THE PANIC OF 1907 AND SOME OF ITS LESSONS

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Every American panic has been characterized by very similar events, which have followed each other in like sequence,—about as follows:

(1) Failure of an important bank or institution,—Ohio Life Insurance and Trust Company in 1857; Jay Cooke & Co. in 1873; Mitchell's Bank, and the Erie Railroad in 1893; and the Knickerbocker Trust Company in 1907.

(2) Heavy withdrawal of funds by depositors, and the failure of many financial institutions.

(3) Demoralized stock market,—affecting banks and depositors alike.

(4) Hoarding of money in large amounts, not only by individuals but by banks, and the partial refusal on the part of banks to pay out cash, resulting in a premium on currency.

(5) Large importations of gold,—$15,000,000 in 1873; $56,000,000 in 1893; and over $100,000,000 in 1907.

(6) Gradual improvement in financial affairs, resumption of specie payments, and disappearance of premium on currency.

(7) Acute trade reaction, discharge of many thousands of employees, and realization that the country must pass through a more or less severe industrial reconstruction.

The present financial disturbance apparently had its inception on the 15th and 16th of October, when it was first known that the Mercantile National Bank, of New York, was in difficulty. The embarrassment of this bank was closely connected with an operation in the stock of the United Copper Company. The stock of this company, which had declined severely, because of the fall in the price of the metal, suddenly advanced, in a few days, from thirty-seven to sixty, by reason of an attempt to corner the stock. Unfortunately for the operator who was engineering the transaction, stock which it was supposed could not be delivered was produced, and the firm of brokers backing the deal was obliged

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to suspend. So far the episode differed little from an ordinary stock market fiasco, but when it was known that the Mercantile National Bank had supplied the funds for the attempted corner and was embarrassed thereby the affair took a more serious turn. The bank was examined, found to be solvent, and help was extended to it. Up to this time the public was not much alarmed, but on Monday, October 21, the Knickerbocker Trust Company, one of the largest institutions of its kind in New York, made an appeal for assistance, which was not granted and the company closed its doors at noon the next day, after a run in which more than $8,000,000 was paid over the counter. The failure of this large company demoralized the stock market. Call money advanced to 70 per cent and many stocks sold at new low records. Depositors in other institutions now began to lose confidence and commenced to withdraw funds. The Trust Company of America and the Lincoln Trust Company, both solvent institutions, were subjected to severe and prolonged runs. In the week following it was estimated that $40,000,000 was paid out by those two companies. At the same time Western banks began to make drafts on their New York depositories and during the week of October 21st, $14,000,000 was sent from New York City to banks in the interior. The withdrawal and hoarding of this vast sum by banks and individuals produced a most acute condition. On October 24th the panic on the Stock Exchange seemed almost hopeless. Call money was practically unobtainable,—only a few loans being made at 125 per cent. At two o'clock, when the demoralization was at its worst, a bankers' pool headed by J. P. Morgan loaned $25,000,000 at 10 per cent,—thus tiding over a situation fraught with the gravest danger. An appeal was made to the Secretary of the Treasury for additional government deposits and gold in large quantities was imported in spite of the fact that the Bank of England, to protect its gold reserve, raised its discount rate to 7 per cent, the highest in thirty-four years. Before relief was obtained from these measures, the reserve of the national banks of New York City had declined to more than $54,000,000 below that required by law. This was the largest deficit on record. Clearing-house certificates were authorized to settle the balances between the banks and a premium of 3½ per cent was paid for currency. The disturbance which, for a time, was confined to New York City

gradually extended and banks in most of the larger cities were obliged to use certified checks, clearing-house checks and clearing-house certificates to make up the deficiency in currency caused by its withdrawal from circulation.

At present, so far as the banks are concerned, the situation is gradually improving. Money is being brought from its hiding places and is again finding its way into the bank reserves and the premium on currency has disappeared. The deficit in the reserves of the New York associated banks has been made good and for the week ending January 11th a surplus was reported for the first time since October 26th. The statements just issued, pursuant to the call of the Comptroller of the Currency are, under the circumstances, unusually good, showing most of the national banks to be in normal condition, many of them holding a reserve in excess of that required by law. Two facts evidence the widespread extent and the violence of the panic. The premium on currency continued longer than in any other period in the history of the country and with a single exception it has taken the New York banks longer to repair the deficit in their reserve. One of the most striking features of the panic is the remarkable way in which the banks have stood up under the strain. In 1893, 160 national banks failed, while in 1907 but twenty-one were obliged to suspend, a number which has been exceeded many times in years in which there has not been a panic.

Such, in brief, are the salient features of the history of the past three months. If these facts afford an adequate explanation of the disturbance, and if from them alone we are justified in drawing a conclusion as to its probable length and extent, it would be safe to say that within a few weeks at the most industry would return to the highly prosperous state of a few months since. Such a conclusion, however, is not warranted. The course of the events of the immediate past is undoubtedly but the surface indication of a deeper and more important economic phenomenon. This belief is strengthened because we now know that the striking events of past crises were but outward manifestations of industrial and financial conditions. When the history of the panic of 1907 is written and its significance fully appreciated, it will undoubtedly rank with the epoch-making panics of 1893, 1873, 1857 and 1837. That the sequel will be similar to that following any of these other critical years, is not at all likely, for the immediate circumstances

that produce a financial or industrial panic are never the same, and it is these circumstances that determine the direction that the disturbance is to take as well as the duration and the severity of the depression that usually follows.

The periodicity of crises is undoubtedly a psychological phenomenon and is an expression of the rhythmic movement between hope and despair, optimism and pessimism, that has ever characterized society. So long as a man is a creature whose judgment is largely determined by his feelings, we are bound to have recurring periods of prosperity and depression. The form that a crisis in modern times takes is, to a large extent, fixed by the existence of credit in many forms and by the great accumulation of loanable capital. The crisis occurs when credit has been unduly extended and the supply of capital exhausted or so involved in unproductive enterprises as not to be available. In every period of business activity, capital is gradually absorbed, there is a heavy demand for funds for investment in new enterprises. As these new enterprises take form and develop, there arises an increased demand for all sorts of labor, from that of the lowest grade manual labor to that requiring executive ability of the highest order. Prices rise, partly because of the increased cost of production and also by reason of the greater demand on the part of better paid labor. The rise in prices, however, is always out of proportion to the rise in wages and thus the ability to save and create new increments to the store of capital is curtailed. If the absorption of capital is not lessened to meet the diminution in its creation, the time must surely come when the supply of capital is entirely inadequate to the demand and going enterprises are then severely hampered by inability to obtain funds sufficient even for ordinary betterments. It has probably never happened that such a situation is appreciated in time to gradually and easily curtail capital expenditures. It is of the nature of man to be swept along on a current of optimism, overdiscounting the future and investing large sums in enterprises whose present worth is largely overvalued. It is only when the breaking point is reached and the crisis is at hand that men come to a realization that credit is unduly extended and capital exhausted.

Since 1897, the year in which were recognized the first sure signs of the present cycle of prosperity, the train of events has

followed pretty closely the lines just indicated. The average of prices in 1907 was higher than at any time in over thirty years. For more than a year past, not only new enterprises, but old well-established industries and railroads have found it almost impossible to obtain the capital requisite to procure the equipment essential, because of the great trade activity. Some time since, many of the important railroads found that the only method by which funds could be secured was by the sale, at a discount, of short time notes bearing an unusually high rate of interest. From 1896 to 1907 the proportion of capital of all national banks to deposits has decreased from $1.00 to $2.46, to $1.00 to $4.82, and the proportion of reserve to deposits has decreased from $1.00 to $5.13, to $1.00 to $6.16. The aggregate resources of all banks was reported in 1897 at $7,822,000,000, and in 1907 at $19,645,000,000. On August 22, 1907, the loans of national banks amounted to $4,678,000,000, the largest total on record. The percentage of reserves to deposits in national banks has shown a constantly declining tendency from 1894, when it stood at 32.7 per cent, to 1907, when it was but 21.33 per cent. In 1896, banks of all classes reported individual deposits of $4,000,000,000, with cash holdings of 10.72 per cent. In 1906, the banks of the United States had deposits of $12,000,000,000, with cash reserves of 8.3 per cent. Moreover, within the past ten years, there has been an enormous destruction of capital. The Boer War, the conflict with Spain, the Russo-Japanese War, the Baltimore fire, and the destruction of San Francisco, involved a waste of capital so prodigious as undoubtedly to weaken the stability of industry the world over. These facts and figures are representative of only a few of the indications of an overstrain on the capital and credit of the country.

If, then, what we have experienced in the few months just past is a real economic crisis, is there anything in the condition and circumstances of the country that would lead us to believe that the depression that always follows such a crisis is to be of a comparatively short duration and of less than usual severity? For the sake of comparison, it is well to take the panic of 1893, inasmuch as the organization of industry and credit at that time was more like that of to-day than at the time of any other crisis in the history of the United States. In almost every respect the country is in better condition than it was fourteen years ago. Possibly

the most important factor is the status of government finance. In the six months from January to June, 1893, the excess of government expenditures over receipts was $4,198,000, and during the fiscal year ending June 30, 1894, the excess increased to $69,000,000. It was even necessary to encroach upon the gold reserve for current expenses, and for months this fund was less than caution and prudence demanded. To-day the government has a working balance of something like $200,000,000, and while expenditures are now in excess of receipts, due to decreased imports, the balance in the treasury is so large as to afford a safe margin for falling revenues. The currency of the country is now safely on a gold basis. In 1893, the money of the country was in a chaotic state, because of the coinage of silver dollars under the Bland Act, and of the issuance of treasury notes of full legal tender to pay for the 4,500,000 ounces of silver bullion purchased each month under authority of the Sherman Act of 1890. It was only when the panic was well under way and the harm done, that Congress was sufficiently aroused to repeal the Sherman Act. Even after this pernicious measure had been wiped from the statute books, the sentiment in favor of the coinage of silver was so strong as to unsettle confidence for several years. The apprehension that existed, both in this country and abroad, as to the ability of the government to maintain gold payments, was one of the fundamental and effective causes of the crisis of 1893. This fear led to a rush to realize on all sorts of property before gold should disappear. British and other foreign investors hastened to get rid of their holdings before the distrust became so general as to cause a severe fall in prices. The excess of merchandise exports in 1892 exceeded the imports by $203,000,000, yet so great was the liquidation in securities of this country by foreigners, that we exported more gold than we received, by $495,000 in that year. Too much emphasis cannot be laid upon this point of distinction, that in 1893 we were threatened with repudiation, whereas, in 1907, the whole world has confidence in our ability to pay our obligations in gold. As a matter of fact, the favorable condition of the finances of the government, the stability of banking institutions, and the soundness of our currency and monetary systems, distinguish the panic of 1907 from that of any other in the history of the country. In 1837, speculative prosperity led to an enormous increase in the note issues of the state banks

made possible by Jackson's destruction of the second United States bank. Much of this circulation rested on inflated assets, and when the treasury issued its famous specie circular, July, 1836, requiring payment for public lands to be made in specie, the complicated credit structure collapsed. The panic of 1857 was precipitated by the vicious banking systems of the various states. In only a few states was the least attempt made to limit bank note issues or to see that the notes had proper assets behind them and the result was inevitable. The enormous issues of government securities, greenbacks, etc., to carry on the Civil War, resulted in overstimulating industry and unduly inflating prices. The crash came in 1873 when the maladjustment of production to consumption broke down the credit structure already overstrained. In recent times railroads and railroad finance have played an important part in every economic crisis. In the last decade, the increase in the mileage of railroads has been comparatively small and what expenditures have been made have been for the improving and extending of established lines rather than for the building of new roads into sparsely settled and undeveloped territory. The gross receipts of railroads are larger per capita of population than at any other period in the history of the country, and this is true at a time when rates have steadily decreased. There can be no question that our railroads are now on a most substantial basis. In 1894, there were 156 railroads operating a mileage of nearly 39,000 miles, in the hands of receivers,—among them were the three great systems,—Erie, Northern Pacific and Union Pacific. It is inconceivable that any such calamity should overtake us now. Of course, it is unsafe to predict the ultimate effect of the falling off in business on the earnings of railroads, but we do know this, that it was the poverty of the West that caused the railroad receiverships in 1893, whereas, today, one of the most reassuring signs is the great strength and stability of the agricultural districts of the West. In 1893, the railroads served a population of 66,000,000. They are now called upon to transport the products of 86,000,000. The world's output of gold has increased from $147,000,000 in 1892 to something over $400,000,000 in 1907, and the fact that the balance of trade is now well in our favor will enable us to secure and retain at least our share of the new metal with which to strengthen our bank reserves. The export of breadstuffs in November was of record propor-

tions, the value being $24,700,000 this year against only $15,416,-000 for the same month last year. This is the first panic year in our history when exports exceeded imports. For the year ending June, 1893, the import excess was $18,700,000, and in 1873 and 1857 the import excess was the largest on record. For the fiscal year 1907, exports exceeded imports by $446,000,000, which places us in a very favorable relation to international exchanges. In 1893, the exports of gold coin and bullion exceeded the imports by over $87,000,000. We have had bountiful harvests, and the prices of all products are high. The reverse of the condition obtained in 1893, when cotton was selling for 8 cents, wheat for 70 and corn for 48. The farmers of the country are especially prosperous, they are lenders, not borrowers, as they were fourteen years ago. These are but a few of the circumstances that distinguish the situation of to-day from that of the last economic crisis. The aftermath of the panic is now becoming apparent in the lessened bank clearings which are running about 30 per cent below those of last year. Prices of commodities are already substantially less than they were four months since. Each of the last three months has recorded a decline in the average price from that of the month preceding, aggregating about 11 per cent. Funds are already showing a tendency to flow to reserve centers, and it is quite possible that in this respect, the history of the panic of 1893 will be repeated. In February, 1894, about six months after the panic of the preceding July, the surplus reserves of the New York banks amounted to $111,000,000, the highest they have ever been either before or since. The gross earnings of some railroads have declined 50 per cent, and the average decrease for all the railroads of the country for December was over 10 per cent. The decline in railroad earnings can be attributed only in part to industrial conditions. Unwise and drastic state laws are having a most serious effect on the earning power of railroads. Already two large railroad systems have been obliged to ask for receiverships. It does not seem likely, however, that these decreases in industrial and railroad earnings will reach dangerous proportions and it is altogether probable that a few months of lessened industrial activity will restore the equilibrium between the demand and supply of capital and relieve the strain. Much, however, depends on the good sense with which the people meet the situation, and the extent

to which they retain their confidence in the basic stability of the country's industry and finance. The people, so far, have faced the changed conditions wisely and bravely.

Every such crisis brings into prominence some weak spot in industrial or financial arrangements. The incidents of the past few months have clearly demonstrated that our currency system is too rigid to meet the varying demands made upon it. It seems to have been a part of the sequence of every panic that an insistent demand should be made for an increased volume of currency. Mr. Bolles, in his financial history, says of the panic of 1873, "The number of remedies was marvelous, the financier suddenly appeared everywhere, and maturing his plans at a sitting, forthwith sent them to Washington." In 1873 the demand was so urgent that Congress passed a bill increasing legal tender notes by $44,000,000, a project which was wisely vetoed by President Grant. After the panic of 1893, the people persuaded Congress to give its approval to a measure providing for the coinage of $55,000,000 of silver, but President Cleveland followed the excellent precedent of Grant and blocked the bill by his veto. Both of these measures were the result of the clamor of an excited people, made desperate by distress. In the present instance, the demand for a more elastic currency is not the result of the pending disturbance, but the need for some change in our currency system has long been recognized. The currency famine of the past few weeks is only an exaggerated form of a trouble from which we have long suffered at the crop-moving period. What is wanted is not an increased issue of permanent inelastic currency, but authority for the banks to put into circulation, in response to the demands of trade, a bank note that will return to the bank of issue and be canceled as soon as the need is satisfied. A system of bond secured notes fails to adequately satisfy the need for currency for four reasons:

(1) It is inelastic. (2) It lessens the loaning power of banks by the amount invested in bonds. (3) It tends to withdraw funds from the locality where needed to the section where funds are cheap. (4) The volume of bond secured notes is determined by the price of bonds, rather than by the commercial need for currency.

The system of national bank notes in this country, secured by government bonds, is essentially irresponsive to the demands of trade and commerce. The need for additional currency is most

urgent in the fall of the year, from August to December, and yet from 1890 to 1906, a period of sixteen years, there was an actual decrease of bank note currency in the fall of three of those years, and in seven of those years the increase was not more than $3,000,-000, whereas an expansion of $200,000,000 would not be excessive. In Canada, with a population of less than 6,000,000, there is an expansion and contraction of about $20,000,000 in the fall of each year; and in Germany the amount of currency varies about $120,-000,000 every three months. This inelasticity of our currency is, in its final result, a tax on the agricultural interests of the West, for it is there that the demand for currency is most insistent and the inability of the banks to meet this demand is indicated by an increase in the rate of discount at certain periods of the year. Even in the face of great emergencies, bond secured notes have failed to expand in anything like the amount they should, and whatever expansion there has been has usually come after the crisis was past. On June 1, 1893, New York banks held a surplus reserve of $21,000,000, and the volume of outstanding bank notes was about $177,000,000. By the first of August of that year the demand for currency had become so intense that the reserves of the New York banks showed a deficit of $14,000,000, a loss of $35,000,-000 in three months, and yet the outstanding bank notes had increased by only $5,000,000. By September 1st, when the urgency was past and currency comparatively plentiful, the volume of bank notes began to expand rapidly, reaching $209,000,000 on November 1st. In October, 1907, when currency was being hoarded and bank reserves were far below the amount required by law, the volume of bank notes increased by less than $6,000,000, but in November, when the situation was improving $50,000,000 of bank notes were issued. Not only do bond secured notes fail to expand in volume when needed, but they fail to contract in proportion to the lessened requirements of trade incident to the depression following a crisis and the result is redundant circulation and exportation of gold at a time when it is particularly needed in the rehabilitation of industry. Of the panic of 1893, Professor Joseph Johnson says, "During 1893, the fours of 1907 sold down to 113, and the banks added to their circulation $37,000,000. During the months of June, July and August of that year, there was a most urgent need for an expansion of the currency, but during these months the new national

bank notes did not appear. Not until the panic was over and the money was piling up in all the financial centers, a drug on the market, did the increase in the national bank note circulation take place. As a result of the panic, business being depressed, the interest rate on prime commercial paper during 1894, 1895 and 1896 was between 3 per cent and 4 per cent. The money supply of the country was in excess of its need, and gold was exported in large amounts." By the amount that a bank is required to invest in bonds to secure circulation is its loaning power curtailed. The statement of a bank with a capital of $200,000, deposits of $500,000, and bond-secured circulation of $100,000, would be as follows:

Assets.		*Liabilities.*	
Reserve	$125,000	Capital	$200,000
Bonds	100,000	Deposits	500,000
Loans	575,000	Notes	100,000
Total	$800,000	Total	$800,000

If, however, the same bank was permitted to issue notes based on assets and secured by the same reserves as deposits, its statement would appear as follows:

Assets.		*Liabilities.*	
Reserve	$150,000	Capital	$200,000
Loans	650,000	Deposits	500,000
		Notes	100,000
Total	$800,000	Total	$800,000

From these two statements it is apparent that the loaning ability of the bank is lessened $75,000 by a needless investment in bonds. The need for currency is greatest in rural communities where capital is scarce and rates of interest high and in so far as bonds are purchased to secure circulation, are such communities deprived of capital of which they have need. The amount is loaned elsewhere at a low rate of interest, in the form of investments in bonds. The record of the volume of national bank circulation, since the passage of the National Bank Act in 1865, shows conclusively that the amount of bank note currency outstanding has varied with the price of bonds and not with the needs of trade. This results in redundancy at some periods and insufficiency at

others, greatly to the detriment of industry. The use of railroad and municipal bonds to secure circulation would possess no advantage over the use of government bonds. A bond-secured circulation is unscientific and economically extravagant. This country has a great sufficiency of this kind of currency, and it would be a serious mistake to extend the system by permitting the use of other than government bonds. The Aldrich Bill, now before Congress, provides for an emergency circulation secured by municipal and railroad bonds. Such a measure does not reach the seat of trouble, and at best will only provide a partial remedy of questionable expediency.

After years of study and discussion, the American Bankers' Association, through its currency commission, has reached the conclusion that the only kind of currency that will respond easily to the need for such a medium of exchange, is that secured by the assets of a bank in the same manner as deposits are secured. The principles upon which the commission unanimously agreed are, in brief, as follows:

(1) A credit currency should be issued by national banks of the country under proper conditions.

(2) A bank note is essentially the same in principle as a deposit payable on demand.

(3) It is important in any plan seeking to provide a more flexible currency, that no measures should be taken that would impair the market value of United States bonds.

(4) Credit notes should be taxed at a rate that will produce a guarantee fund sufficient to redeem the notes of failed banks.

(5) Banks should keep the same reserve against credit notes outstanding as is now required by law against deposits.

(6) Active daily redemption of credit currency is the proper and only means of making it elastic, preventing redundancy and automatically adjusting its volume to the actual requirements of commerce.

Much of the opposition to the so-called asset currency arises from the failure of people generally to appreciate the essential similarity between a bank-note and a deposit, and also because of the fact that until within a very few years before the passage of the National Bank Act, note issues of banks exceeded deposits, and hence the losses and disturbances occasioned by improper

banking were attributed to over-issue of notes. Therefore, the absolute safety of bond-secured notes, as provided for in the National Bank Act, has fostered a prejudice against bank notes otherwise secured. It is probable, however, that had the proportion of bank notes and deposits in the early days been reversed, the losses due to unwise banking would have been equally severe. Frequent bank failures were due, not so much to the form of the demand liabilities of the bank, as to the nature of the loans that the bank made. It is not likely that we shall have a rational reform of our currency system until the similarity between the bank note and the deposit is clearly understood, and the prejudice against any form of security for circulation, other than bonds, is dispelled. That bank deposits constitute a medium of exchange as truly as bank notes, is not a new discovery. The principle was clearly enunciated by Alexander Hamilton in 1790,—"Every loan which a bank makes is, in its first shape, a credit given to the borrower in its books, the amount of which it stands ready to pay, either in its own notes, or in gold or silver, at his option. But in a great number of cases no actual payment is made in either. The borrower, frequently, by use of a check or order, transfers his credit to some other person to whom he has a payment to make. This man, in his turn, is as often content with a similar credit, because he is satisfied that he can whenever he pleases, either convert it into cash or pass it to some other hands as an equivalent for it. And in this manner the credit keeps circulating, performing in every stage the office of money, till it is extinguished by a discount with some person who has a payment to make to the bank to an equal or greater amount."

To illustrate the contention that there is no vital difference between a bank note and a deposit, take a specific instance. A jobber sells a bill of goods on time, sixty or ninety days, and desires to obtain the present use of his funds. He takes the note that he has received, to the bank, and has it discounted. He does not want gold, but what he does want is something that he can use in payment of his obligations and, accordingly, he receives credit on the books of the bank for the face of the note, less the discount. This credit is a demand liability of the bank, and is used by the depositor, by means of checks, as a medium of exchange. It is currency in every true sense, having the same effect on prices

as a like amount of bank notes. Suppose, however, that the bank had authority to issue, and the jobber desired and received bank notes in exchange for the notes discounted. The result to the bank and to the volume of currency in circulation is precisely the same. The bank has added precisely the same amount to its demand liabilities, and the volume of currency outstanding is the same, the bank note taking the place of a deposit. By making a loan the resources of the bank are increased in the form of a promissory note and the deposit, or bank note, on the liability side of the account, has the security of the assets behind the loan. For example, take the bank above referred to, with a capital of $200,000 and deposits of $500,000. If this bank issues no notes and holds a 25 per cent reserve against its deposits, its statement would be as follows:

Assets.		*Liabilities.*	
Reserve	$125,000	Capital	$200,000
Loans	575,000	Deposits	500,000
Total	$700,000	Total	$700,000

If, however, the bank has the power to issue notes against which it holds the same reserve as against deposits, the statement would be as follows:

Assets.		*Liabilities.*	
Reserve	$125,000	Capital	$200,000
Loans	575,000	Deposits	400,000
		Notes	100,000
Total	$700,000	Total	$700,000

So far as the bank is concerned, the situation in the first supposition is the same as in the latter, except that $100,000 of its loans had been made in notes instead of deposits. The aggregate of the bank's liabilities is the same as well as its resources. With the community that the bank serves, the situation is very different. By being able to offer to its borrowers the choice of a deposit credit or a note credit, the bank supplies the community with that form of credit instrument which it can use to the best advantage, thus facilitating industrial transactions to a much greater degree than would be the case could the bank only offer the deposit credit.

Mr. Henry Dunning McLeod, in his history of economics, gives a very lucid explanation of the similarity between the deposit and bank note. He says: "And as every advance a banker makes is done by creating and issuing a right of action against himself to his customers, and as a banker has an unlimited right of buying any amount of debts or obligations from his customers, by creating as many of these deposits, rights of action or issues, as he pleases, it follows that every banker has the right of unlimited issue; and a sudden increase of deposits is, therefore, nothing more than an inflation of credit, exactly similar to a sudden increase of bank notes. Deposits are nothing but bank notes in disguise." With the exception of a few savings banks, every bank in the country has the right to issue these credits, which are but bank notes in disguise. This fact should make it very clear that there would be no risk in permitting national banks to issue bank notes, called such, under proper restrictions. It should also emphasize the great need for legislation requiring banks organized under state charters, to carry sufficient reserves. Loans are usually based on mercantile transactions and, therefore, the deposits or bank notes have a security equal to the soundness of business generally, which, as a matter of fact, is all the security that is behind any credit instrument. The objection that asset currency would lead to inflation, is unsound, for the reason that whatever amount of such currency might be issued, would simply displace a like amount of deposit currency, as is shown in the two statements just given. Sound banking depends, not upon the form of demand liability, but on the kind of discounts made. It is on this point that great stress should be placed. As long as a bank's loans represent legitimate, sound business transactions and an adequate reserve is provided, the amount of credits, whether deposit or bank note, is comparatively unimportant. At the present time, the currency of the country can be unduly inflated solely through the medium of deposits, by the making of unwise and unsafe loans. It is proposed to further secure the bank notes by requiring the same reserve of gold, or its equivalent, as for deposits. Theoretically, there is no more reason for taxing a bank note than a deposit, but to absolutely secure the notes of failed banks, it is proposed to levy a tax sufficient to provide for such notes, and inasmuch as an average of about 2 per cent is paid on deposit balances, the tax on notes should un-

doubtedly be sufficient to off-set this. The notes of a bank differ from its deposits in this respect, that they are intended to circulate over a much greater area than the representatives of deposits, checks and drafts, and it is often impossible, or at least inconvenient, for the holder of a note to obtain reliable information as to the solvency of the bank upon which a note is drawn. It is essential, therefore, that a guarantee fund be provided to absolutely secure every bank note issued, irrespective of the soundness of the particular institution on which it is drawn. Approximately 95 per cent of all the business of this country is transacted by means of bank deposits, and this will continue to be the case, whatever form the currency of the country may take because of the superior convenience of checks as a medium of exchange. When currency is wanted, the need is imperative, as we have all learned to appreciate, and the banks should be in a position to satisfy that need. Deposits, since they originate in industrial transactions, and are permitted to expand and contract practically unhampered by legislative restrictions, constitute the most elastic medium of exchange ever devised, and if the banks of the country are ever to serve the community as they should, like freedom must be given to note issues. Unnecessary restrictions on the power of banks to issue notes are a serious handicap to industry. The desirability of an elastic currency is felt more strongly in the smaller towns of rural communities, where funds are needed to pay for farm labor, etc., particularly during the harvest time. Could the banks serving the agricultural districts offer to their clients bank notes instead of a deposit, the necessity for withdrawing currency from the East would be avoided as would also the return movement which creates a plethora of loanable funds in New York, unduly stimulating speculation and giving a wrong impression as to the plentifulness of capital and credit. An asset currency is not a new kind of medium of exchange. Practically every civilized nation of importance permits note issues secured in part, at least, by the general assets of banks. Canada, Scotland, France and Germany, all make provision for bank notes of this nature. The Reichsbank, of Germany, is permitted to expand its circulation without limit, but if the amount of note issues uncovered by cash in bank, exceeds 450,000,000 marks, the bank must either increase its coin reserve to cover the excess or pay a tax of 5 per cent on the amount over

the limit of 450,000,000 marks. Of this bank, Dunbar says: "The effectiveness of the elastic limit, in time of crisis, has never been severely tested, but it has been found to meet with much success, exceptional temporary demands for currency, which, under a rigid system of issue, like that of the Bank of England, could only have been satisfied by the withdrawal of specie or notes from the reserve. It is noteworthy that with one exception the limit has been only exceeded at the end of September and at the beginning of October, or at the end of December and the beginning of January, at the opening of the autumn or winter quarters of the year, when, for various reasons, there is regularly an increased demand for currency. In England, similar demands can be met only by withdrawal from the reserve of the Bank of England and through the temporary nature of such demands is well understood and in itself causes no alarm, the difficulties of the situation are thereby enhanced when the bank is trying to strengthen its reserve against more serious drain in other directions. Such demands the Reichsbank is enabled to meet, without difficulty, through the device of the elastic limit." Representative Fowler has prepared a bill for introduction into the House, which revolutionizes the entire currency system of the country, and its enactment would, without doubt, unnecessarily disarrange existing financial methods to the detriment of industrial conditions generally.

The laws of finance are as well known and as sure in their operation as the laws of physics and the problem before us is simply to apply these laws wisely. For many years, because of the conditions peculiar to this country, we were obliged to conduct our financial affairs along unknown and untried paths, the experience of the older countries did not afford suitable precedent for our guidance, but to-day we have reached a stage of development wherein we can learn much from the older countries, and it certainly is the part of wisdom to profit by their experience.

Should the present financial disturbance be the means of inducing Congress to pass a bill providing for an asset currency as outlined by the currency commission of the American Bankers' Association that would respond as easily and as readily to the needs of trade and industry as does the deposit currency, we might feel almost repaid for the discomfort and distress of the period. On the other hand, unless the present system of bank note

currency is modified in a rational and scientific manner, we must expect the periodical repetition of the disturbance through which we have just passed, for of all the factors that tend to develop unsound industrial conditions, a system of bank note currency that fails to expand or contract when it should, is the most potent. The plan proposed by the currency commission of the American Bankers' Association is the result of years of experience and study on the part of the leading bankers of the country, and for this reason, if for no other, it merits most careful consideration. It is undoubtedly the best plan now before the American people.