LESSON XV.

BANKS AND BANKING.

1. Object of Banks.—The object of banks is to concentrate at convenient points, and thus to utilize in the highest degree, that portion of the capital of a community which is in the the form of money. Money in the pocket of an individual is entirely useless; and as long as it remains scattered around among individuals, a large part of it must be in this useless state. The individual may not want to use it himself for some time, and may not know of any other man, whom he would be willing to trust, who wants it, and hence it must continue to lie idle. But let all this unemployed money be collected together at some convenient point, and be intrusted to the management and care of a committee or board consisting of the most skilful and able of the depositors, and the case is

at once entirely altered. The lender has no longer to spend his time in quest of a borrower, nor the borrower in quest of a lender, but they are both brought together by the establishment of the bank. The borrower now knows where to apply for money, and the lender intrusts the loaning of his money to the directors of the bank, who make it their business to learn the pecuniary responsibility of borrowers, and exact good security in the form of indorsers, etc. They also furnish themselves with the means of keeping the funds intrusted to them securely, and with all the other means and appliances of banking. Thus the whole business of borrowing and lending is greatly simplified, and rendered safer and more profitable to both parties.

2. Kinds of Banks.—If the coin of a town or a neighborhood is simply collected together and deposited in a bank for safe keeping, this constitutes what is called a *bank of deposit*. In such a case the depositor is credited with the coin in the books of the institution, and if at any time he wishes to make any payment to another, he simply

draws an order or "check" on the bank and hands it to him, which perhaps he in turn deposits with the bank, and the cashier transfers the amount in his books from the former owner to his credit. Thus a large part of the coin in the community will soon be found lying idle in the bank, payments being made almost wholly by checks. But the bank, finding the depositors disposed to let their deposits remain in its vaults, takes the liberty of loaning the coin to others, who also, perhaps, will let it lie there, and simply draw checks against it to make payments with, the money on which, in many cases, is not actually drawn out but left on deposit again. Thus it may safely loan much more coin than it actually owns. When it has reached this stage, it is called a *bank of discount or loan.* But the checks of an individual would not be likely to be acceptable with all persons and in all places where payments are to be made, and in order to meet this difficulty, the directors of the bank prepare notes or "bills," which obligate the bank to pay on demand, in coin, the sum they represent. These bills, signed by the president and

cashier of the bank, have more of a public character, and hence will be much more generally current than the private checks of individuals. Banks under this form are called *banks of circulation;* they still continue, however, to receive deposits and pay the checks of depositors, as under the previous forms.

3. Organization of Banks.—Banks are thus a natural and necessary growth in the progress of the business of a country. Their importance, however, as having control of the money of a community, makes it necessary that they should be strictly guarded by law. Their privileges and their obligations must be clearly defined. Under our former system of banking, this was done by charters granted to each bank by the several States. These charters, together with certain general laws of the State, fixed the value and number of the shares, the manner in which the funds were to be paid in, the number of directors, the mode of organizing for business, the proportion to be maintained between the amount of specie on hand and

their circulating notes, the nature and extent of the liability of the stockholders to redeem their notes, the rates of interest and exchange which they might charge, and all other essential points connected with the business. But under our present national system of banking, the privileges and responsibilities of banks are defined in a general law of Congress.

By this law, the banking capital of the country is fixed for the present at three hundred millions of dollars ($300,000,000), and definite portions of it are assigned to the several States. And within these limits, any number of persons, not less than five, may organize themselves as prescribed in the law, for banking purposes, and, on depositing with the Secretary of the Treasury, at Washington, United States bonds to the amount of at least one hundred thousand dollars ($100,000), may be allowed by the controller of the currency to enter upon the business of banking, with bills which he is to furnish them at the rate of ninety thousand dollars for every one hundred thousand dollars of bonds which they deposit, thus fixing definitely the amount of their issues. The bonds deposited

are to be kept in trust for the banks, and as security for their bills; the interest on them, however, is to be paid over to the banks semi-annually, provided their management is satisfactory. The law also requires that they shall redeem their bills in lawful money, fixes the rate of interest and exchange which they may charge, the taxes to which they are liable, the reserves which they are to keep on hand, and all other essential details. Under this law the bills must all be good, even though the bank fails, since they are secured by United States bonds, deposited at Washington. Any overissue of notes, too, is prevented, and thus a much steadier money-market secured than under the former system of State banks.

4. Profits of Banks—The profits of banking, like the profits of any other kind of business, depend very largely upon its management. While one man succeeds in a given kind of business, another, under precisely the same circumstances, will fail; and all for the want of economy and shrewdness in management. But there are certain regular sources

of profit in banking which may be easily pointed out. Under the present United States banking law, there is, in the first place, the semi-annual interest on their capital, which is in the form of United States bonds deposited at Washington. This being paid in gold, amounts at the present time (1867), in currency, to about eight per cent. Besides, the law allows the banks to take the rate of interest authorized by the laws of the State where they are located, together with the customary rates of exchange, where they furnish drafts on other cities. And as this is all paid at the time the note is given, it bears interest from that time, and hence is better than compound interest; this, in a large business, amounts to considerable. Banks, too, have more or less money deposited with them for safe keeping,—in large cities an amount, in many cases, greater than their circulation. And as a certain proportion of this is sure to remain on hand, they can loan this, and thus get a profit from it. These are the regular sources of profit to banks, which are diminished, however, to a certain extent, by the losses on loans,

the expense for a bank building and fixtures, by the salaries of officers, the State and United States taxes, and the necessity of redeeming their bills at certain points; which latter expense, however, may be greatly diminished by skilfully managing the circulation of the bank so as to keep its own bills, as far as possible, away from the points where they are to be redeemed. Indeed, under the present system of banking, there is little need of any redemption at all, since the bills of every bank are equally current all over the Union, and "greenbacks" are no more valuable than the national currency.

5. Government and private Banking.—Our present national system of banking is not a system of government banking, although it rests wholly upon the government credit. It is to all intents and purposes a system of private banking,—a scheme for utilizing the public debt, by making it, in the hands of the people who hold the debt, the basis for banking. A government bank, on the contrary, is a bank with special privileges over other banks guaranteed to it by the government,

like the old United States Bank, the Bank of England,* or the Bank of France, in which the government is a stockholder and the chief patron. Of such a bank the government not only borrows largely, but collects its revenue through it, and transmits its funds from one part of the country to another by its agency. In a still more literal sense the government goes into banking, when it issues bills directly for the circulating medium of the country, as has been done by our government during the late war. The legal-tender notes are issued directly from the Treasury Department of the United States, and to this extent the Treasury has become a banking institution. Now, as the control of the money of a country, by putting out more or less according to the real or fictitious wants of the government, is a most mighty influence, when it is in their hands it will inevitably

* The Bank of England, however, is more like our present system of national banking. It differs from it in being a single corporation, privileged above other banks in the kingdom by being the fiscal agent for the government, and having almost the sole right of issuing bills for circulation · but its capital, like our banks, is all invested in the public funds

be used for political purposes, and hence is incompatible with free institutions such as we enjoy, as well as with the just demands of business, by which it is not at all controlled.

It is to be hoped, therefore, that the present government circulation, now that the emergency has passed which called it forth and justified it, will be withdrawn as speedily as possible. Then there will be left, as the fruit of the war, our system of national banking, which is certainly a great improvement on our former system of State banking. Experience, doubtless, will suggest various improvements in the details of the system, but its general principles, I am persuaded, are correct. And when specie payments shall have been resumed, it may well be extended, so that any man or set of men who shall deposit with the Treasurer of the United States a hundred thousand dollars or more in United States bonds, and make provision for redeeming their bills in specie, shall receive therefor from the Treasury ninety per cent. in currency, which they shall be authorized to circulate and use as money. Then banking, like other kinds of business, will be *free*, and will regulate itself.

6. Redemption of Bills by Banks.—The National Currency Act requires that the banks organized under it shall redeem their bills at their counters on demand in "lawful money." This lawful money at present is legal-tender notes; but after the legal-tender act shall have been annulled and specie payment been resumed, the legal money will be specie. Besides, these banks are required to redeem their bills in certain cities designated in the act, and for this purpose to keep deposits of legal money with such banks as they may elect in those cities. This is designed as a continual test of the responsibility of the banks, since their bills naturally flow into certain cities in the way of trade, and must there be redeemed without the demand of any particular person. And to settle balances between the banks of a city, they have what are called "clearing houses," where all the checks drawn on each of the banks, and passing in the course of business into other banks, are sent daily for redemption. These checks are there assorted and set off against each other as far as they go; those banks that are found to have sent in a less amount in the checks of any other bank than that bank has against them, being required to furnish the money to settle the balance. This is a great convenience, saving the use of the amount of money represented by the balanced checks, and securing the daily redemption of these checks. The *bills* of other banks also might be brought into the clearing house by each bank, and there be set off against each other, and balances redeemed in like manner.

7. The Security of Banks.—Under our present system of banking, the bill-holders are amply secured from ultimate loss by the bonds deposited with the United States Treasurer at Washington. If the bank fails to redeem its bills, these bonds are pledged to redeem them. Indeed, one of our national banks can fail only by doing a bad business, by getting rid of its bills, either by loaning them to persons who do not repay them, or by

fraud. Their danger does not arise from a sudden call to redeem their notes in legal-tenders, for such calls are rarely made, since the one kind of paper is no more valuable than the other. But when specie payment is resumed the case will be different. With but a fourth or fifth the amount of specie which they have of bills, and often with large deposits which are liable at any moment to be drawn out in specie, any sudden demand for gold, as for exportation, must put them to a heavy strain, and may compel a suspension. Hence some financiers discountenance a return to the specie basis at all. But this is only advocating a permanent suspension, which must, at least, be as bad as a temporary suspension from a failure to meet the demand for specie at any time. Others, on the contrary, would have the banks keep the same amount in specie which they have in bills. This would enable them at all times to convert their bills into coin, but at the same time this coin would be entirely useless except in very rare crises, and would hence be so much dead capital, bringing in no interest. Experience shows

that, with careful management, a fourth or even a fifth of the amount of the capital of a bank in coin is sufficient to meet all the demands upon it for specie, and hence is all that need be kept. If all banks had this proportion, they would be reasonably safe. When the circulation is not excessive, coin is usually wanted only to pay for goods imported from abroad in excess of our exports. And as foreign exchange rises just in proportion to the amount of this excess, it tends to check itself. Our foreign business fluctuates, of course, but not more than our domestic business, nor on any different principles.

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