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The Bank Act and the Crisis of 1866

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Source: *Journal of the Statistical Society of London*, Vol. 35, No. 2 (Jun., 1872), pp. 171-195

Published by: Wiley for the Royal Statistical Society

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Accessed: 27-06-2016 05:21 UTC

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Journal of the Statistical Society of London

JOURNAL OF THE STATISTICAL SOCIETY,

JUNE, 1872.

The BANK ACT and the CRISIS of 1866.

By HAMMOND CHUBB, ESQ., B.A.

[Read before the Statistical Society, 16th April, 1872.]

WITH great deference to the Council of this Society, I venture to suggest that inconvenience arises from the absence, in the quarterly *Journal*, of the discussion which takes place in this room after the reading of a paper. I do not for a moment imply that the Society is responsible for the views put forth in the papers which it prints, but the prominence given to those views, without any allusion to the very pertinent remarks by which, in my short experience, they are often controverted, must, in a measure, lead to an erroneous opinion of the position in which a question has been left. I am led to these remarks by the perusal of a paper read last year, by a member of this Society, on the "Rate of Interest during Monetary Crises." Many of the views urged in this paper were admirably met in the discussion which followed, but as the *Journal* is silent as to this, many startling conclusions remain apparently unanswered. Thus, it is stated of the Bank Act of 1844, that it is "perhaps the most absurd and disastrous Act which has ever been placed upon the statute book of this or any other country." Whatever be the opinion of individual members, I venture to think that this Society is scarcely yet prepared to pass a judgment in such sweeping terms.* But, whilst I confess that my present remarks have arisen from a study of the paper to which I have referred, I have no desire now to answer it directly. It would be but a cumbrous mode of conducting an argument, to answer by a paper one year, the views

* It must be remembered that neither the Society nor the Council undertake any responsibility in respect of the opinions expressed in papers printed in the *Journal*, and that no judgment is ever pronounced by the Society upon those opinions or upon what may be stated in the discussions which arise when the papers are read. These papers express the individual opinions of the writers, and they are printed for the information of the Fellows and the public, as evidence of the transactions of the Society, but not as communicating the general views of the members on the subjects treated of. A notification to this effect is printed in each volume of the *Journal*.—(ED. S. J.)

enunciated in another a year previously. I would rather, if I can, treat the subject generally; looking, however, upon the views contained in the paper alluded to as a fair sample of those held by persons who are opposed to the laws which now prevail in regard to the subject treated of.

I must be allowed to make only one other personal observation, which is, that whatever I may say in this paper, I say entirely on my own responsibility, and from my own convictions; and that any opinions I may quote, or facts I may make use of, are drawn always from such published sources as are equally open to every person.

It is my wish, and it is, I am afraid, more than the limits of this paper will permit, to inquire how far some of the ills popularly ascribed to the Bank Act are properly due to it; and then to endeavour, by the light gained from the late crisis, to ascertain whether there be not some other and deeper causes for these ills than those generally urged, and to seek in what direction it would be desirable to make further investigations. Before, however, these questions are entered upon, it is very desirable to examine some of the terms which are used in connection with this subject. From the paper referred to, looking upon it as a fair representation of the reasoning employed by those who approve its doctrines, I select two terms only, not because there are not many others, but because I regard them as being peculiarly unfortunate and dangerous. These two terms are, "The functions of banking," and "Banking currency."

It is said that "the special function of banks, and their sole function apart from the receiving of money in 'deposit,' is to 'mobilise property,' to give *general currency*, in the form of coin, "notes, or cheques, in exchange for securities in the form of *commercial currency* (bills) or other kinds of negotiable property." This language I hold to be misleading. The business of a banker is to deal in money—to receive it on deposit on certain conditions, and to employ it, after fulfilling these conditions, in the best way he can for his own advantage. In this he performs many functions. In dealing with the deposits entrusted to him, he finds that he must keep a certain proportion in cash, a certain further proportion he invests in short dated securities, and the remainder, with his own capital, he may invest in Government or other easily realisable securities. Experience tells him that the best short-dated securities are good, legitimate, commercial bills; and he invests in them, not because it is his special function to "*mobilise property*," but because they fall in best with that condition under which he is liable at any time for the deposits left in his hands.

As regards the second term, I find the following definition given of it: "*Banking currency is simply the exchange of one kind of nego-*

"*tible property into another kind more widely negotiable. That is "all."* Can anything be more vague than this? Does it mean that there are to be various degrees in the negotiability of the currency which a banker gives in exchange for a bill he has bought? This I believe to be by no means intended. By the "*other kind "more widely negotiable,"*" it is probably meant to refer to cheques and bankers' balances. But these could not conveniently be particularised. On the one hand, it would not answer the writer's purpose to suggest that a cheque should not at any time be convertible into bank notes, or bank notes into coin; and, on the other hand, it is not intended to limit a banker's operations by these very inelastic commodities. I am almost forced to the conclusion that the term is used to denote an elastic kind of currency, which shall be gilded, so long only as circumstances may permit, with the fiction of convertibility.

I will assume that there is no need to recapitulate here the chief points of the celebrated Bank Act of 1844, though so much misunderstanding appears still to exist, or at least so many misstatements are made in regard to them, that I am almost tempted to do so. I may, however, say of this Act, that, like many other acts of our English legislature, it is a compromise—having for its object the security and convertibility of bank notes and their regulation beyond and within certain limits, by the unerring index of the foreign exchanges; or, in one word, to give to English bank notes the essential characteristics of money.

The Act, so far as results are concerned, must be judged simply by the answer to the questions, has it or has it not fulfilled the objects for which it was designed? If it be conceded that it has secured the convertibility of bank notes (and I think it may be shown that it has done no more, even if it has done so much), then it has been successful. If it be insisted that in effecting this evils have been brought about, these evils must not be attributed to the operation of the Act, but must be regarded as the accompaniments of the use of convertible bank notes with a regulated issue; and if these evils are held to be intolerable, there is nothing to be done but to revert to the use of notes which may or may not be convertible, and be issued in regard to supposed local requirements, and not with reference to international dealings. I know that there is a school of economists who are not prepared to admit these conclusions, who hold that we may import almost any amount of foreign goods; that we may take up foreign loans; that we may travel abroad and accept foreign services; and, notwithstanding all the cost, have money at home to press on works or the manufacture of goods to any extent our activity or the hope of gain will lead us. Whilst their money is away, they would have a fictitious money at

home—their substance away, its shadow here, with all a shadow's unreality. Those who hold these doctrines, use arguments also which appear to me to be as full of contradiction as the doctrines themselves. In the very paper before me, I find it said, in p. 350, "Secure the currency by all means. Take whatever precautions Parliament may judge necessary to secure the validity of the note,"—whilst the tenor of much of the argument is in favour of a state of things nearly if not quite what it was before 1844. Now the Act of that year is the most distinct utterance Parliament could give of what it does think necessary to secure the validity of the note. Those, therefore, who use this language, appear to be asking for two opposite things in one breath, viz., they ask Parliament to give them free issues, and to authorise this system in spite of a law which lays it down that restriction within certain limits is absolutely necessary.

The Act was a compromise. For with a view to avoid injury to existing interests, it permitted issuing bankers to continue their issues within certain limits. And this is still its weak point. There is little doubt that it was expected that these issues would have been absorbed more quickly than has been the case; and if the Act can be said to have failed in any of its provisions, it is in regard to this subject. Lessons are to be learned from a study of these issues, the force of which it is impossible to believe has been realised by those who advocate a freer issue of notes on any other base than gold. Mr. Gladstone, speaking in 1866, asked with reason, "What part has been played during this period by the country bank circulation? Has it been found available for the wants of the country? There has been an immense demand for notes and coin. If the country bank circulation had been in a satisfactory state, it is evident that not only the notes and coins of the Bank of England, but those of the country banks themselves would have been largely drawn upon. Instead of that, however, we have actually seen the country bank circulation diminished by not less than a million, at the very time of this drain upon the Bank of England." The return given in the Appendix fully bears out this statement. With money at 10 per cent., the issues of private and joint stock banks were 1,000,000*l.* less than they were when the rate was at 6 per cent. Nor, it will be seen, was this peculiar to the year 1866. The crises of 1847 and 1857 exhibited precisely the same results, and bear equally strong evidence of the unsubstantial character in seasons of dear money of issues based on credit. And the mischief does not end here: for, though there are no published returns which would clearly show the extent to which it was carried, it can scarcely be denied that, concurrently with the diminution in the volume of credit notes, there was a great demand for bullion to

support those which remained. These facts go far to refute the views of those who love to picture the plenty that would exist under an unfettered system, and hold that the power to issue notes would be used with freedom whenever the demand for money might be urgent.

The following will, I think, be found to be a fair statement of some of the more serious of the evils which are commonly attributed to the system which obtains under the Act:—

1. The frequent changes in the rate of discount, and especially the prevalence sometimes of very high rates.

2. The contraction of the currency at times when probably the need of it is greatest.

3. The consequent crippling of trade, and the injury to traders who, in other circumstances, could continue to carry on an active business.

The advantages which it is conceived might accrue from some other system, as yet undefined, are of course the very opposites of these evils:—

1. By some means the rate of discount might be maintained at a more even rate.

2. There might be an expanding issue, which would widen the more it is needed.

3. And it is almost implied that all traders, whether doing business within their means, or whether *in extremis*, have a right to the conversion of their “commercial currency (bills) into another “kind more widely negotiable.”

Indeed, if my memory does not deceive me (and here again I regret that there is no record of the many admirable remarks which he made on the paper I refer to), our respected President of last year committed himself to the view that what was wanted was a grand central dépôt, where, as a last resort, money might be obtained in times of pressure.

The point which strikes me more than any other in all these complaints is the constancy with which the subject is regarded from one point of view alone. They resemble the impotent cry of the ruined man for the needs of the hour, rather than the calm consideration, at an earlier stage, of the causes which have brought him to ruin.

Let me endeavour to examine some of these complaints.

And first, that as to the fluctuations in the rate of discount, that is, in the price of money; and frequent contractions in its supply. The true answer to this would be that the Bank Act has nothing whatever to do with the matter. It only secures the genuineness of money. Let us look at the question under another aspect. Suppose spirit of a certain proof is ordinarily worth 20s. a-gallon,

but from an excess of demand for it, there ensues a scarcity. Two courses are open to a dealer. He may either put up his price for the true spirit to say 25s., or he may give the same quantity of liquid with one quarter less spirit in it. The price to be paid for the actual spirit is the same in both cases. Those, however, who clamour for increased issues, when gold, the spirit of our currency, runs short, fail to realise the truth of this. Now the Bank Act only says that the former course, the true, straightforward course shall be that taken. If money, from exportation or from excess of employment for it runs short, it says that that which remains shall not be diluted, but fall under the ordinary law of prices. With its plenty or its scarcity the Act has not the most distant connection. And no one can say why money should not follow the course of every other item of trade. If bonds, or shares, or tea, or cotton, become scarce, no one hints that a rise in its price is out of course, or even objectionable. A distinct understanding as to what really constitutes money, would make the matter clear; but this is not always convenient. Not only is there in many minds a confusion (pardonable in some cases, it must be admitted) between money and those expedients for economising money, which for a time, and within a limited area, may perform the functions of money, but there is an almost equal confusion amongst others, between property and money. Because property which is in common request is generally exchangeable for money, they come to regard property as money. The question as to its being in common request quickly takes a second place in the minds of those who naturally are disinclined to depreciate their property: and the belief that in the possession of any kind of property (possibly of goods for which there is no present demand) they possess money, they are indignant that they cannot obtain on their property that which the world will regard as money or currency. Hence this vague notion as to a banker's duty, and the ultimate conclusion that his *sole* function consists in his exchanging that which is not money for, first its representative, and then, when this will no longer answer, for money itself. They fail to see that money is the standard by which these things are valued, but that the things themselves are not money.

The other complaints as to the contraction of the currency and the crippling of trade, as well as the craving for an expanding issue in times of difficulty, hinge of course upon the mistaken views just referred to. Trade and commercial activity are said to be a nation's prosperity. Granted; but what kind of trade? Can there be more than one answer to the question whether this applies to trade carried on within safe limits, or to that which is so overstrained that it must infallibly lead to a collapse?

The increased price of money and the difficulty of obtaining it,

tell us, in the most natural way, that the nation is trading beyond its means, or that we are living too rapidly or too luxuriously. The floating capital of the country, with which enterprises should be carried out, is diminished, and the rate of discount, which is the measure of the value of this capital, rises. But when it becomes necessary to restrict trade, we have the well known picture held up to our pity of the honest trader—the victim to the system—whose trade, good in all other respects, is only crippled because he cannot obtain sufficiently cheaply, the means with which to carry it on. But is “honest” quite the word to apply to such an one? Remember, it is not the trader who has always kept fairly within the compass of his own capital, but the trader who cannot renew his bills, who cannot exchange his “commercial currency,” that is in this precadiment. Such a man has been trading on fictitious capital, and the question is whether trade so carried on can be of advantage. Sir Robert Peel had this very point in his mind when he said, “it may be a question whether there be any permanent “advantage in the maintenance of private or public credit, unless “the means of maintaining it are derived from the *bonâ fide* “advance of capital, and not from a temporary increase of pro- “missory notes issued for a special purpose.” So far as he could speak, he answered the question distinctly enough. Those who think differently, appear to hold this curious position. They cling to a gold currency, for they know it is the almost universal measure of value: they know that its quantity is limited, and that its value, relatively to all other things, is regulated strictly by its quantity; they would not of course wish to separate themselves from other nations, with which indeed they generally desire to extend their dealings, and yet they wish to separate themselves to this extent, that whilst other nations should measure their goods by this common standard, they should have a currency capable of any degree of extension, which shall be gold and yet not be gold. So, too, the speculative trader is always anxious to individualise himself, and yet to be of the nation. “Give me,” he says, “the means I “want. I have nothing to do with these national crises.” But he cannot separate himself thus. He has been swelling the volume of fictitious capital; he has been doing his utmost to force into circulation an unreal currency; he has been eating up the temporary fruits of it, and with the break-down of these, he must suffer with the rest.

The dear price which the individual or the nation has to pay for money, may be likened to the pain which a person feels who has carried to excess any natural function, harmless in itself, as eating or walking. May I be allowed to illustrate my reasoning by a very familiar example. A modest manufacturer of any article of

limited consumption, let us say carriage wheels, finds that in very easy times he can get readily an advance by means of bills upon his manufactures; and on this he enlarges his premises, employs more men, and makes more wheels. Finding his paper, based upon these, still acceptable, he carries on a considerable trade. He lives well, and spends freely of his profits. But then comes a time when even carriage wheels fall heavy on the market. Advances on them can only be obtained with the utmost difficulty, or not at all, and what then is his position? His profits spent in good living, and his goods at a discount, the only course for him is to limit his production, and for his friends, through whom he has been able to maintain the prices of his goods, to wait, happy if the natural decay of wheels will in time bring the security for their advances to its ordinary value once more. Had this man by some inventive genius been able to make his goods at half the ordinary cost, he would have benefited the world and himself at the same time; but he only made more things than were wanted, and at a price people would not pay. There are economists who will say that he acted well—that in stimulating trade he did a national service. But this is the point. Manufacturers would indeed have a merry time of it, if they could make their goods without reference to the capacity of the market to absorb them. This question is probably the disagreeable element in their business. Now the truth is that those who urge that a banker's special function is to *mobilise* bills, simply mean, though I do not suppose they will admit it, that it is the duty of a banker to act as a universal customer, and buy up all the goods people choose to make in excess of the demand for them. It is no question here as to the advantages or otherwise of legitimate speculation, I would only decry those who would speculate on other person's means; and that doctrine which lays it down that it is a banker's function to supply those means. "To destroy speculation," says Mr. Hubbard,* "is to destroy the energy of the country." And again, "Speculations undertaken by men of character, of capital, and of credit, will seldom work harm." . . . Further, he says, "It is not the lending at low interest to men who deserve credit, but the lending at *any* interest to men who deserve no credit . . . that occasions so many failures . . . so much ruin." Copious supplies, which it may be assumed never would have been lent, had the credit of the individuals, or the true value of the property securing them been seen in its true light, were advanced in the period under consideration, and the only natural results followed. In examining further into this subject, it will be important to trace how this could have been brought about, and what is the machinery by which

* "The Currency and the Country," 1843.

persons of no credit or concerns of no worth, have been able to attract means for a time from presumably tenacious holders.

That the practice of the peculiar functions of banking, or, as I should prefer to call it, the misuse of the banking system, which was illustrated in the case of an obscure trader, by which a fictitious capital has stimulated trade to an unhealthy state, has been freely practised of late years in this country, may, I think, be proved by the crisis of 1866.

The three great crises since the passing of the Act of 1844, have had each a different origin. Of the two earlier ones, in 1847 and 1857, I shall now say nothing. They would, I believe, illustrate and strengthen my present argument, but they would, unless the subject were treated at greater length than my limits allow, tend to complication. The third and latest, that of 1866, may be called a banking or rather a financial panic, and its causes may, I think, be traced with sufficient clearness. For many years previously the practice had grown up under which many banking and other commercial houses borrowed enormous sums at interest from private lenders, with a view to employing them profitably. In the Appendix I give the accumulations thus held by the joint stock banks in London alone between the years 1861 and 1866, so far as these can be obtained from the unfortunate mode in which their accounts are rendered. The increase here is stupendous, but this statement takes no account of the private firms, discount houses, financial associations and others, which grew up prior to, and about this period. For as the public became initiated into the system under which they found their spare money employed for them, so there very soon grew up a class of undertakings, whose special object was to employ these deposits in commercial transactions, and who held out to their clients, as inducement, the high profits which it was stated this class of business would afford them. Here was the first element of danger, in the existence of a class of pseudo-banking establishments, with vast means at command, prepared to give effect to the false principles of banking which have been enunciated.

The first and great employment of these accumulations was in discounting bills of exchange, or, in the expressive language of the theorists, the giving a *general currency* in exchange for a *banking currency* (bills). But as the supply of good trade bills was limited, and the needs in respect to these were met by the first class houses then existing, and as bills must be had, it followed that in a short time the worthless expectations of almost any hazardous undertaking, fostered into being by the then misunderstood principles of limited liability, came to be represented by bills, and to be regarded

as "banking currency" by those houses who, if they had not received them, would simply have had no business.

This state of things, and what followed cannot be described more truly or more graphically, than in the language of the city article of the "Times" of the 12th May, 1866 :—

"For more than three years the speculative propensities of the public have been stimulated by the manufacture of finance bills for millions upon millions. This paper, which ought never to have been admitted within the walls of a respectable bank or discount establishment on any terms whatever, no matter what might have been the character of its endorsements, was taken freely in all directions. . . . Every contractor who wanted to make a railway, or build a city, had only to go to a finance concern, pay them an enormous bonus, and be furnished with what was called 'money' in the shape of bills drawn by himself and accepted by the company. Of course these bills were not to be paid till all the grand works in question were completed and had become *bonâ fide* property, although, perhaps, the prospect of that consummation might be at two, five, or ten years date. The reliance was that the bills drawn at short periods of three or six months, might be indefinitely renewed, and so tempting was the operation, and so enormous the apparent profit, that at length the competition of the various companies was such as actually to induce contractors to invent schemes to favour them with this kind of business. . . . The bills answered all the purposes of money. . . . But what is the sequel? At length it is discovered that the prodigality of the national expenditure thus encouraged causes gold persistently to leave the country, so that the outflow can be checked only by a constant enforcement of a high rate of discount."

This is strong language, but who can say that it is untrue? Is there any need, in order to prove it, to bring forward a list of the unsound schemes which were set on foot about that period? In the Appendix is shown a list of a few of the undertakings in which the single house of Overend, Gurney, and Co. were involved at the date of the transfer of the old business to the limited company. The balances then due on only thirteen accounts amounted to 3,500,000*l.* The hope of recovery was estimated at only 711,500*l.*, and the deficiency considered to be 2,788,500*l.* A complete list would certainly be curious, as showing how thoroughly different tastes had been considered in the modes devised for employing money. Railways, steamships, land companies, hotels, shipbuilding, finance associations, building operations, the purchase of the private businesses of individuals, and banking under improved systems; there is scarcely a branch of industry which did not share

in the false prosperity of the hour, or which was not stimulated into production of some kind entirely beyond the wants of the time, and which did not in turn stimulate individuals to an expenditure, both at home and abroad, utterly beyond the resources of the nation.

A general outline of the course pursued by these concerns is known to most persons conversant with financial matters; to some persons indeed even details must be painfully familiar. Nevertheless, as it may be convenient to take some case in illustration of my argument, I select one only, that of the Chatham and Dover Railway Company. And let me be allowed to say, that I choose this case, not only because it quite satisfies my requirements, but because the great publicity with which its affairs were canvassed, makes it, perhaps, better known than others; and, further, because the cordial admission, even by those who suffered most, of the good faith of those at the head of the company, will absolve me from any suspicion of holding up any individual concern here for any other object than that of illustrating a principle.

The Chatham and Dover Railway Company raised capital, in the three usual forms of ordinary stock, preference shares and debentures, to an amount of 15,253,520*l.*, and expended in works, &c. on their line, 10,625,498*l.* That is to say, that the cost of raising these ten millions and a-half was 4,628,022*l.* This represents the measure of the unwillingness of the public to invest in this undertaking; and the cost of the expedients for obtaining the sum in spite of their unwillingness. The course pursued in the later stages of the company's career, for up to a certain point the ordinary system sufficed, was this. A contractor having undertaken to construct certain sections of the line, subscribed for the ordinary capital issuable in respect of these sections, and gave a receipt to the company as for a sum of money: the company, on the other hand, giving the contractor a receipt for the full amount represented by the shares, in consideration of his undertaking to construct the line. Here was the first step. A certain class of security had been created, valueless, so far as its general acceptance by the public was concerned, but still security of a certain class. On this the law allowed the issue of a certain proportion of debentures, and these were issued at once. But even these ordinarily high class securities were not convertible into money, so little did the investing public encourage the undertaking, and it became indispensable that they should be "mobilised,"—to borrow the term authorised by the advocates of free banking; and to do this they were lodged with societies who, for a consideration, consented to regard them as securities, and on the strength of them accept bills drawn by the contractor. Thus the bonds were converted into what is styled "commercial currency," and here it became the banker's "function"

to do the rest. It was his province to give this *commercial currency* a *general currency* in the form of cheques, &c., and he acted his part bravely.

Here we have the whole system displayed; the various forms of what is termed currency, with the varying degrees of circulation enjoyed by each. And the curious part is that the last form, equally with the first, was fictitious, and that neither rested on any solid foundation whatever.

The results are striking and instructive. Here was a railway which people did not want, and for which they were not inclined to pay. Had it been made with the accumulated or surplus capital of individuals, there might have been a remote chance of some profitable return. The prospect, however, was not attractive, and people would not invest. But people would blindly trust their money to the care of bankers or finance societies, and through them, under the fiction of commercial transactions, they did actually contribute to the very thing they would not look at in its true shape, and that at such stupendous cost, as to render any chance of profit utterly hopeless. But the evil does not end here. Had persons invested capital in the railway, it is very probable they would have lost it, and the matter would have ended. The bills, however, which were ultimately fabricated, were held in numbers by firms who could not possibly know the mysteries of their creation, so that when their worthlessness became apparent, dismay was scattered far and wide amongst a class of persons who would not have dreamt of holding railway property. In short, the result was that bills to a very large amount were in circulation, having the form of true commercial bills, but representing only some unknown share in the works of a hopelessly insolvent railway.

With slight variations adapted to the different circumstances of each case, the system adopted by this company was carried out in a great number of instances; and property of all degrees of value, or which it was hoped might have some value ultimately, but which ought all to have been represented by invested capital, was converted by millions into bills and called currency. Meanwhile the operation of the Bank Act during the same period was precisely what its framers had intended that it should be. By the evident warning conveyed in the rising rate of discount or price of money to those who cared to read the index rightly, it pointed out with unerring truth the extent to which the national resources were being contracted, and trade or expenditure of some kind was being overstrained. And it not only did this, but it did one thing more. Amidst all the depreciation which showed itself on every side and in every shape, when the only result which could happen did come about, the bank note maintained its promise to the letter.

The antagonism, however, between true currency and false, seems to say plainly that there is a flaw somewhere, and people have a right to ask whether these cruel disturbances must be expected periodically. Is the present state of things so perfect that there is nothing to be done but to go on with it, knowing that the terrible reckoning shall come again, with its sure outcry for more money, when there is no more of it to be got; knowing that there will again be heard the often repeated demand for a repeal of the Bank Act—a demand that means simply this—“debase your currency, weaken it out, dilute it, only give us some;—whatever it be, it will suit our needs for the hour. Never mind that ruin will only come a little later—never care that we shall soon see what we now call money divided into two classes, gold what it was and is, but notes meaning anything;—this wretched moment will be got over, and the crash may fall on other shoulders!” This is the question, and for the most part I can rarely detect, in the general consideration given to the subject by writers, any other elucidation than is contained in one or other of these two answers; either that it must be so, and matters be left to work out their own cure, or, that the present Act is wrong, and must be abolished or materially modified.

The question, Must these crises occur? is one to which a consideration of the past must readily supply an answer. Assuming our present system in all its parts to remain unchanged, and the same views in regard to it as have hitherto influenced people, to continue in force, not only may their recurrence be expected, but with considerable regularity. The further question however, Can any measures be taken to avert crises, or rather, to render their coming less probable, or even to modify their effects when they do come? is more difficult to answer. I believe the question to be still in that stage in which inquiry, the collection of facts and the elucidation of first principles, are yet needed. It is in this spirit alone that I venture to approach the subject.

And here let me remark that the chief difficulties which appear to lie in the way of success, are to be found, as I think, in these considerations:—That the causes which tend to produce crises are due to the natural impulses of men, who are actuated by energy, shrewdness, and hope of gain; and that the measures to be taken, or the influences brought to bear upon them, must be of a restrictive character. Look at the last three panics: they have been followed by periods of very restricted trade; then by periods of healthy activity, followed by periods of such excessive and overstrained trading, that another crisis with panic necessarily ensues, in which almost all that is unsound, with much unfortunately that is sound, is ruthlessly swept away. A panic is a terribly stern and violent

remedy. But, if it is to be avoided, the whole power which it exercises of sifting out what is good from what is bad, and all its restrictive effects, or nearly so, must be introduced into our commercial system, only at an earlier stage. The enterprises started before their time, and by other means than *bonâ fide* invested capital, are effectually put an end to by the first panic. What is wanted is, that by some means equally effectual, a stop should be put to such enterprises altogether. We may as well revert to the labours of the alchemists of old, in their endeavour to create gold, as attempt to devise any system by which unsound or overtrading can be long maintained.

The first consideration should be to determine what part of our present system is at fault, this system consisting of gold or notes convertible into gold as a base, with a superstructure of credit.

For some years past the cry has been against the Bank Act, which may be said to control the first part of our system, and it would indeed be difficult to find stronger language against that much abused measure, than has been heard not long since in this room. But I shall have laboured in vain if I have failed to show that the Act has nothing whatever to do with producing panics, otherwise than as a barometer may be said to bring about foul weather when it shows that it is going to happen.

A crisis is caused by an insufficiency of capital for carrying on the undertakings which have been set on foot: a panic is the unreasoning fear of those who find themselves likely to be affected by such a condition of things. The Bank Act does not diminish the supply of capital. It keeps that currency, by which of course capital may be represented, in a sound condition, but it has nothing to do with the amount which may be kept in this country. Our currency is gold, and there is a perfectly sufficient supply of this in the world. If the means of getting rid of it from this country are easy, the means of obtaining it are clear. Too strong a protest cannot be raised against those arguments in which currency and capital are confused, and especially against those popular writers who, taking some period, or even day in times of panic, point to the gold in the Issue Department of the Bank, which is really held by the public in the shape of notes, and picture the relief which would be occasioned if this were suddenly to be distributed through the banking department; forgetting, or, I am afraid, ignoring the evident truth that if their principles had previously been in existence, this stock of gold, along with every other stock, would probably have long before disappeared.

If I have put forward just conclusions in regard to the operation of this Act, and to the causes of the late crisis, it will be apparent that no hope of avoiding a recurrence of the one, is to be

found in any organic change in the other. I do not say that modifications of the Act may not be desirable. It would certainly be of advantage if the extinction of the private issues could by any means be hastened. I believe it would save some misunderstanding if the present complicated system by which the Bank is compensated for the duty of conducting the issue department, were simplified. Other changes might be suggested; but any change which would weaken its power to maintain a pure currency would be a retrograde step, leading simply to disaster.

But if we hold that this part of our system is beyond reproach, it is incumbent to show what part is not; the system consisting, as has been said, of (1) gold, and notes convertible into gold; and (2) a superstructure of credit.

Now the inquiry into the crisis of 1866 has, I think, brought out the fact strongly, that during that period and for a few years previously, there were, in effect, two currencies, if I may call them so—a true and a false. The Bank Act has maintained the one, perfect, simple, and true—a currency which has never failed to perform its proper functions. On the other hand, an extension and misuse of what is called the credit system has fostered the growth of another kind of currency, in the shape of bills, &c., far beyond the proportion it should always bear to the currency founded on gold. This, which is no true currency, and for which indeed a new term has to be employed, viz., “commercial currency,” is of a kind which admits of no regulation, and until it shall collapse, is subject to no restriction, and scarcely any limit.

Let us for a moment see how this is shown in the inquiry. Prior to the crisis trade had been active, foreign loans heavy, expenditure lavish, and capital, as evidenced by the high rate of discount, scarce. Those undertakings, therefore, which should only be carried out by accumulated capital should have been entered into with extreme caution, but, instead of this, the promoters of various works found that they could, for a time at least, obtain unlimited capital by the manufacture of bills, though these had often no other foundation than the possibility that the work might ultimately be carried out, and the hope that it might prove profitable; and when such instruments were created, those were found who, either innocently in the way of business, or under an unfortunate conception of the true functions of a banker, gave these bills—this “commercial currency”—a “currency having a wider circulation”—not money, for the truth is, as has been stated by Mr. Wolowski, that *money* is but little needed when credit abounds, bankers’ balances and cheques then sufficing.

This extension and misuse of the expedients for economising money, and the danger arising from the practice, did not escape the

foresight of many of our standard writers on the currency. But as their efforts were devoted chiefly to securing the regulation and convertibility of bank notes, this part of the subject held but a second place, and seems to me never to have received that consideration which its vast importance claims for it. Mr. Norman says,* “no multiplication of bills as to amount, no increased facilities “in their employment . . . can, except for a short period, keep “the level of general prices elevated above their real money range.” Of the truth of this there can be no doubt. The question is, what period was in his mind when he used the term “short period?” Probably he could have then had no idea of the ingenious expedients which would have been resorted to prior to 1866, to give, for so long a season as was then experienced, the power he denies to the instruments to which he referred.

Be this as it may, it is this part of our system, and not that which is regulated by the Bank Act, which contains the elements of danger; and it is only, I believe, as this subject is more clearly understood, as the true use of credit and the danger of its abuse are more commonly realised, and as the public mind shall seize the somewhat difficult truth to lay hold of, that instruments founded on credit are not money, that any well founded hope exists, if not of avoiding in the future a repetition of those evils which left so cruel a mark in 1866, at least of modifying their violence when they overtake us.

It would perhaps be wiser for me to end my paper at this point, satisfied if I am only correct in my general conclusions. Anything further can only be regarded in the light of speculations on my part, and be valued simply as such. But if permitted, I venture to indicate the directions in which it seems to me that the subject might be pursued.

In the endeavours to give to credit some of the attributes of currency—to create a false currency when the true has left us—two things are needed; (1) the means which give a semblance of currency; (2) the instruments to which this currency is given: and each demands attention.

As regards the first point, it is a common view to regard such concerns as “Overend, Gurney, and Co.,” certain of the finance societies, and some of the more reckless bankers as the cause of the late crisis. And so no doubt they were by the unwise use of their unhealthy accumulations of idle capital. The danger of this system appears to lie in the uncertain position which the capital thus accumulated holds. A balance on an ordinary banking account, has a

* “Letter on Money,” 1841.

certain element of permanency. The relations of a banker and his client are generally of a lasting character, and, so long as the account exists, it is clearly understood that a fair balance is to be maintained. But those who lodge money at interest, appear to desire all the advantages attaching to the power to realise at will, and yet to obtain the benefits attending permanent investment. The companies who hold money on these terms are almost forced into the purchase of bills; and if there be danger in companies holding, under an obligation to employ it at high interest, money which belongs to individuals who are too ignorant or too timid to invest it for themselves, how much is this danger increased when these holders buy bills, which, really representing invested capital, are studiously devised to blind the holder as to the nature of the investment he is actually making. This has been strongly illustrated in the case of the railway company. They could offer but poor security, but they very much desired capital: there were people who had capital but would not lend it. It needed these go-betweens to receive the timid proprietors' capital, on the plea of holding it at call, and to invest it in the railway undertaking under the fiction of buying bills. Ultimately, of course, the railway company, the finance operator, the original lender, who all, unknown to themselves and each other, had combined to build a worthless railway, together with a vast number of others connected more or less with the system, fell in one common ruin.

If this branch of the subject offers a wide field for consideration, a still wider field will probably be found in regard to the instruments to which a kind of currency is attempted to be given: in other words—bills.

Now I am afraid it will seem a very simple remark, if I express my conviction that there is greatly needed a more general knowledge than now exists in regard to bills and credit instruments, especially as to the occasions when they ought or ought not to be used. Any one who studies the history of a commercial crisis, must be struck with the feeling that some persons seem to be guided in this matter by a code of morality peculiar to itself. The mind is impressed with the idea, and the paper read last year, to which I have referred, seems, if I read it rightly, almost to sanction the notion, that many people regard the creation of a bill, without the most remote thought of its payment at maturity, simply as an ordinary business transaction; that it is a simple financial operation, rather to the benefit of the nation than not; and that the meeting a bill when due, should not be effected by the vulgar device of its payment, but by recourse to further financial operations. Such operations beget a "commercial currency," to which it is "the special function of a banker to give a wider circulation," &c.

A bill may be conveniently described, for the present purpose, as a representative of indebtedness, in such a form that it may pass from hand to hand. If B owes A money, then a bill drawn by A and accepted by B represents the debt, and contains an acknowledgment of it, and a promise of its payment at a given time. If C buys this bill, he buys A's right to recover this debt. It is not a cheque, for that gives the payee a right to a definite portion of a certain sum of money; a bill only gives its holder a right to the result of a claim against a certain person at a certain period; and there is this further difference, cheques can only be drawn to the extent to which they can be met; whereas bills may be drawn to any amount, and every debt, or intended gift or imaginary dealing might be represented by a bill.

Such being the characteristic of bills, it would appear to be desirable that their creation should be restricted to limits within which they cannot be injurious, but only be beneficial; that the fulfilment of the object stated in them be assured; and that the holders of them be given some means of ascertaining that these general principles have been considered; and for this purpose three things appear to be necessary, 1st, that there should be some common understanding as to the conditions under which the creation of a bill is advantageous and not harmful; 2ndly, that the circumstances under which it is created should be such as to warrant its being met at maturity; and 3rdly, that it should bear upon it some evidence of the purpose for which it was created. I know that I lay myself open to be told that bills are based upon credit, and that this being so, it is to the credit of the individuals who place their names upon them, that attention must be paid. But to this I would answer that, whatever the theory may be, the objects I have suggested as desirable are in fact matters of the highest importance to those who would select the bills they hold with care. There are, I believe gentlemen who almost devote their lives to a study of bills with a view to ascertaining the truth on these points; and so proficient do they become, that it is said, from the appearance of a bill they can tell you all about it, almost by a kind of intuition—much as some men can tell which way the wind is going to blow, or whether there is mineral underground. I shall be told again, probably, that the class of bills to which I have referred as causing injury in 1866, were not held by first-class houses with established business. Without pausing to consider how far this amounts to an admission that there are different classes of bills, I would remark that this fact adds to the danger. It is the advance of borrowed money on a bad bill, by a house without established business, that causes harm; it is through the action of such houses, in connection with such

instruments, that loans are granted of that class to which Mr. Hubbard imputes such injurious consequences.

Assuming it, however, to be admitted that the points I have suggested as beneficial in regard to bills, be held to be desirable, it is necessary to examine these instruments to ascertain how far they come up to the standard. To do this, I venture to divide bills into three classes:—

Commercial bills ;

Accommodation bills ; and

Bills based on property of a stationary character.

The truest example of a good commercial bill, I take to be a bill which represents the value of reproductive capital in some form or other. Goods of all kinds have a period in their history when they may be said to disappear for a time, either in the course of undergoing change by manufacture, or whilst being conveyed from one part of the world to another, or when lying by in a necessarily dormant condition ; and the true commercial bill is an instrument by which the capital represented by the goods during such period, shall not be lost to the owners. But the whole point of the arrangement lies in the reproductive character of the goods. The capital represented by the bill should exist only whilst that sunk in the goods is dormant ; the moment the goods, so to speak, reappear, the bill should cease to exist. Thus, a bill which is created when a cask of sugar is consigned to the hold of a ship, and is liquidated when that cask reappears and is made use of, falls completely within the definition of a true commercial bill : but a bill representing a share in the ship conveying the cask does not. The greater proportion of ordinary trade bills probably fall within the former category, and fairly fulfil the objects for which such instruments are useful. There are, however, some practices in regard even to these to which I think attention might be directed. Passing by the case, so commonly referred to, of a bill being created on each occasion when the goods it represents change hands, so that there may be many bills based on only one thing of value (for I have not intended to imply that the holder of a bill has any claim on specific goods, but only that bills drawn on goods are clearly within the limits in which they are beneficial), I would point to the pertinacity with which the issuers of some bills cling to the old forms when the surrounding circumstances have greatly changed. Bills on goods shipped from India, for instance, are, I believe, still drawn ordinarily at six months—the period actually consumed a few years ago in the conveyance of the goods to Europe. But this period may now probably be put at four months instead of six. In this case it would follow that one-third of the whole amount of bills drawn on goods shipped from the east—bills which formerly represented the

purest form of commercial bills—now swells the volume of what must be called fictitious capital.

The second class of bills—accommodation bills—need not detain us a moment. We all know what they are. In their best form, they are instruments of doubtful propriety, and are looked askance at by most writers on credit: in their grossest form they are contemptible, and only exist to the extent that the hopeful persons who draw them, can find credulous persons, or worse, to buy them.

The third class of bills, for which it is difficult to find a suitable name, I have illustrated in this paper by those issued in connection with the railway; and it seems to me that they altogether violated the legitimate purpose of bills by converting into what has been so aptly called "*commercial currency*," that which should only have been represented by invested capital. Unless the public had done what they previously had shown a manifest disinclination to do, viz., to invest their surplus capital in the railway works, there was not the slightest pretence for supposing that these bills could be paid at maturity, unless by the issue of others in their stead. I go so far as to say that they were not in fact bills at all. They were in truth little debentures—a small change for the debentures on the faith of which they had been accepted.

Now when a person lends on mortgage, or buys a debenture, it is seldom without inquiry as to the merits of the security, to which the instrument itself at once points him; but to the buyer of a bill the real security can, at the best, be but a matter of guess work, and bills of the class in question, both by their title and their form, carry deception far and wide. Representing one thing, they have been dressed out in a form which has hitherto represented another; and instead of being held by the investing portion of the public, as a mode in which they could dispose properly of a portion of their surplus capital, they have been held improperly by the commercial part of the community as commercial bills. The argument, that bills should be considered simply with regard to the credit of the individuals whose names are upon them, seems, in regard to these bills, to lose all its force. For a contractor may be wealthy, and his capital more than ample for his general purposes; the capital of a shipbuilding company may be quite sufficient for their plant and legitimate trade credit; but when looked at as the chief safeguards in respect of bills which may represent in one case the cost of a line of railway, and in the other, of a fleet of ships, both of which, railway and ships, may turn out unprofitable speculations, these capitals will probably represent but a very modest proportion of the engagements they are presumed to guarantee.

If what I have called true commercial bills need some changes—changes which may perhaps be best left to those who use such.

bills to carry out; if also it should seem desirable or possible to make bills falling under the second denomination, bear some clearer indication on their face of what they are than they do at present; the bills coming under the third class, which have sprung into unusual life within these last few years, and which I believe possess elements full of danger for the future, seem to me to need separation from the others by some very clear line of demarcation, and to demand regulations in regard to their issue of a far and more definite character than now exist.

In conclusion, for this paper has far exceeded its proper limits allow me to say one word of apology. I consider that any one coming to this room and saying, "I have a scheme here which will "set all our currency theories right, and make all panics things "of the past," would be at least an enthusiast, if nothing worse. I have attempted nothing of the kind. As I have selected the crisis of 1866 for consideration, I have of course limited my observations to the working of our system at that period, and have merely endeavoured to point out, in contrast to the sound parts, those weak places in it, which, as I believe, manifested themselves then with peculiar distinctness. With this view I have striven to show that the Bank Act secures us nearly, if not quite, a perfect currency. But as, notwithstanding the Act, we did in 1866 have a crisis, followed by a panic of almost unexampled intensity, I have ventured to suggest that this state of things was owing, in the main, to the introduction and misuse of a spurious currency, if I may call it so, which answered a purpose for a time, to the derangement however of all sound business, as it enabled persons to promote undertakings which the common sense of the nation held to be profitless and unsound, and enabled others, who possessed no capital, to compete on unfair terms for a while with those who had it. I have endeavoured to show that this spurious currency consisted of (I cannot use a better term than that used here last year) "*mobilised bills*," or, in reality, bills having little or no true base, but to which an undue use of banking facilities had given a "*wider circulation*" in the shape of bankers' balances, cheques, &c. Believing this to be the case, I cannot hold with those who would mend matters by repealing the Bank Act: but I lean to the belief that a remedy should rather be sought in connection with those means, by which the creation of this spurious currency to so large an extent is made possible. I am the more strongly led to this view, because it appears to me, that instruments formerly used, and still used with the utmost advantage under certain conditions, have been made use of under circumstances to which they are not adapted. Immense changes have taken place within a comparatively short period—aided by the ease with which public companies can be formed, and

the extension of banking facilities; but no precautions appear to have been taken against the misuse of those instruments which were adapted to a state of things antecedent to these changes. As I have seen public attention but little directed to this branch of the subject, or only feebly so, I have presumed to think that advantage may arise from a wider discussion of it.

If it be said that, whilst I have been bold enough to suggest discussion, I have not ventured to suggest any definite proposals, this is true. I have abstained from doing so, partly on principle, from a feeling that the time is hardly yet ripe for it; and also, I frankly admit, from a profound sense of my own incompetency for such a task. This paper will, however, have fulfilled its object, if it enable me to record in the Society's *Journal* a protest against what I believe to be the unsound views which already appear there; and still more, if it be instrumental in bringing to the subject on which it treats a wider consideration than it appears to receive at the present time.

APPENDIX.

TABLE I.—*Weekly Average Amount of Bank Notes Issued by Private and Joint Stock Banks in England and Wales from October, 1847, to January, 1848, with the Rate of Discount during the same Period.*

1847. Week Ending	Private Banks.	Joint Stock Banks.	Total.	Minimum Bank Rate of Discount.
	£	£	£	Per cent.
Oct. 2	4,402,368	3,155,877	7,558,245	6
„ 9	4,489,110	3,170,819	7,659,929	„
„ 16	4,522,385	3,223,756	7,746,141	„
„ 23	4,412,021	3,177,560	7,589,581	„
„ 30	4,223,947	3,054,470	7,278,417	8
Nov. 6	4,039,039	2,880,658	6,919,697	8
„ 13	3,869,295	2,729,915	6,599,210	„
„ 20	3,715,826	2,594,672	6,310,498	„
„ 27	3,635,411	2,527,304	6,162,715	7
Dec. 4	3,571,668	2,455,189	6,026,857	6
„ 11	3,524,654	2,408,811	5,933,465	„
„ 18	3,507,143	2,396,411	5,903,554	„
„ 25	3,525,157	2,417,528	5,942,685	5
1848.				
Jan. 1	3,556,139	2,418,137	5,974,276	5
„ 8	3,689,862	2,490,633	6,180,495	„
„ 15	3,779,106	2,559,601	6,338,707	„

TABLE II.—*Weekly Average Amount of Bank Notes Issued by Private and Joint Stock Banks in England and Wales, from October, 1857, to January, 1858, with the Rate of Discount during the same Period.*

1857. Week Ending	Private Banks.	Joint Stock Banks.	Total.	Minimum Bank Rate of Discount.
	£	£	£	Per cent.
Oct. 3	3,807,764	3,145,150	6,952,914	5½
„ 10	3,887,209	3,176,898	7,064,107	6
„ 17	3,877,170	3,153,332	7,030,502	7
„ 24	3,811,271	3,079,389	6,890,660	8
„ 31	3,778,172	3,093,665	6,871,837	„
Nov. 7	3,715,662	3,073,263	6,788,925	9
„ 14	3,628,731	3,024,876	6,653,607	10
„ 21	3,499,744	2,914,555	6,414,299	„
„ 28	3,269,052	2,779,784	6,048,836	„
Dec. 5	3,239,479	2,641,454	5,880,933	10
„ 12	3,137,425	2,530,471	5,667,896	„
„ 19	3,052,625	2,457,487	5,510,112	„
„ 26	3,020,485	2,429,668	5,450,153	8
1858.				
Jan. 2	3,034,830	2,402,827	5,437,657	8
„ 9	3,143,751	2,497,642	5,641,393	6
„ 16	3,198,670	2,562,564	5,761,234	5
„ 23	3,200,931	2,557,144	5,788,075	„
„ 30	3,151,672	2,527,721	5,679,393	4

TABLE III.—*Weekly Average Amount of Bank Notes Issued by Private and Joint Stock Banks, in England and Wales, from April to October, 1866, with the Rate of Discount during the same Period.*

1866. Week Ending	Private Banks.	Joint Stock Banks.	Total.	Minimum Bank Rate of Discount.
	£	£	£	Per cent.
April 7	3,000,982	2,631,737	5,632,719	6
„ 14	3,026,554	2,649,153	5,675,707	„
„ 21	3,002,049	2,628,111	5,630,160	„
„ 28	2,978,588	2,565,187	5,543,775	„
May 5	2,977,668	2,590,947	5,568,615	7
„ 12	2,978,972	2,589,772	5,568,744	8
„ 19	2,891,717	2,523,492	5,415,209	9
„ 26	2,734,531	2,411,921	5,146,452	10
June 2	2,695,546	2,303,240	4,998,786	10
„ 9	2,617,837	2,243,139	4,860,976	„
„ 16	2,552,918	2,199,681	4,752,599	„
„ 23	2,505,741	2,182,365	4,688,106	„
„ 30	2,497,790	2,174,969	4,672,759	„
July 7	2,530,106	2,206,319	4,736,425	10
„ 14	2,535,621	2,222,033	4,757,654	„
„ 21	2,503,014	2,196,048	4,699,062	„
„ 28	2,480,016	2,154,322	4,634,338	„
Aug. 4	2,492,983	2,158,000	4,650,983	10
„ 11	2,515,620	2,176,475	4,692,095	„
„ 18	2,496,361	2,131,276	4,627,637	8
„ 25	2,476,760	2,163,195	4,639,955	7
Sept. 1	2,492,184	2,157,820	4,650,004	6
„ 8	2,526,182	2,184,374	4,710,556	5
„ 15	2,531,284	2,213,770	4,745,054	„
„ 22	2,574,249	2,247,944	4,822,193	„
„ 29	2,674,091	2,295,518	4,969,609	4½
Oct. 6	2,779,987	2,337,034	5,117,021	4½
„ 13	2,901,472	2,414,632	5,316,104	„
„ 20	2,905,819	2,448,255	5,354,074	„
„ 27	2,893,339	2,423,969	5,317,308	„

TABLE IV.—*Statement showing the Amount Held on Deposit by the Principal Joint Stock Banks in London (taken from their Half-Yearly Reports), in each Half-Year, from 1861 to 1866.*

		Number of Banks.	Amount of Deposits Held.
			£
1861.....	{	6	43,038,100
		6	46,854,800
'62.....	{	6	50,605,600
		7	50,744,500
'63.....	{	9	54,212,000
		9	61,866,000
'64.....	{	10	69,569,800
		11	87,283,900
'65.....	{	11	90,704,100
		11	89,052,700
'66.....	{	11	85,648,500
		9	81,067,600

Note.—This statement does not include the Bank of England, the private bankers, or the various discount houses or finance associations.

TABLE V.—*List of Certain Firms and Companies to which Messrs. Overend, Gurney, and Co. had made Advances, and the Estimated Value of these Advances at the Time of the Transfer of Messrs. Overend's Business to the New Company.*

	Due to Overend, Gurney, and Co.	Estimated Value.	Deficiency.
	£	£	£
The Atlantic Royal Mail Steam Packet Company	839,345	160,000	679,345
Millwall Ironworks Company and C. J. Mare	422,565	Nil	422,565
East India and London Shipping Company.....	397,653	25,000	372,653
Thomas Howard	331,765	Nil	331,765
Greek and Oriental Steam Naviga- tion Company.....	144,144	7,000	137,144
David Leopold Lewis	341,560	182,000	159,560
Kelson, Tritton, and Co.	291,391	187,500	103,891
Railways belonging to Overend, Gurney, and Co.	243,070	54,000	189,070
Laurence and Fry	148,544	21,000	127,544
T. and G. Garraway	190,977	10,000	180,977
Charles Joyce and Co.	78,729	62,000	16,729
Halliday, Fox, and Co.....	34,628	3,000	31,628
Z. C. Pearson.....	35,693	Nil	35,693
	3,500,064	711,500	2,788,564