AMERICAN ECONOMIC ASSOCIATION
QUARTERLY

Formerly published under the title of PUBLICATIONS OF THE AMERICAN ECONOMIC ASSOCIATION

THIRD SERIES. Vol. IX, No. 1.

ISSUED QUARTERLY. PRICE, $4.00 PER YEAR.

PAPERS AND DISCUSSIONS

OF THE

TWENTIETH ANNUAL MEETING

MADISON, WIS.

DECEMBER 28–31

APRIL, 1908

PUBLISHED BY THE
AMERICAN ECONOMIC ASSOCIATION
PRINCETON, N. J.
LONDON: SWAN SONNENSCHEIN & CO.

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MONEY AND BANKING.

ROUND TABLE DISCUSSION: D. R. DEWEY, *Chairman.*

D. R. DEWEY: The plan before us for consideration to-day is that proposed by the Currency Commission of the American Bankers' Association. In brief, its salient point is the issue of additional credit notes equal to 25 per cent. of the capital up to 40 per cent. of the bond-secured circulation, subject to a tax of 2½ per cent. per annum. Provision is also made for the issue of additional notes subject to a higher tax of 5 per cent.

Although it is desirable that discussion as far as possible should be concentrated upon this particular plan, it must be remembered that Congress is not confined to the acceptance of this, or of that of no legislation at all. There are other plans as well as that of the American Bankers' Association; and, if one is persuaded that some currency legislation is necessary, judgment as to this particular plan must involve a comparison with others. Among these other plans may be mentioned (1) that of a central bank of issue,—a bank of banks, (2) an extension of bond-secured circulation so as to admit railroad, state, and municipal bonds as a basis of security, and provide for the emission of short-term notes based upon such securities; and (3) provision for bank-note issues upon bank-book credits, regardless of a security by national or other bonds held in pledge by the government. In the list thus specifically enumerated I have omitted the so-called asset currency plan of the Chamber of Commerce, and Ex-Secretary Shaw's plan for an emergency currency, because it seems to me at bottom they involve the same principle as that of the Bankers' Commission. While there are differences as to the percentage of issue of credit notes, and rates of taxation to be imposed while in circulation, they are alike in tying up the new circulation to government bonds.

We have then to consider the respective merits of an extension of circulation based upon government bonds; of a circulation based upon government and other bonds; of a circulation based on general bank credits; and finally of a circulation which may be put forth by a central bank, as supplementary to the circulation which individual banks now carry.

The plan of the American Bankers' Association is frequently spoken of as a plan for asset currency. It will be observed, however, that it is simply a proposition for the issue of notes equal to 125 per cent. upon bonds, 100 per cent. of which shall be, as at present, taxed ½ of 1 per cent., and 25 per cent. shall be taxed at 2½ per cent. The ostensible object of this plan is to provide a certain portion of currency which will adjust itself to the periodic movements of the money market, and which will presumably flow and ebb according to the demands for the movement of crops and for special emergencies. Advocates of this plan, so far as I am aware, do not emphasize the need of a permanent addition to the total supply of bank-note money. They are, however, desirous of introducing some element of elasticity. The question therefore before us is, will a currency issued in this way, which is based primarily upon the amount of bond-note circulation, and consequently upon the amount of bonds available for notes, create this elasticity?

It is estimated that this plan would provide, on the basis of present circulation, a possible increase of a little over 200 millions of credit notes. In this connection it is to be noted that, during the past ten years, there has been an increase of bank-note circulation of 400 millions. If the bonded indebtedness of this country should increase so as to make a larger amount of bonds available for bank-note circulation, then there would be a possibility of still further increase in the credit-note circulation; the two, credit-note and bank-note circulation, would go hand in hand.

Elasticity apparently is to be secured by two forces: First, a tax of 2½ per cent., and second, an extension and improvement in redemption facilities. If, however, there is to be a system of real and effective redemption, why a tax of 2½ per cent.? If, however, there is not to be automatic redemption, as works out, for example, in the Canadian system, is a tax of 2½ per cent. sufficient to force retirement? Is there not the possibility, therefore, that the credit-note in times of industrial prosperity may stay out continuously? and may not the financial demand for this credit currency be as urgent as the commercial crop-moving demand?

Elasticity of circulation presupposes effective agencies for retirement and redemption of notes. Does the plan of the American Bankers' Commission provide any way by which these credit notes will inevitably flow back? The report says that "the Comptroller of the Currency shall designate numerous redemption cities conveniently located in the various parts of the country. Through the agency of the banks in such cities, adequate facilities shall be provided for active daily redemption of the credit notes." But will the establishment of "adequate facilities" necessarily result in the retirement of such notes? We have in this country 6000 individual national banks, each independent of the others. Our banks have not been trained in redemption and there is not that rivalry between a few competing bank systems, such as obtains in Canada, which would lead banks to present for redemption the notes of other banks. Can this redemption be obtained except by the passage of a law forbidding any bank to pay out the credit notes of any other bank? and does not effective redemption involve the machinery of either a central bank or of systems of branch banks? It must also be remembered that bank notes are regarded by the people at large as absolutely sound, as good as government legal tender, and that consequently they stay out in the hands of the people for a considerable period of time. We must also remember that the Treasury department has, for governmental ends, actively opposed the retirement of bank-notes and practically held out special privileges to banks which would run counter to commercial forces. If elasticity can be secured in as simple a way as that implied in the Bankers' plan, why would it not be possible to improve the present methods of redemption so that there would be an ebb and flow?

The plan of the American Bankers' Commission is confessedly a compromise. It is believed by many, however, to be a step toward asset banking. If the bond circulation should decrease, the plan provides that the authorized issue of credit notes shall be increased to a correspondingly greater percentage of its bond-secured notes. We must therefore face this contingency and pass judgment upon the wisdom of indirectly introducing the banking principle into our monetary circulation. If this principle is to be adopted, we should do it with our eyes wide open and judge of the present proposal by its possible consequences. If, however, our national indebtedness increases, so that our bank-note circulation is still harnessed to government bonds, will any real advance be made toward an elastic credit currency?

Again it may be asked whether it is desirable to adopt any new currency plan before certain reforms in our banking system have been put in operation. Some of these seem so obvious and pertinent to the ends which the Bankers' Commission desires that they fall within the scope of a discussion on the currency. Among these defects may be mentioned the question of:

1. Insufficient reserve, particularly of country banks and the centralizing of such reserves in New York City. The Clearing House banks of that city have repeatedly called attention to the evil practice of paying interest on deposits of bank balances.

2. The inadequacy of redemption facilities. May we not establish a satisfactory system for redemption of present bank-note circulation before we attempt to introduce further circulation?

3. The over-investment of banks in stocks and securities which cannot be rapidly liquidated, thus tying up the funds of the bank for too long a period.

4. The bad banking methods of trust companies.

5. The speculative character of the call loan market in New York City.

6. The absence of any system whereby negotiable paper can be easily rediscounted so that loanable funds will flow to the place where they are most needed for commercial purposes.

7. And, finally, the rigidity of national bank reserves. Might it not be possible to permit our national banks, in accordance with a suggestion of Mr. Schiff, to encroach upon their reserves, say up to one-fifth of such reserves, by payment of a tax of 6 per cent.? This would let loose about $125,000,000 which might be as service-

able for emergency circulation as the credit notes of the American Bankers' plan.

The foregoing suggestions are made in a spirit of inquiry rather than that of captious criticism. It is easy to criticise any currency plan, but it is also easy, when we are overwhelmed by a mass of conflicting details, to be diverted from fundamental principles. Whether we are agreed or not in our measure of belief in the quantitative theory of money, it seems to me that we must all be impressed by the profound changes which must be effected by the enormous new supplies of gold. We have also been living in a period of unprecedented industrial prosperity, which has strained, and was bound to strain, to the utmost, the adjustment of the supply of capital to its demand. There should therefore be a sober consideration as to whether this is a time to make a legislative change in our currency system, without at least an exhaustive preliminary investigation of the real changes which are taking place, the objects which are desired, and whether the agencies proposed are likely to accomplish such ends.

William A. Scott: In considering the plan of the American Bankers' Association, I have been guided by two principles which I believe to be sound. The first is that, for the elastic element of a currency system, in addition to deposits subject to check, bank notes issued against commercial assets under such conditions that the quantity in circulation will expand and contract automatically with those assets, approximates the ideal closer than any other form of currency. The second is that the issue of such a currency should be concentrated in as few hands as possible. The first of these principles seems to me to result from the very nature of commerce and of the banking business. The two are related in such a way that the demand for currency registers itself at banking institutions in the form of the presentation for discount and the liquidation of commercial paper (this term being used in its broadest sense). If, therefore, such presentation and liquidation automatically brings into and takes out of circulation the currency demanded, the need for elasticity is met in an ideal manner. The second principle seems to me to be established by experience. The tendency in all European countries and Canada, where alone any great amount of experience with this sort of currency has accumulated, has been in the direction of the concentration rather than the diffusion of issues. In most European countries a single bank of issue is clearly preferred, and in Scotland, Ireland, and Canada the number of such banks is small. In none of these countries is there apparent any disposition to increase the number of issuing banks. The tendency is clearly and decidedly in the other direction.

Those features of the plan of the American Bankers' Association which aim at giving this country a bank-note system based on commercial assets appeal to me very strongly, but I cannot favor that one which allows all the national banks of the country, and such others as may be established, to issue such currency. I think I appreciate the practical considerations which led the commission to incorporate this feature in their plan, but, personally, I would prefer to defer still longer the currency reform which the country so much needs to the taking of a step so clearly in the wrong direction as this one seems to me to be.

My objection to this feature of the plan is not only the principle I have laid down, because I am willing to admit that in this matter European experience may not be the last word for us, but my belief that country banks do not need the privilege of note issue in order to satisfy completely all the legitimate demands of their communities. The reports of the Comptroller of the Currency make this very clear. They show that practically at all times, during the crop-moving seasons as well as at other periods of the year, and even when the money markets at the great centers are stringent, they carry respectable surplus balances with their correspondents in the reserve cities. During the last two years in the state of Massachusetts these balances have never been reported to be less than 23 per cent. of the total kept with reserve agents (that is, 23 per cent. more than they were permitted to count as part of their legal reserves), and in the report for September 4, 1906, they were as high as 45 per cent.; in Iowa during the same period they were never less than 50 per cent. of the total, and in the June and September, 1906, reports, they were 59 per cent. of the total. These two states are fairly representative of the others. These figures seem to me to indicate that the loan funds normally placed at the disposition of country bankers are considerably in excess of the need for loans in their localities, and that, in consequence, these banks are bound to have abundant reserves on deposit with their reserve agents to meet the demands made upon them. This view is also confirmed by the observation, which I think most students of economic conditions in the United States have made, that our country districts are rapidly growing wealthy, that is, that they are saving a goodly share of their income and are investing these savings in the great enterprises of the country as well as in purely local concerns. With a banking system like ours, this necessarily results in the conditions revealed by the figures of the Comptroller of the Currency. If we had a branch bank system, these conditions would be revealed in the accounts representing the relation between the country branches and the central institutions.

So long as the banks in reserve cities are able to respond readily and completely to the drafts of their country correspondents, the latter will be able to supply the wants of their customers. But right here the rub comes. To meet the demands of country correspondents depletes the reserves of the banks in the reserve cities, frequently reducing them below the limit prescribed by law. During the last two years in each report of the Comptroller of the Currency the reserves of a number of these cities have been below 25 per cent. The figures are as follows: In the report of January 29, 1906, seventeen cities were under the mark; in that of April 6, 1906, twenty-one; in that of June 18, 1906, seventeen; in that of September 4, 1906, twenty-four; in that of November 12, 1906, twenty-one; in that of January 26, 1907, twenty; in that of May 20, 1907, nineteen, and in that of August 22, 1907, nineteen. The problem before the country is clearly revealed by these facts. It is the reserve cities that need the aid of an elastic system of note issues. If they could supply the needs of their country correspondents in whole or in part by means of such notes, or even if they could in this way supply the wants of their local customers, they could hold on to their legal tender money and even draw into their reserves a portion of that in general circulaton. The necessity for an undue contraction of their loans would thus be prevented.

I regret that the committee of the Bankers' Association did not concentrate its attention on this problem. I know that its members felt that any scheme that did not treat all the national banks alike would fail to command the support of Congress or of the country banks, but I wonder if the experiences through which we have just passed and are still passing may not have changed the views of many congressmen and bankers regarding this matter. The recent large increase in the number of persons who have expressed their belief that a national bank with a monopoly of the right of note issues is the correct solution of this question would seem to indicate that this is the case. In any event, would it not be better to work out a thoroughly practical plan along right lines and then push it hard and continuously until Congress yields than to give support to a plan which may prejudice rather than advance correct measures in the future?

Isaac A. Loos: I should like to ask Professor Scott whether it would not be more correct to describe the refusal of solvent banks to pay checks in currency during the recent stringency as extra legal rather than illegal? Of course, the banks themselves knew that they had no warrant in law for that practice. And again, is it not overstating the case to argue that clearing house loan certificates could not be developed into an emergency currency because these instruments have hitherto been used only as an exchange medium between banks? Is is not true that during the recent panic, in many of the towns of the Middle West, clearing house loan certificates were issued in round numbers in comparatively small denominations and used as exchange media in the ordinary retail trade just as cashier's checks were so used? I know this was actually done, for example, in a number of Iowa towns.

Frank L. McVey: Various persons, in addition to one of the speakers of the afternoon, have emphasized the central bank as the essential thing necessary to solve the banking problem in the United States. The argument for this position has been drawn from European experience, overlooking the fundamental differences in extent of territory and financial habits of the people. The development of banking in this country has been along local rather than the centralized lines as seen in Europe. Here the citizen has gone into banking voluntarily, forcing in time the state to regulate his business, while abroad the state, by the absence of systematic banking, established a central bank to meet the needs both of the government and the people. Another difference is to be noted in the matter of deposits. The people of Europe have never been depositors to the degree that they have in America, and the emphasis, in consequence, has been placed upon the central organization that could supply the demand for notes. With us each community has provided its own bank, developed deposits, and carried on its business in an increasing measure by checks and drafts, giving but secondary consideration to the question of notes.

It is argued that the difficulties which have beset us in the recent financial panics are directly traceable to the absence of a satisfactory note issue system, and the lack of a central bank in which reserves could be deposited and a special reserve system created to meet the bankers' demand for cash. While recognizing the weakness of our note issue system and the breakdown of the reserve scheme, the fact of the matter is that the trouble lies a great deal deeper than is evidenced by the demand for a central bank.

The banking capital of the United States has been and is inadequate for the amount of business now done upon it. No other business attempts to do as large a percentage of business upon its capital as the majority of the banks have been doing in the last ten years. A bank's capital is invested in money and quick assets easily convertible into money. To tie these assets up in industrials and collateral which is not readily convertible is to threaten the stability of the bank. For nearly a decade the percentage of capital to volume of business has steadily declined. Since then the amount of business has increased by leaps and bounds. The result which has followed was inevitable, and one not likely to be materially bettered by the adoption of a central bank.

The simple device of prohibiting the deposit of reserves at interest with reserve city banks would keep the reserves at home and materially better the depositor's chance of getting his money, as well as protect the community from the variances in the fortunes of city banks.

Whatever may be said of a central bank from a banker's point of view, it is a political impossibility in America. The fear of centralized control over credit and note issue are so abiding that the party which champions such a measure is pretty sure to go down to defeat; but, moreover, the organization of such an institution, with the 15,000 banks, state and national, would hardly meet the problem in a state so extensive in territory and so vast in commercial enterprise. The organization of clearing house associations as legal institutions and as a recognized part of the banking system, with powers to issue notes in conformity with general regulations, would meet the conditions of the problem, while the prohibition upon local banks to deposit any part of their 15 per cent. reserve with reserve city banks would materially reduce many of the difficulties now associated with the piling up of reserves in New York City. Such a provision would effect some of the speculative business now financed by city banks, but would undoubtedly give a firmer tone to the whole banking business in America.

It is not to be understood by these remarks that I regard innovation as unnecessary, but I do not have any confidence in the creation of a central bank to affect materially the situation so long as we have a bond-secured note issue and the piling up of reserves in central cities.