

protecting instincts of men, especially of capitalists, will be forced to confess that the recurrence of crises must be accepted as inevitable. The more highly developed is the economy of money the greater must be the sum which banks and bankers are liable to be called upon to repay on demand or at short notice in proportion to the reserves of money kept in their coffers; and the greater also must be the amount of bills falling due daily, and largely met as they fall due by the proceeds of bills drawn daily and discounted as drawn. The smoothness of action of the commercial machine evidently depends upon the continuance of that confidence which is ordinarily felt by the creditor-class in the solvency of debtors, and any access of distrust may easily produce consequences culminating in a crisis. Bankers who are at once debtors and creditors are necessarily constrained to protect themselves in such periods of defective confidence by declining to meet the applications for loans and discounts which are forced upon them; and a sharp competition ensues for the possession of the ready money that is available in the market. The pressure is concentrated upon the Bank of England, and the publicity of the condition of that institution, consequent upon the weekly issue of its balance-sheet, lets all men know the rate of decline of its cash reserve. At such a time an accident may cause the spirit of caution to pass into apprehension and panic. The fear that the cash balances of the banking department may be exhausted incites bankers to hasten to anticipate one another in withdrawing any reserve they may have kept at the bank, and the rate of diminution of the cash of the department is accelerated. It is obvious that the condition we have described is in its origin independent of any particular regulations adopted with respect to the note-circulation of a community; and it has, in fact, been experienced in Great Britain under all varieties of laws, and in the United States, in Northern and Southern Germany, and in the British colonies under an equally wide dissimilarity of currency-regulations. Our history previous to 1844 shows that such a condition may be aggravated, if not precipitated, by an antecedent issue of notes increasing the proportion between the volume of transitory credits and the cash available to meet instantaneous demands; and as long as the issue of notes was unrestricted, bankers could never resist the temptation to make up, by an increase in their issues, any diminution in their available cash, a cause directly provocative of a further diminution by its effect on adverse exchanges, and therefore producing a sharper reaction when the necessity was at last recognised of recovering the balance between their cash in hand and their liabilities. The Act of 1844 cannot prevent panic, but it prevents bankers from resorting to causes which aggravate panics, and it moreover supplies a means of allaying the unreasoning terror in which panics culminate. Were it not for the separation of the issue and the banking departments we should be constrained to witness and tolerate periodical suspension of cash payments, as this would be the only means left of appeasing alarm; and this desperate expedient has been, in fact, employed over and over again, under such circumstances, both in England and elsewhere. The Act of 1844 gives us a less dangerous, though by no means a perfectly harmless, power. When the minds of creditors are unhinged, and all are competing for money which is not in existence in sufficient quantities to satisfy their demands, the announcement that the Government has authorized the bank directors to suspend the action of the Act and to fall back on the resources of the issue department operates as a charm. The mere announcement is often enough to put an end to the panic previously prevailing, the feverish fit passes away, and the customary temper of confidence is more or less slowly restored.

We conclude that the existence of the Act of 1844 is justified even when it is suspended, for it provides, in the maintenance of the cash reserves of the issue department, a stock of money, the unlocking of which furnishes the means of arresting panic which would otherwise have to be sought in a periodic suspension of cash payments. It has naturally been asked whether the law might not be saved the apparent discredit involved in its being set aside by an act of the Executive Government, acting on the faith of a subsequent indemnity from Parliament, by the embodiment in it of a power authorizing its suspension under circumstances that provoke its suspension. Mr Lowe, as Chancellor of the Exchequer, introduced into the House of Commons, in 1873, a bill having this object. He proposed that the Bank Act might be suspended by order of the Government of the day when the *minimum* rate of discount had reached 12 per cent., when the exchanges were favourable to England, and when the governor and deputy-governor of the bank certified that panic had caused a large portion of the bank notes nominally in circulation to be locked up and withdrawn from circulation. The authority of Mr Gladstone's administration had declined when this bill was introduced, and it was not well received. It was contended that the conditions proposed by Mr Lowe had not always existed when the Act had been suspended, and they would be so rarely satisfied that the power of suspension promised by the bill could never be exercised. It was further contended that Mr Lowe's attempt was necessarily impracticable. In seeking to define beforehand the conditions of suspension of the Bank Act, he tried to define the conditions of a panic; and to attempt to define the conditions of that which is in its essence unreasonable was a logical contradiction. A panic has no laws: it has no fixed shape. It is precipitated we know not how; and we are in the midst of it before we are aware. As it is thus impossible to prescribe beforehand the conditions of panic, it may reasonably be thought that it is better to leave to the Government of the day the responsibility of acting when a panic has demonstrated its existence. Mr Lowe's bill, assailed from many quarters, was withdrawn without the opinion of Parliament being taken on its merits, and no attempt has been since made to bring the subject before the Legislature.

We have already said that Sir Robert Peel contemplated an ultimate extinction of all note issues save that of the Bank of England; and he probably expected that the substitution of Bank of England notes for all others would not be long delayed. The progress actually achieved towards this end has been very slow. Out of 204 private banks in England and Wales left by the Act of 1844, with total privileged issues of £5,153,407, no more than 85 have ceased to issue; and the amount they issued which is now withdrawn was £1,283,041. Of joint-stock banks 18 have ceased to issue £842,453, out of 72 having privileged issues of £3,495,446. Only one Scotch bank has ceased to issue notes since the Scotch Act of 1845, and no alteration whatever has taken place in the fixed issues of the Irish banks. It may be added that the provisions of the Act of 1844, relied upon by Sir Robert Peel for bringing about by arrangement a substitution of Bank of England notes for those of privileged bankers, have been for many years entirely neglected. With these facts before us it is not surprising that, in 1865, Mr Gladstone, as Chancellor of the Exchequer under Lord Palmerston, should have submitted to the House of Commons a bill dealing with the subject. By it, it was proposed that private banks of issue in England and Wales should be released from the existing restriction that the numbers of partners must not exceed six, and that joint-stock banks should be allowed to come within the circle of sixty-five miles from London upon their

undertaking to pay annually to the Exchequer a duty at the rate of 2 per cent. (altered in committee on the bill first to 1½ and then to 1 per cent.) on their average issues, and that thereupon their privileges of issue should be assured to them until 1890 (altered in committee to 1875 and 1880), after which these privileges should cease and determine. The bill was purely permissive; but it was thought by its author that a large proportion of the English banks of issue would place themselves under its operation, and further legislation would be practicable with respect to the rest. The bill, however, was less and less approved as it became better known, and it was ultimately withdrawn. From that time no legislation on the subject has been contemplated until the session 1875, when the action of the Scotch banks in establishing head offices in London was followed by an agitation, described in the section on Scotch banks (p. 332), which has resulted in the appointment of a select committee on the law of banking and of note issues.

The Select Committee thus appointed has received a vast mass of evidence on the law and practice of banking and of the issue of notes, but the session has been allowed to close without any attempt being made to report on the subject of the committee's inquiries, and no practical action is expected to follow the termination of its labours. It must be admitted that the obstacles to legislation, supposing legislation to be desirable, are considerable. The bankers of the kingdom are largely represented on both sides of the House of Commons, and they are on the whole well contented with the present state of the law, while the great body of the public are profoundly ignorant and uninterested in it. The inaction to be overcome is so great, and the force available is so limited, that nothing will be done except under the influence of a commercial crisis, when almost anything may be done. The aim of economists and statesmen should be to produce a body of authority that may command respect even in the midst of universal agitation; and the inquiries of the Select Committee to which we have referred might be useful for this purpose, if they had been pursued with any discrimination. As it is, the evidence received by the committee will probably serve as a quarry to which wisdom and unwisdom may equally resort for facts and arguments.

At the risk of stating something that may appear too obviously true to require statement, we would submit that the question, whether bankers should be permitted to issue notes, must be determined upon a balance of opposing considerations of expediency. Many of the advocates and supporters of Sir Robert Peel's legislation of 1844 have said, apparently with a conviction that they were expressing an axiomatic truth, that the issue of notes was no part of the business of a banker. Mr Gladstone has, within the past session, spoken in this sense. The force of assertions of this kind cannot be admitted. There is no law of nature limiting the action of a banker within the bounds sought to be prescribed; and if we accept as the definition of a banker a person whose business it is to borrow and lend money, we cannot but recognize in the issue of transferable notes a most convenient process of carrying on this business. A banker who issues notes borrows so much from the persons from time to time holding them, and this money he has lent to the customers indebted to him. The reasons of convenience which justify a prohibition of the liberty of issue are, first, that experience has shown that this process of borrowing is too potent and too easily abused to the precipitation and aggravation of commercial crises; and, secondly, that the great and almost insuperable difficulty of refusing to receive notes which have obtained general currency makes it almost desirable that such notes should possess some

better guarantee than can be always forthcoming of the solvency of private issuers. These are the reasons which prevail to uphold Sir Robert Peel's legislation, and which impel us to consider what means may be discovered of perfecting his policy by the unification of issues throughout the kingdom.

We believe the propagation of clear ideas on the subject of the note currency, and the acceleration of the time when one currency only shall be in circulation, would both be greatly facilitated by a mechanical and local separation of the issue department from the Bank of England. Much confusion of thought still prevails by reason of the fact that the Bank of England is used as the agent for managing what is now a state issue, resting, so far as it is uncovered by specie, upon state security. If the business of issuing notes were removed bodily from the Bank of England and located in a Government office, and the name of the notes at the same time changed, it could not fail to be seen that the business left behind in Threadneedle Street differed in no essential particular from that of any other banker in Lombard Street, and much of the superstitious regard of the City for the Bank of England, and trust in its assistance in time of trouble, would be rapidly destroyed. It would then be understood that the cry for ministerial interference at the time of crises and of incipient crises was nothing more than a claim for the nation to cover with its credit those who had not been prudent enough to maintain adequate reserves for their own defence; and, as this would be understood beforehand, it would induce the consequence of greater circumspection on the part of dealers in money and a less temptation to rely on extraneous aid. The purely mechanical act of removing the issue of notes from Threadneedle Street would make the facts of the situation plain, and would bring about an alteration of conduct among London bankers, so that it should conform to the facts thus perceived. It has for some time past been clearly perceived that the delicacy of the condition of the money market in London has been much exaggerated, and the feverish tendency to crises materially excited, because the cash reserves kept by the London bankers are disproportionately small compared with the amount of their instantaneous liabilities. Competition has, of course, been a considerable element in causing this attenuation of cash reserves. Each joint stock bank has struggled after that increase of credit which follows an increase of dividends; and the unproductive cash balances on hand have been kept down to the lowest limit. They would, however, never have been reduced to such narrow dimensions but for the reliance placed on the assistance of the Bank of England in the last extremity; and if it were made plain that the Bank of England is itself nothing more than a big joint-stock bank, this reliance would disappear. Many schemes, equally ingenious and chimerical, have been recently put forth for compelling bankers to keep larger reserves of cash in proportion to their deposits. The true way to remove the danger always threatening us under the system that exists is to produce a conviction among bankers that they must not expect help elsewhere if they become distressed through a default in their own reserves of cash.

If the separation of the issue department from the rest of the Bank of England was completed by its transfer to a Government office under the management of State agents, the unification of the issues of the kingdom might be accomplished by legislation akin to that adopted by the United States in relation to the national banks. Each bank of issue might be required to withdraw its own notes and to receive and put out in exchange for them notes emanating from the State establishment, but bearing a statement on their face of the banks through which they were issued. Government securities should be deposited by

the issuing banks for the amounts thus put into circulation, which must not exceed the amount of their existing authorized issues; and the interest on these securities would be paid to the banks, less a fixed charge to defray the cost of preparing and issuing the notes delivered to them. The notes thus issued would be payable at the central State office, and would circulate throughout the kingdom; but as often as they were brought back to the central office they would be cleared again by the several issuing banks for reissue, unless the latter desired to retire from the arrangement, in which case the issuing bank would redeem the notes it issued, which would be cancelled, and the securities deposited, or a corresponding part of them, would be handed back. It would not be improper to force this plan on the acceptance of the privileged banks of issue, although we believe it would be freely accepted, inasmuch as their notes would at once acquire currency throughout the kingdom without discrimination of locality in exchange for the deposit of security, and the gain they now realize from the issue of notes would be left undiminished. We must, however, repeat the expression of the conviction that neither this nor any other change of the present system can be regarded as practicable until the impulse of agitating circumstances has stirred up Parliament to face the question.

Different Species of Banks—The Clearing-house—Authorization of Banks with Limited Liability.

We have elsewhere hinted at the subdivision of the business of banking which has accompanied the development of commerce. A banker borrows and lends money, but the conditions under which money is borrowed or lent may be extremely various, and the different classes of bankers are distinguished from one another by differences in the rules which they observe in borrowing or lending. Bankers may borrow money on call, at deposit, on debentures, at interest, or without interest, and they may lend on open credits, by discounting bills, by advances on mortgage repayable in instalments or otherwise, &c., &c.

Banks of Deposit.—These banks receive money on deposit, that is to say, on conditions that a certain prescribed notice shall be given of the time of withdrawal. They allow interest, and they usually lend a large proportion of their money on securities which are not at any moment immediately capable of being realized.

Land Mortgage Banks may be classed with banks of deposit, but they are also accustomed to borrow on debentures repayable at the end of one, two, three, or a larger number of years, at rates of interest varying with the period of the debenture. These institutions were first started for the purpose of granting facilities to the mortgagers of land. The money received on debentures was lent out again to proprietors and purchasers of land, who repaid their debts by annual instalments. It was in this way that the legislation of Stein was facilitated in Germany; the peasant being able to obtain at once from the Land Mortgage Bank the capital necessary to redeem the feudal rights of his lord, a debt which he repaid by a series of annual payments often corresponding to what he had previously paid as rent, until he became an absolute unincumbered owner of the fields he cultivated.

Credit Companies, such as the *Crédit Foncier*, the *Crédit Mobilier*, &c., &c., are strictly analogous to land mortgage banks, except that they invest their funds in loans on the security of general industrial undertakings, to which business they have added the function of negotiators of direct loans between companies formed for the conduct of such undertakings and the capitalist public.

Discount Banks and Discount Agencies borrow money on

call or deposit, and lend it exclusively in the discount of bills and negotiable securities, which they often rediscount with capitalists desirous of investing their money in forms capable of being speedily realized.

Trust Associations borrow money on debentures and invest it in the loans of foreign states or similar securities,—the principle of such an association being that the original investor can be secured against the default of any one borrower by the receipt of a high average rate of interest and the general solvency of the rest.

Savings-Banks are institutions established for the receipt of the smaller savings of the poor. As at present existing they are divided into two classes, the Trustees' Savings-banks and the Post Office Savings-banks; but it seems probable that some rearrangement of their machinery will be made in the next session of Parliament. For further particulars see SAVINGS-BANKS.

Allusion has already been made (*ante*, p. 316) to the Clearing-house. This institution was established, just a century ago, as a place where the clerks of the bankers in the City of London could assemble daily to exchange with one another the cheques drawn upon and bills payable at their respective houses. Before the Clearing-house existed, each banker had to send a clerk to the places of business of all the other bankers in London to collect the sums payable by them in respect of cheques and bills; and it is obvious that much time was consumed by this process, which involved also the use of an unnecessary quantity of money and corresponding risks of safe carriage. In 1775 the common centre of exchange was agreed upon. Its use was confined to the bankers,—at that time and long afterwards exclusively private bankers,—doing business within the City, and the bankers in the west end of the metropolis used some one or other of the City banks as their agent in clearing, a practice which still continues. When the joint-stock banks were first established the jealousy of the existing banks was powerful enough to exclude them altogether from the use of the Clearing-house; and some years elapsed before this feeling was removed so as to allow them to be admitted.

At first the Clearing-house was simply a place of meeting, but it came to be perceived that the sorting and distribution of cheques, bills, &c., could be more expeditiously conducted by the appointment of two or three common clerks to whom each banker's clerk could give all the instruments of exchange he wished to collect, and from whom he could receive all those payable at his own house. The payment of the balance settled the transaction, and an analysis of the statistics of the Clearing-house by the late Mr Babbage (*Jour. Statist. Soc.*, March 1856), shows that the amount of cash that passed was often less than 4 per cent. of the total sums cleared. Latterly, however, the arrangements of the Clearing-house have been further perfected, so that neither notes nor coin are now required. The Clearing-house, as well as each banker using it, has an account at the Bank of England; and the balances due at the close of each day's transactions are settled by transfers from one account to another at the bank.

The use of the Clearing-house was still further extended in 1858, so as to include the settlement of exchanges between the country bankers of England. Before that time each country banker receiving cheques on other country bankers sent them to those other bankers by post (supposing they were not carrying on business in the same place), and requested that the amount should be paid by the London agent of the banker on whom the cheques were drawn to the London agent of the banker remitting them. Cheques were thus collected by correspondence, and each remittance involved a separate payment in London. In 1858 it was proposed to set up a country clearing-house in

London; but it was suggested by Sir John Lubbock that the existing establishment could accomplish what was desired, and this was eventually done. A country banker now sends cheques on other country banks to his London correspondent, who exchanges them at the Clearing-house with the correspondents of the bankers on whom they are drawn. (Sir John Lubbock, *Jour. Statist. Soc.*, Sept. 1865.) It will be easily understood that an extraordinary economy in the use of coin has resulted from these arrangements; and in the paper by Sir John Lubbock to which we have referred, he gives statistics showing that out of the sum of a million paid into the bank in which he is a partner, only £21,500 consists of bank notes and £6210 of coin. An ordinary weekly clearing varies from 100 to 130 millions; in 1868 the weekly average was, however, no more than £65,397,075, from which it rose continuously to an average of £116,254,717 in 1873. There was a little falling off in 1874, which is now being recovered.

Up to the year 1858 banking companies could not be constituted with limited liability of partners except by way of privilege under special Acts of Parliament, Royal Charters, or Letters Patent; and although the Bank of England, and the three oldest established banks in Scotland, were thus favoured without any consequent deterioration in the character of their management, abundant arguments were adduced in deprecation of a general law on the subject. In 1858, however, an Act was passed authorizing the formation and registration of banking companies with limited liability, and also enabling existing unlimited companies to register as associations with a limited liability of partners, subject to a proviso that, if the bank was a bank of issue, the liability of its partners should remain unlimited in respect of such issue. Several banks have been established and registered under this law, and no evil results have been observed to follow.

Present Management of the Bank of England.

When the charter was renewed in 1833, the notes of the Bank of England were made legal tender everywhere in England except at the bank. Of the wisdom of this regulation no doubt can be entertained. Bank-notes are necessarily always equivalent to bullion; and by making them substitutes for coin at country banks, the demand for the latter during periods of alarm or runs is materially diminished, and the stability of the bank and of the pecuniary system of the country proportionally increased.

Since 1826 the bank has established branches in some of the great commercial towns. The mode and terms of conducting business at these have been described as follows:—

“The branch bank at Swansea [and the same is true of those established in other places] is to be a secure place of deposit for persons having occasion to make use of a bank for that purpose; such persons are said to have *drawing accounts*: to facilitate to the mercantile and trading classes the obtaining discounts of good and unexceptionable bills, founded upon real transactions, two approved names being required upon every bill or note discounted; these are called *discount accounts*. The applications of parties who desire to open discount accounts at the branch are forwarded to the parent establishment for approval, and an answer is generally received in about ten days. When approved, good bills may be discounted at the branch without reference to London. Bills payable at Swansea, London, or any other place where a branch is established, are discounted under this regulation. The dividends on any of the public funds, which are payable at the Bank of England, may be received at the branch by persons who have opened *drawing accounts*, after signing powers of attorney for that purpose, which the branch will procure from London. No charge is made in this case, except the expense of the power of attorney and the postage incurred in transmitting it. Purchases and sales of every description of Government securities are effected by the branch at a charge corresponding to that made by the local bankers where the branch is situated. A commission, including brokerage in London, and all expenses of postage, is charged on paying at the Bank of England bills accepted

by persons having drawing accounts at Swansea, such bills to be advised by the branch; also for granting letters of credit on London, or on the other branches. The branch grants bills on London, payable at seven days' date, without acceptance, for sums of £10 and upwards. Persons having drawing accounts at Swansea may order money to be paid at the bank in London to their credit at Swansea, and *vice versa*, at a charge of 6d. in lieu of postage. The branch may be called upon to change any notes issued and dated at Swansea; but they do not change the notes of the bank in London, nor receive them in payment, unless as a matter of courtesy where the parties are known. Bank post bills, which are accepted and due, are received at the branch from parties having drawing accounts, and taken to account without any charge for postage; but unaccepted bank post bills, which must be sent to London, are subject to the charge of postage, and taken to account when due. No interest is allowed on deposits. No advance is made by the branch upon any description of landed or other property, nor is any account allowed to be overdrawn. The notes are the same as those issued by the parent establishment, except being dated Swansea, and made payable there and in London. No note issued exceeds the sum of £500, and none are for a less amount than £5.”

The Bank of England transacts the whole business of Government. “She acts not only,” says Adam Smith, “as an ordinary bank, but as a great engine of state. She receives and pays the greater part of the annuities which are due to the creditors of the public; she circulates Exchequer bills; and she advances to the Government the annual amount of the land and malt taxes, which are frequently not paid till some years thereafter.”

The Bank of England rarely discounts bills that have more than two, or at most three months to run, and it were well were this rule generally observed by other establishments. The discounting of bills at long dates is a powerful stimulus to unsafe speculation. When individuals obtain loans which they are not to be called upon to pay for six, twelve, or, perhaps, eighteen months, they are tempted to adventure in speculations which are not expected to be wound up till some proportionally distant period; and as these not unfrequently fail, the consequence is that, when the bills become due, there is commonly little or no provision made for their payment. In such cases the discounters, to avert an imminent loss, sometimes consent to renew the bills. But, while a proceeding of this sort is rarely productive of ultimate advantage to either party, the fact of its having taken place makes other adventurers reckon that, in the event of their speculations proving to be less successful than they anticipated, their bills will be treated in the same manner, and thus aggravates and extends the evil.

In other respects, too, the discount of bills at long dates, or their renewal, or the making of permanent loans, is altogether inconsistent with sound banking principles, for it prevents the bankers from having that command over their resources which is advantageous at all times, and indispensable in periods of difficulty or distress.

In the discounting of bills, a great deal of stress is usually laid, or pretended to be laid, on the distinction between those that arise out of real transactions and those that are fictitious or that are intended for accommodation purposes. The former are said to be legitimate, while the latter are stigmatized as illegitimate. But Mr Thornton¹ has shown that the difference is neither so well marked nor so wide as many suppose. A notion seems to be generally entertained that all real bills are drawn against produce of one sort or other, which (or its value) is supposed to form a fund for their payment. Such, however, is not always, nor even most commonly, the case. A, for example, sells to B certain produce, for which he draws a bill at sixty days' date. But prices are rising, trade is brisk, or a spirit of speculation is afloat, and, in a week or two (sometimes much less), B sells the produce at an advance to C, who thereafter sells it to D, and so on. Hence it may, and, in fact, frequently does happen, that bills amounting to

¹ On the Paper Credit of Great Britain, cap. 2.

