from the prime ministership in late 1935 had left the Mackenzie King Liberals to grapple with the Depression. King applied his usual caution to the situation. He asked Montreal businessman Arthur Purvis to study ways of stimulating employment. Inspired by the American New Deal, Purvis's National Employment Commission suggested that the broadly based construction industry was an ideal candidate for a nudge from the state. Late in 1936, Finance Minister Charles Dunning announced a "home improvement" loans scheme that would allow home owners to borrow up to $2,000 from the banks to renovate their homes. Ottawa guaranteed the loans up to 15 per cent of the aggregate loans made by each bank. The loans could be repaid on instalment, and interest of 6.20 per cent was levied.[81] All the details aside, the home-improvement loans were simply intended to put paycheques in builders' pockets – to boost spending power.

The banks eagerly participated in the home-improvement plan. The plan diminished the bankers' credit risk and brought business to the branches. The CBA worked closely with Ottawa to introduce the loans; in 1938, for instance, the association president Dobson urged member banks to give prominence to the loans in their spring advertising. The Royal Bank quickly became the leading home-improvement lender, with 26 per cent of loans made by the end of 1937. The plan was a great success; by 1940, $50 million had been dispensed under the scheme. It had brought the state and the banks together in an unprecedented manner. The scheme worked because the government shouldered some of the risk involved in lending in hard times, risk the banks alone carried at the decade's outset. It did not, however, revolutionize Canadian banking overnight. Together with the establishment of a central bank, the Canadian financial system was discovering new ways of facilitating economic growth. In 1936-37, for instance, agreements were made with the Alberta and Saskatchewan governments to allow the banks to finance farmers' annual purchase of seed grain under a government guarantee.[82] In themselves, none of these measures would have ended the Depression. They did, however, point to a different future for banking. The outbreak of war would deliver a huge injection of purchasing power into the economy; the banks would help to administer its application. As the war economy began to subside, Ottawa and the banks returned to the banking innovations of the late 1930s – a government-guaranteed farm-improvement loan scheme was introduced. This was banking for a more-complex, precarious national economy. Always a bank undaunted by new frontiers, the Royal Bank had been quick to establish itself on this new frontier of banking, not without initial hesitancy but ultimately reconciling itself to change in the spirit of Edson Pease.

In May 1941, John Maynard Keynes quietly slipped into wartime Ottawa. As a consultant to the British Chancellor of the Exchequer and a director of the Bank of England, he had just come from consultations with the U.S. Federal Reserve. Now he wanted to see Graham Towers at the Bank of Canada, but he did not want the Americans to learn of his visit. Knowing this, Towers proposed a private dinner party to fill their evening. It would be a surprise birthday present for Randolph Noble, Keynes's ardent Montreal admirer, who now found himself on leave from the Royal Bank as Sugar Administrator in the wartime bureaucracy.[83] We can only speculate what else they celebrated that evening.