The Panic of 1907 & Subsequent
Currency Legislation in the United States

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Little need be said about the events leading to the financial disturbances during the year 1907. The period just preceding the panic was one of prosperity, industry and commerce were favored by good prices and extensive activity. The country quickly recovered from the panic of 1903. Financial and industrial activity was general throughout the entire world. On the European continent, Germany's issue of her securities in 1905 was 70% larger than in 1904. The whole world seemed to enter into an era of frenzied speculation. Then came the Russo-Japanese War with its burden calling for large loans from Paris, London, and New York. It is safe to estimate the requisition of Japan in foreign markets during 1904-1905 at about one billion dollars.

In 1905 the fixing of the discount rate of the Imperial Bank of Germany at 5, 5⅔, and 6 per cent.—the last named figure being the highest ever reached—did not seem to retard German speculation. (1) In Egypt, Japan, and South America, also, the "fever of entreprise" seemed to be in the air.

In 1905 a group of Stock Exchange operators and speculators, wealthy capitalists and bankers, formed a pool in railway stock amounting to tens of millions of dollars, and the stock of these companies was forced up as much as twenty per cent. All this was carried on in the face of falling bank reserves and rapidly rising money rates. That year the full legal rate, plus a banker's commission, brought the actual rate up to 7 per cent. This showed that general trade felt the

1. A. D. Noyes - FORTY YEARS OF AMERICAN FINANCE P 325
strain. Stock speculation went on. Money was raised in London on the collateral of speculative holdings, and great blocks of stock were shipped from New York to the English market. Money rates also advanced in Europe.

On November 11, 1905, and again on December 9 of the same year, the reserves of the New York Associated Banks fell below the twenty-five per cent. ratio to deposits as stipulated by the National Bank Act. In November, call money on Wall Street was quoted at twenty-five per cent., and still speculation continued. Some of the leading men in financial circles then began to predict panic unless the frenzied speculation was brought to a halt.

All of these events not only had a dominant influence on the financial markets, but also had their effect on the social life of the people. Extravagant living, spectacular in its extent, was indulged. A few men on the inside became millionaires over night. Others who already controlled large funds became proportionately more powerful. These men drew into their hands many additional instruments of production and transportation. New trusts were formed. Competition was forced out by huge combinations under the leadership of such financiers as J. P. Morgan, E. H. Harriman, James Hill, and the Vanderbilt family. Then occurred the Equitable Insurance Company scandal, when a quarrel between the president, James W. Alexander, and the vice-president, James H. Hyde, made public the questionable

1. A. D. Noyes p 328
dealings of the company. Followed an investigation by the New York State Legislature, under the leadership of its counsel, Charles E. Hughes. This need not be discussed here. Suffice it to say that the findings were sensational, and had an unfavorable influence on public opinion.

What might have happened under the second administration of President McKinley, we of course can not tell; but his death brought into the seat of power Theodore Roosevelt, who declared for the policies of Mr. McKinley. He warned the public against the dealings with corporations, and declared that the individual and corporate increase in fortune was due to natural causes in the business world. In advising against dealing with corporations, he said: "To strike with ignorant violence at the interests of one set of men almost inevitably endangers the interests of all. The mechanism of modern business is so delicate that extreme care must be taken not to interfere with it in a spirit of rashness or ignorance."

We need but mention the dissolution of the Northern Securities Company under the Sherman Anti-Trust Law, and the prosecution of the Standard Oil Company, and the subsequent fine of this company by the Circuit Court. During 1906 we heard the warnings of the experienced critics, and we remember how little attention was paid to them by the powerful capitalists who were engineering the American speculation of the day. Nor did Europe seem to heed the warnings, for it was stated on the highest banking authority that the United States could

borrow almost an unlimited amount from Europe. The statement proved true. Serious estimation of the use of outside capital at this time involved sums which bewilder the imagination. It was asserted by financial authorities that credit up to $500,000,000 was obtained in Europe, while our interior banks placed not less than $300,000,000 in New York City.

The Union Pacific Railway sold a great part of the shares it obtained in the Northern Securities liquidation of both Northern Pacific and Great Northern stocks. Consequently the company held, June 30, 1906, in cash and money on call, $55,968,000 as against $7,345,000 twelve months before. This mass of capital was used to purchase shares of New York Central, Atchison, Topeka, and Santa Fe, and Baltimore and Ohio, all active. Of these securities some, apparently, were procured from holdings of "inside financiers," others from the open market. The Union Pacific then borrowed $75,000,000 more on its notes, and used the proceeds similarly. Taken all together, about $131,970,000 was invested in railroad stocks by the Union Pacific, under the guidance of Mr. E. H. Harriman. In August, 1906, the annual dividend on its common stock was increased from 6 to 80 per cent., and extended speculation took place on the Stock Exchange. The value of the stock as quoted on the exchange rose thirty-five points in two weeks, and there was a general rise in other stocks.

The strain now imposed on banking resources was heavy, and before the month was over, not only the demand rate for money on Wall Street, but also the discounts of merchants, commanded the highest rate outside of panic years, since 1867. In the month of September, 1906, the New York banks reported a deficit in reserves. Appeal was made to the United States Treasury, and in response the Secretary of the Treasury Shaw deposited government surplus funds in the banks on the promise that such funds should and would be used for the importation of gold. Securities were supported, and in September not less than $36,000,000 in gold was engaged in Europe for export to New York. Europe had not looked for this turn of events. In October the reserves of the Bank of England fell to a ratio of only 35-½ per cent., the lowest since 1893, resulting in a very weak condition for the fall season. By the middle of the month the bank rate rose from four to five per cent., and on the nineteenth of the month it touched six per cent., the highest point, with one exception since 1873. The Bank of England had warned the joint-stock institutions to call a halt in their grants of credit to New York, and threatened an advance to seven per cent. in the bank rate. American speculation was checked, because fortunately for London, the warning was heeded by the smaller institutions.

The rise on the Stock Exchange came to a sudden stop. It began to look as if the speculators were in a trap. Exhaustion of credit resources began now to make itself felt in

1. A. D. Noye - p 357
other quarters than the stock market. The railway companies had been laying plans for a huge extension and improvement of their plants. One of the well-known railroad presidents had publicly declared in order to avert "commercial paralysis," which "long continued would mean slow commercial death," that the railways must raise not less than one thousand million dollars of new capital per annum during the next five years.

But the railways suddenly found the money market shut against their stocks and bonds. Unfortunately, some of the companies had already committed themselves to costly undertaking on the basis of borrowings from the open market, and they had to meet this indebtedness. A similar situation caused the panic of 1873 when Jay Cooke and Company and the Northern Pacific Company were crushed under a huge mass of floating debt. Also the large railway failures of 1893 can be laid to a similar cause.

As their floating debt of 1906 approached maturity, the railways made vigorous attempts to avert the impending crisis, through the placing of one to two year notes, at interest from five to seven per cent., to which was added a heavy commission for the banker. This was successful. During the first few months of 1907 about $299,000,000 was raised on this temporary basis.

In March of that year, and again in August, there occurred on the Stock Exchange sales so enormous and at such sacrifices in values, as to convince the men of Wall Street that forced liquidation was being carried on by the larger financiers. Panic began to show itself in foreign markets. In April 1907 the market of Egypt collapsed. Blocks of shares of stock were waiting to be sold, although the market was so full of paper that the offer of shares in any security sent quotations downward. It was known that some of the smaller houses were on their last legs, and when the panic became acute, one of these firms suspended payments. In May a run by depositors at Cairo began, and one of the important banks was forced to suspend payments. They had been working beyond their means of obtaining outside capital.

About the same time the Japanese market began to fall into panic. When the "speculation" was allowed to go too far, and in face of the fact that no help could be obtained, certain Japanese banks had to suspend payments. By October Germany found herself in straightened circumstances, and felt the grip of her biggest panic since 1857. Money rates were boosted to the breaking point, firms of all kinds failed, payments were suspended by many more; the whole Empire was affected. This panic was felt throughout Europe, Asia and Africa. Chile was also affected. Exchange on London had previously fallen, currency was depreciated greatly, and a run on the banks of Chile followed, resulting in the failure of many.

Treasury notes were issued by the Government to aid the threatened firms. Holland and Denmark also passed through a thorough convulsion of the credit markets. Banks failed in both countries.

Why had the markets refused to recognize the signs of the panic? Wise-aces in banking circles in America had been firmly converted to the belief that such years as 1873 or 1893 could not happen again. This belief rested on the great economic growth, the establishment of the gold standard, and the enlarged and apparently secure resources of the banks. But the real cause, which was not considered by these men, was the unprecedented strain on credit. Panics had been predicted in 1901 and 1903, but the predictions had failed. When a panic was again predicted for 1907, it was questioned by the financiers as well as the public. Besides this, the year 1907 did not come within the "twenty year cycle" which had been the length of periods between former panics. Perhaps the increased demand for capital immediately following the year 1904 had a great deal to do with the shortening of this period of immunity.

Early in 1907 the country found itself in an atmosphere of apprehension. In June an $8,000,000 iron manufacturing company located in New York City went under. In mid-summer two New York City loans, offered for public subscription, failed to find a market. In the autumn the New York Street Railway Company, capitalized at $52,000,000, went into the hands of receivers.

Charles W. Morse, (a New York banker) had bought up, in New York City, half a dozen banking institutions of second rank. He used the stock in one bank as the collateral on which to raise money to purchase another. This "chain-banking," as it is called, caused the Mercantile National Bank, on the sixteenth of October, to appeal to the Clearing House for aid, and in response, a committee from the Clearing House began to investigate the situation. The Clearing House then announced that it would tide the bank over provided the directors of the bank would resign, as the predicament in which the bank now found itself had been brought about through the speculation in copper stock by the president of the institution with the bank's funds. This publicity caused bankers to look into the condition of their customer banks, and a general overhauling of banks' accounts took place.

Suddenly, on October 21, the National Bank of Commerce announced that it would no longer accept checks for collection drawn on the Knickerbocker Trust Company. The morning of the twenty-second of October saw a great run on the "barred" institution, and by noon the Knickerbocker closed its doors. The next day every trust company in the city was besieged by panic-stricken depositors.

Under the laws of New York, trust companies were not required to keep cash reserves against deposits. They could

2. A. D. Hoyes - p 367.
invest deposit-funds in real estate, buy and sell stocks and bonds, lend money on reality; but these powers were either denied outright to deposit banks by law or were most scrupulously restricted. The trust companies found their authority in a section in the Trust Company Act, probably not intended for this application, but which provided for their acceptance of "any and all such powers and trusts of whatever nature and description as may be conferred upon or intrusted or committed to it by any person or persons." This then covered their power to deposit and invest. Between 1899 and 1906 the number of trust companies increased from sixty-eight to eighty-six. They could offer interest which the banks, because of their necessary fifteen and twenty-five per cent. reserves, could not afford to pay. Although these trust companies were not members, they cleared through the Clearing House.

As early as 1903 the Clearing House expressed its purpose or requiring the trust companies to maintain a large reserve. In February, 1903, this institution passed a rule to the effect that trust companies must maintain a cash reserve of ten per cent. This brought on a controversy. The banks were accused of attempting to ruin their competitors, and nearly all the trust companies broke off Clearing House relations. This meant that the trust companies would still lack any required reserve, that the payment of balances would necessarily be paid over

1. A. D. Noyes - p 368
their own counters, and that a complete reversion to the old banking era would ensue. And this body of institutions possessed a larger aggregate sum of depositors than the whole system of banks had possessed in 1873. Of their clients, a great number were savings' depositors, and a class of people who are easily alarmed. All of these conditions helped very materially in bringing on critical times.

The Knickerbocker Trust Company closed its doors on October 23. By night many other trust companies sought aid from the banks. This action, chronicled in the morning's papers brought on a run at once, and by noon of October twenty-third, lines of terror-stricken depositors stood before the doors of nearly every trust company in New York City. Lines of these agitated depositors had formed in many cases before the bank had opened its doors in the morning. The main competitors of the Knickerbocker in catering to the "uptown" clientage was the Lincoln Trust Company with demand deposits aggregating $16,000,000. The Trust Company of America had accumulated demand deposits of about $42,000,000. The Lincoln Trust and the Trust Company of America were the victims of probably the most exciting and spectacular "run" ever seen in our financial history. The creditor banks had no other means of drawing their obligations on the besieged banks than by stationing

bank messengers in the lines of the frightened depositors and thus awaiting their turn at the window.

Mr. Cortelyou, Secretary of the Treasury, quickly saw the gravity of the situation, and coming from Washington to New York he arranged to deposit $35,000,000 of the surplus of the government with the national banks, by whom it was advanced to trust companies against their liquid assets. This sum, however, was mostly engulfed in the payment of depositors, the Trust Company of America alone paying off depositors to the amount of $34,000,000. These runs continued for fourteen days, the depositors standing in line all through the night. Ten million dollars in cash, supplied by other institutions, went with the rest. The run was not stopped until the sixth of November, the older companies organizing to help the younger, hard-pressed institutions. Six banks in Greater New York and three trust companies besides the Knickerbocker closed their doors, and a general run on the saving's banks caused the application of the "sixty days notice rule" for the withdrawal of deposits.

On October twenty-fourth the panic swept over the Exchange. Restriction of credit, caused by the precarious position of the banks, reached an extent, which, if continued, it meant general insolvency, for the Stock Exchange community.

1. Secretary Cortelyou, report in U. S. Senate, Jan. 29, '03.
2. Oakliegh Thorne Pres. of Trust Co. of America, Nov. 6, 1907.
community demand loans rose to 12½ per cent. J. P. Morgan came to the rescue of the President of the Stock Exchange by the release of $25,000,000 at high rates to meet the pressing needs. This timely action prevented the close of the exchange. But the banking crisis had just begun. Interior banks took alarm and withdrew their balances with the New York banks, which was a repetition of history.

The New York Banks on Saturday, October twenty-sixth, determined to take out Clearing House Certificates to help the hard-pressed banks through the loan of cash reserves to their neighbors, but which was to bring about the suspension of cash payments by the Clearing House. Before the panic was over, there was about $88,420,000 of certificates in use. Nearly every clearing house in the country took similar action.

Reserves of the New York banks fell to a deficit of $54,103,000 by November 3, as against $16,545,000 in the panic year of 1893. Cash was hoarded by individuals, and it is estimated that by such action $296,000,000 was withdrawn from circulation. This caused the issue of clearing house certificates by banks of Pittsburg and Chicago, where the pay-roll of manufactures meant the payment of large sums of money, amounting to about $96,000,000 in this makeshift currency.

The premium on currency was four per cent. This caused a stampede to draw on Europe for gold. The exchange rate in London in November was 4.91, but in spite of the fact, in two

1. A. D. Noyes - p 373.
months $90,000,000 was imported from Europe into this country because of the rate. The reserve of gold in the Bank of England fell $31,000,000 in two weeks after the New York panic had begun, and on November seventh, the bank rate rose to seven per cent. for the first time since 1873. Even a high rate as eight per cent. or nine per cent. was intimated if the outflow of gold continued to New York. Banking authorities in England said that it was high time for Federal intervention in this country, and for the guarantee of banks by the government.

As is usually the case, the markets were passing out from the actual crisis at the moment when despair seemed to have gained full sway in the financial community. The futile expedient of the government on the issue of $50,000,000 Government Bonds and $100,000,000 in one year notes was resorted to, and these were offered to the banks with the view of providing a basis of a new circulation. This action was caused by the clamor for help, and on the recommendation of Lombard Street. Only $24,998,040 of the bonds and $15,436,500 of the one year notes was taken. It soon appeared how foolish it this recourse was, and how brought about complications rather than ameliorating the strain. This caused the government to withdraw their loans suddenly from the market. With the arrival of the first shipments of gold from Europe, the acute

1. N. Y. Financial Chronical, Nov. 9, 1907.
2. London Economist, Nov. 9, 1907.
3. London Economist, Nov. 9, 1907.
5. A. D. Noyes - p 376.
stage of the panic ended.

There were left the long after-effects, of which the panic itself was only a premonitory symptom, and which came in sight only gradually, along with assertions that they would not come at all, as is usually the case on occasions of this kind.

The panic of 1907 resembled that of 1873. Capitalists refused to believe that the critical period was at an end. The panic was unlike that of 1893 in that it did not follow a period of misgiving and uncertainty, leading to the confirmation of the belief, on the part of the community, in the certainty of prolonged reaction and depression. The sequel of 1907 was necessarily recognized. It is a matter of record, which shows an increase in commercial failures of thirty per cent during the last month of that year as compared with 1906. The first nine months of 1908 showed an increase of fifty per cent over 1907 in the number of failures, and of one hundred and twenty per cent in liabilities during the same period. A vast shrinkage of the iron trade showed itself to a percentage of fifty per cent. The traffic receipts in railways also furnish a very interesting set of data, and may well be taken as criteria of commercial activity during the period. The decrease for the full year of 1908 showed a shrinkage of $290,000,000. Checks drawn on banks decreased seventeen per cent. Textiles decreased twenty five per cent in output; a ten per cent decrease in wages with a reduction of twenty five to thirty per cent in prices, and a great increase in the number of unemployed persons were other factors in the after-effect of the panic.

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Bradstreet's report.
Fully a year passed before the financial markets and the combinations of capital were willing to realize or recognize changed conditions.

Little need be said here of the organizing of the "Sunshine Movement," "Prosperity League," and "Re-employment Day." The objects were to make members of the community feel that if they thought they would be prosperous, that very thing would come to pass.

The United States Steel Corporation refused to change the price of steel, although their sales amounted to only about fifty per cent. of their pre-panic sales. It is a matter of record that E. H. Gary, Chairman of the Board of Directors of the corporation said that the fact of variation in demand and supply does not necessitate a change in price, and that 1907 prices were to be maintained.

On the exchange, repeated outbursts of speculation occurred, each of which affirmed the passing of the after-effects of the panic. In November, Mr. Taft was elected President of the United States by a large vote. The speculative public rushed again into the Stock Exchange, speculating capitalists again resumed the manipulations of the market, and the "bulls" placed the stocks on a higher level than in either 1906 or 1907.

The end of this demonstration came in the early months of 1909 when prices of steel came down, and when the abnormal transactions on the exchange ended. In the future the trend

2. Statement of E. H. Gary, April 9, 1908.
of the country's history will be fixed by the interplay
of its natural resources, by the capacity for production,
industry, inventiveness, and versatility of the people, and
by their disposition to rash exploitation of such resources,
and towards venturesome experiments with capital. Such it
has been in the past, and so it shall be in the future.
WHAT IS THE REMEDY?

The currency commission of the American Bankers' Association, after a long and careful study of the financial situation, has reached the conclusion that the only kind of currency which will respond easily to the need for a better 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 the 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 value to the actual requirements of commerce.¹

Frequent bank failures are due not so much to the form of demand liabilities of the bank as to the nature of the loans ¹¹Myron T. Herrick. Panic of 1907 and Some of Its Lessons.
that the bank makes. Until the similarity between the bank note and the deposit is understood, there is little hope for any rational reform of our banking system.

There is no vital difference between a deposit and a bank note, and yet very few people can recognize any essential likeness between the two. Let us take a specific case. 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 to the bank, and has it discounted. He does not want gold, but something that he can or will use in payment of his obligations. He receives credit on the books of the bank for the face of his 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 has 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 is precisely the same. The bank note takes the place of a deposit.¹ It is true that the deposits do not circulate over as large a territory as do the bank note, but in case of payment a distance from the banks, drafts may be drawn on the deposit account and tendered in payment of the debt.

In case of circulating notes, the holder of each and every bank note cannot tell as to the solvency of the banks by whom they are issued, so necessarily there must be a guarantee fund provided to secure absolutely every bank note issued, irrespective of the soundness of the institution upon which it is

¹Myron T. Herrick, Panic of 1907 and Some of Its Lessons.
Although approximately 95 per cent. of the business of the country is done by means of bank deposits, and will continue to be the case because of the convenience of checks as a form of currency, yet when currency is needed it is imperative that it be supplied, and the banks should always be in a position to satisfy that need. In order to give the community all over the country the service required, the freedom of note issue must be given to the banks with no more restriction than the deposit currency freedom.

An elastic currency is needed more particularly in the smaller towns and the farming communities, where the moving of crops necessitates fluctuation in the amount of currency. This brings to our attention the question of the asset currency, which although not a new thing by any means, is rather a stranger to us. Canada, France, Scotland, and Germany all make provision for this sort of bank notes. Dunbar has said concerning the asset currency of the Reichsbank of Germany, in part: "The effectiveness of the elastic currency in times 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."¹

The plan proposed by this 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, merits the most

¹Myron T. Herrick- Panic of 1907 and Some of Its Consequences
careful consideration.

"If our system had been such that the country bank first, then the reserve city bank, and finally the central reserve city bank, could have supplied some sort of credit notes in payment of their deposits, the situation in 1907 would have been entirely different. With such an elastic currency, there would be no variation in the volume of credits. Reserve money in the banks, which was ample for the deposits, would have been ample for the credit notes if they had been available."¹

There is no need to go further into this discussion of the need for a new revision of our banking system. It is obviously wrong, and by necessity must undergo a complete change. Let us then consider the new legislation during the year 1908.

¹Wm. Barrett Ridgely, Comptroller of the Currency.
After the panic of 1907, efforts were made for an improvement in the currency and banking system. When Congress convened in the spring of 1908, Senator Aldrich of Rhode Island introduced a bill into the Senate. On April 7, 1908, soon after Congress convened, the bill was passed by the Senate, after the section in regard to circulation based on railroad bonds had been stricken out.

The bill was then placed before the House, and was referred to the committee on Banking and Currency. After a lengthy discussion by many leading bankers and financiers of the country, it was finally tabled and apparently killed. Those in control of the program in the house took the matter out of the hands of the committee, and Mr. Vreeland from New York State introduced a new bill which the House promptly passed. But the Senate had to be reckoned with, and as the House had refused to accept the original bill, so did the Senate now refuse to pass the Vreeland bill. Although there were conferences between the members of both branches, they could come to no agreement.

As the session was nearing a close, and it was felt that some sort of financial legislation must be passed at this time, efforts were resorted to for forcing such legislation. To insure the success of this scheme, a qualified form of bribery was employed. The public buildings bill, commonly known as the "pork bill", was held over the heads of the members as a club.

Bankers' Magazine, June, 1908.
to force them to come to an agreement on the currency bill.¹ This "club" was the appropriation for public buildings, which naturally every member was striving to get in order to stand well with his constituents. "A more degrading and humiliating exhibition of unscrupulous abuse of the power of legislation by a national body it would be hard to find in all history."² With this as a measure of coercion, the new currency legislation was passed.

On May 28, 1908, the House of Representatives, after a debate of one hour, passed a bill, in which the Senate concurred, to amend the National Banking law. It had not been considered by any regular committee of either branch of Congress, but hastily put together by a Republican caucus committee as a political rather than a financial expedient, so that the Republicans might be able to say in the coming campaign that they had made provisions for an "Emergency currency" in case of a renewal of the stringency of the preceding autumn. The bill consisted of a part of a measure prepared somewhat earlier by Congressman Vreeland of New York, and of a part of the Aldrich bill which had previously passed the Senate. It embraces the principles of an "asset currency," which neither house of Congress ever previously accepted. It must therefore be considered a step in the right direction. The bill was signed by the President.³

This gives us an idea of how the bill passed Congress, secured the President's signature, and became a law. The Act

¹Bankers' Magazine, June, 1908.
²New York Journal of Commerce.
³Horace White, Money and Banking, Appendix A.
was approved May 30, 1908, and the bill has come to be called after the date of its approval. In order to see the relation of the bill better, the summary of such sections of that bill relating to issue of national bank notes is hereby quoted from Mr. Horace White in his book entitled *Money and Banking*.

"Thus the Act of May 30, 1908 authorized in two different ways, the issue of national bank notes additional to those heretofore existing, namely:

1. By the pledging of any securities including commercial paper, representing actual commercial transactions and bearing two or more responsible signatures, and running not more than four months. Such securities and paper shall remain in the custody of the national currency association to which the bank applying for the circulating notes belongs. The amount of notes issuable thereon shall not exceed 75 per cent. of the cash value thereof. All the banks in the currency association are jointly and severally liable for all the circulating notes so issued.

2. By the transfer to the custody of the Treasurer of the United States of any bond, or other interest bearing obligations, of any state of the United States, or of any legally authorized bonds of any city, town, county, municipality, or district in the United States. Against securities, circulating notes may be issued not exceeding 90 per cent. of their market value.

All the securities in both categories are subject to the approval of the secretary of the Treasury, who may require additional securities, or a substitution of other securities, in any case where he deems the existing ones insufficient. The national currency association may exercise the same powers and make the
same requirements in respect to the securities deposited with them by any bank in their respective associations.

Bank notes in either of these categories shall be subject to a tax of five per cent. for each month until a tax of ten per cent. per annum is reached, which rate shall continue as long as they remain outstanding. For all such notes the issuing bank must keep a redemption fund in the Treasury of the United States of ten per cent., i.e., five per cent. more for the amount required for redemption of notes issued against government bonds. The Treasury assumes the responsibility of redeeming the notes of all failed banks. No notes have been issued under this act."

This, then, is a summary of the measure which caused most of the debate in Congress over the bill. There is no reason why I should take the time and space to discuss the bill as it passed Congress. It might be interesting to read the debate on the bill in the reports of the 60th Congress, first session, on pages 7065-7077 of volume 42, part 8. The measure hinged on the question of emergency currency, of the issue of national bank notes by the Treasury on the basis of the bonds heretofore listed. It is unnecessary to go over the bill as it aassed, inasmuch as the original Aldrich bill has been discussed, and the changes have been noted.

It is also of great interest to note that the very section of the Aldrich-Vreeland bill of May 30, 1908, which caused the greatest debate and discussion, not to mention a large amount of criticism, has never been used. That is to say, under that
section which enabled the issuance of an "emergency currency", no national bank notes have been issued. It may be said with a great deal of truth that the bill has helped our financial condition in a large measure. It has stood like a monument, watching the fluctuation of our money market, and has ever been ready to put forth its power of note issue. That very fact has, in my opinion, had a steadying influence on the money market of our country, and if it has, the bill must be considered at least a step toward a better basis of currency and banking in this country. The bill will expire June 30, 1914.

Section 17 of the bill provided that a commission be created to be called "National Monetary Commission," to be composed of nine members of the Senate, to be appointed by the Presiding Officer of the Senate thereof, and nine members of the House of Representatives, to be appointed by the Speaker thereof: and any vacancy on the commission shall be filled in the same manner as the original appointment.

The commission appointed is as follows:

<table>
<thead>
<tr>
<th>Senators</th>
<th>Representatives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wilson W. Aldrich, Rhode Island</td>
<td>E. B. Vreeland, New York</td>
</tr>
<tr>
<td>Eugene Hale, Maine</td>
<td>J. W. Weeks, Massachusetts</td>
</tr>
<tr>
<td>P. C. Knox, Pennsylvania</td>
<td>Theo. E. Burton, Ohio</td>
</tr>
<tr>
<td>J. C. Burroughs, Michigan</td>
<td>G. F. Burgess, Texas</td>
</tr>
<tr>
<td>J. W. Bailey, Texas</td>
<td>A. P. Pujo, Louisiana</td>
</tr>
<tr>
<td>H. D. Morey, Mississippi</td>
<td>L. P. Padgett, Tennessee</td>
</tr>
<tr>
<td>H. M. Teller, Colorado</td>
<td>R. W. Bonynge, Colorado</td>
</tr>
<tr>
<td>F. P. Flint, California</td>
<td>J. McLachlan, California</td>
</tr>
</tbody>
</table>
THE ALDRICH PLAN.

The Aldrich-Vreeland Act was passed May 30, 1908, as a temporary measure for protection against severe money stringencies or panics that might occur prior to the enactment of a permanent measure pursuant to the recommendations of the National Monetary Commission. Therefore this Act should not be criticized as though it were designed to be a permanent addition to our currency laws. ¹

The Monetary Commission created by the Act of May 30, 1906, had been hard at work on the preparation of a measure which would meet the demand of currency reform. During 1911 while Congress was in session, the measure, as prepared by the Commission, was introduced.

Nelson W. Aldrich, introduced in Senate suggestions to overcome the past difficulties. He was of the opinion that the banking law had become obsolete, and that it should be modernized. To this end he submitted to the Senate an outline for a plan of betterment.

The essential feature of it was the establishing of a banking institution which was to be the fiscal agent of the government with a capital not exceeding $300,000,000. ² It was to be called the "Reserve association of America." Its stock could be subscribed for and owned solely by the national banks of the United States, in exact proportion to their capital, and was not transferable. The main office was to be at Washington.

¹Victor Morawetz - Banking and Currency Problem, p.64
²Horace White, Money and Banking, p. 437.
The earnings were to be paid to the stockholders at first, to the extent of four percent., and subsequently to the extent of five per cent., on the paid in capital; all other earnings were to go to the government. No bank was compelled to join the association.

All banks who subscribed would be grouped into associations, not less than ten banks in each, and they must have an aggregate capital of not less than $5,000,000. These groups were to be subdivided into fifteen divisions called districts. A board of directors was to be elected annually by each bank having one representative and one vote, without reference to the size of the bank.

In each of the fifteen districts there was to be a branch of the Reserve Association, governed by a board of directors chosen by the local associations composing that district. Additional Directors equal to one-third of the members of the local associations were to be appointed to represent the business interests of the locality other than the banking interests.

A board of forty-five directors would control the Reserve Association. Six of these would be the governors, two deputy-governors, the Secretary of the Treasury, the Secretary of Commerce and Labor, and the Comptroller of the local associations. The governor and the two deputy governors were to be selected by the President of the United States from a list submitted by the board of directors. Each branch would have a manager and a deputy-manager appointed by the governor with the approval of an executive committee of the central board of directors.

The government of the United States and those national banks
owning stock in the reserve association would be the sole depositors in said association, and the business of said association would be confined to the government and the subscribing banks. The association could rediscount any commercial paper bearing the endorsement of any bank having a deposit with it, provided that such paper had been made thirty days prior to the date of rediscount, and had not more than twenty-eight days more to run. It could also rediscount for any depositing bank, any paper arising out of commercial transactions running not more than four months, but such paper must be guaranteed by the local association, of which the bank seeking rediscount was a member. Any member of a local association could apply to that association for a guaranty of the commercial paper which it desires to rediscount. The total amount of guaranties by a local association would not exceed the aggregate capital and surplus of the banks forming the local association.

The Reserve Association could also in certain cases discount the direct obligation of a depositing bank when accompanied by satisfactory securities, the loan not to exceed two thirds of the actual value of the pledged securities. The association would pay no interest on deposits. The rate of discount was to be uniform. The association would buy from, or sell to, its depositors, foreign bills of exchange, arising from commercial transactions, running not more than ninety days and bearing the signatures of at least three responsible parties. It could have agencies in foreign countries. All government funds were to be deposited with the association, the government disbursements being made by drafts or checks drawn on it.
The section of the bill on the note issue was important and interesting. The national banks could maintain their existing issues of circulating notes, but there were to be no further issued beyond those then outstanding, nor could notes voluntarily recalled be issued again. For a period of one year, the Reserve Association should offer to purchase at not less than par the two per cent. bonds held by national banks as securities against their circulation, which the currency privilege attached to said bonds, and assume all responsibility for said notes, it being the policy of the United States to retire such bond-secured circulation and to substitute therefor notes of the Reserve Association, subject to certain rates of taxation. Of the notes issued by the association, one-third must be covered by gold or other lawful money, and the remaining two-thirds by the United States bonds or bankable commercial paper of specified kind. These circulating notes were to constitute a first line upon all the assets of the Reserve Association.

These are the main provisions of the bill as presented before Congress in 1911. The advantages in the plan are numerous, but the disadvantages somewhat over-weigh them.

In fact, although under a different name, this was nothing more than a central bank plan. Probably "Reserve Association" was a better name, since it better indicated the principal object in view, and since it avoided popular prejudices attached to "Central Bank." ¹

Its first endeavor was to strengthen the whole body of

¹Horace White, Money and Banking, p. 441.
banking by economizing the cash reserves of the country and making them available for the protection of banks and businessmen at all times, especially in times of squalls. It endeavored and I believe well, to put an end to the motive of banks to make runs on each other, or for depositors to make runs on the banks. The bill gave us a way to refund the two per cent. bonds into three per cent. in a manner which would allow the Reserve Association to dispose of the bonds and so eventually get rid of the bond basis of our circulation. Another advantage of the plan is the aim to establish a discount market for the discount of commercial paper which measures up to the standard, and a flexible currency to be based on general banking assets and the automatic return of the government surplus revenue to the money market from day to day.

There is every reason why the plan would have been a steadying influence on the market, in that it would tend to prevent trade reactions because of the standardization of commercial paper discounted by a more mutual supervision of the banks in the local association, and by creating more responsibility and more conservative action on the part of the bankers. Because of the banking reserve centered in such a large and strong institution, there would be no limit to the amount of currency issued, no delay in its issue, and no inability to redeem on demand. The chance for crisis would be lessened, although I do not believe that panics, inasmuch as they are a state of mind, can be legislated against.

Perhaps the objection that politics would have played too large a part in the management of the plan has some foundation.
However, while nearly any institution under government management is more or less influenced by politicians, it is hardly likely that a man in whom as much trust is placed as in the President of the United States would allow politics to dictate as to his appointments of the governor and the deputies of such an institution. I do not believe that we can easily picture a contest between the President and an institution owned by thousands of banks all over the country.

Professor Wm. A. Scott in his monograph in the American Economic Review for June, 1911, says: "Persons who suspect that any measure proposed by Senator Aldrich must necessarily be designed to play into the hands of the interests will look for a "joker" in his plan for the management and control of the proposed institution. They will have considerable difficulty in finding it, however. Wall Street could control the new institution only by absolutely controlling a majority of the banks that will purchase stock in the institution, and even then its control would be tempered by the Federal Government, and by the representatives of the commercial and industrial world provided for in the scheme."

This Aldrich plan was discussed in both houses of Congress and by the Currency and Banking Committee in each branch, but finally, after a long and bitter debate, the measure was tabled. The National Monetary's plan for a Central Bank as proposed under the Aldrich plan did not meet with the approval in Congress, and its work for better currency reform went for nothing.

During the last few years we have not heeded to any great
extent such legislation as would permit an issue of elastic currency, because conditions in our country have made such a means unnecessary. For that reason perhaps, our legislation has been sufficient.
THE FINANCIAL SITUATION.

The Act of May 30, 1908, was intended only for temporary purposes, and was passed with the idea of affording a measure for improvement in currency conditions until better and more permanent legislation could be passed by Congress. Our banking and currency system still had its defects. The Currency Commission of the American Bankers Association had been deliberating and considering the question for some time, with the following conclusions:

1. In the first place our currency is too rigid; that is, there must be a greater investment in government bonds than can be issued in currency which in a measure impairs rather than increases our power to aid commerce and trade. Then we can redeem our national bank notes only in the cities of central reserve banks, unless those notes become unfit for circulation. It is certainly unsound banking.

2. Under the present system there is no cooperation among the banks. This is not felt until undue financial strain sets in, but in such times of stress each bank is thrown independently of other banks, when under a system of cooperation the banks might better help each other.

3. A great defect in the present situation is the fact that our present system of reserve is unsound in that during periods of stringency and panic, the necessity arises for the individual protection of the reserve of each bank and competition is forced, for in order to maintain themselves, each bank contends against
each other bank. Thus a great deal of this reserve money goes into small hoarding, depriving and destroying, in times of stringency, the strength and power which might better be gained by cooperation and a pooling of reserves for mutual support of the banks and the common good of the public.

4. Under the present system there is no provision made for any substitute for legal reserve money as a medium of circulation other than the national bank notes secured by government bonds, whose inflexibility has already been pointed out. The use of the legal reserve money in circulation without any substitute forms an economic waste.

5. There is very little elasticity in the circulation, the amount of commercial transactions could remain constant, there would be no need for this elasticity, but there is always either an increase or a decrease in the volume of business, and this means either a surplus or a deficiency, with the latter too often the case. This is best illustrated by the crop moving time. At the fall season when grain is being harvested in the western part of the country, there is a great demand for money in that part of the United States for the expense of moving the crops. Then it is that money flows from the east to west, sometimes making a strain on the eastern banks. That means that money will become "tight" and rates of interest will rise, and that in some measure commerce will suffer. After the grain has been harvested and the agriculturists get their money for their crops, the deposits which they make in the western banks swell the reserves, and the money surplus is shipped back east. Then
money is "easy," rates are lowered, and as sometimes is the case the money becomes a "drug" on the market. An elastic currency for issue at such times when it is needed, and the retirement of the same amount when there is no longer a demand for it, would put an end to this shifting of the money from one section of the country to the other. Loans would then be normal, and rates of interest would remain constant.

6. The banks so restricted in the use of their legal reserves suffer, because it prohibits their lending when unusual demands are made upon them, as the reserves cannot be protected by the substitution of some other kind of satisfactory money, nor can the reserves be replenished by adequate rediscounting facilities which would enable the conversion of their available assets into cash for that reserve.

7. Another glaring defect in our present system appears in the methods in our independent treasury system. The government acts as a partial custodian of its own funds, which results in irregular withdrawals of money from the bank reserves and from circulation, materially interfering with the even course of business.

8. There is no open market for commercial paper. With such a market, banks would be enabled to purchase commercial paper with their surplus funds or, on the other hand, sell in that market the paper held by them when it becomes expedient to increase or strengthen their reserve or to meet the demands made upon them.

9. Then we are weak in that we lack provision for the establishment of American branches in foreign countries. Such branch-
es are really necessary for the development of our foreign trade.

On the other hand the present system has some distinct advantages. They may in part be enumerated as follows:

1. The present system enables each community to organize and control its own banking facilities.

2. It has so furnished the government with a market for its bonds, that the government has been able to reduce by two-thirds the rate of interest. The bonds have not only been kept on a par through this means, but in the case of the two per cent. bonds, a premium has been obtained.

3. It has provided the country with a stable bank note circulation of uniform value, which although it is defective in some ways, is strong and sound.

One of the most important things to be considered is the separation of our banking and currency system from political influence. It has been the experience of foreign nations that results can be better obtained by the establishment of a privately owned central organization, dominated and controlled by the government. Take for instance the Imperial Bank of Germany or the Bank of France.

The Imperial Bank of Germany is owned wholly by private share holders and politics does not play a part, but it is under the exclusive control of the government, and the officers of the bank are considered as government employees. The bank is allowed a fixed amount of uncovered notes. For all above that sum it must have in its reserves an equal amount of cash, but this is not like the Bank of England, an inflexible rule. The bank
may issue uncovered notes in excess of the prescribed limits by paying a tax of five per cent. per annum on the excess, but its reserve must not at any time be less than one-third of its outstanding circulation. This elastic clause has been vindicated by experience. The Imperial Bank is required to give its notes in exchange for gold coin or for bullion, and its notes are legal tender. All note-issuing banks are required to receive each others' notes at par, and to redeem their own notes at Berlin or Frankfort, as well as over their own counters. The net profits are divided between the shareholders and the imperial treasury in proportion fixed by law. The Imperial Bank has many branches. Here is an example of a strong institution where politics does not dominate the control and management.

The situation at the present time has been set forth in detail. We realize what the defects of our system are. We know what must be done to better the conditions in this country, and with this in view we can look at future currency and banking legislation in a much more critical light.

And now we are prepared to take up the more recent currency legislation which was passed by the present Congress on December 23, 1913. Someone has said that this new piece of banking reform is the greatest bit of legislation which has been passed since the adoption of the Declaration Of Independence. That is a rather early prediction, and the measure must be given a thorough try-out before that fact can be established.

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1Horace White, Money and Banking, p.399.
The Federal Reserve Act, the most recent currency legislation in this country, was introduced into the House of Representatives on June 26, 1913. This bill, known as the Owen-Glass bill, after the names of Congressman Glass and Senator Owen, was referred to the Committee on Banking and Currency, and after a few very slight changes by that Committee, it was passed by the House. The bill remained in the hands of the committee until September 9, 1913, when it was reported to the House, and passed by it September 17th. The Senate Committee on Banking and Currency had anticipated the bill's passage, and had begun hearings on it September 6. After the passage of the bill in the House it promptly appeared in the Senate, which referred it to the Committee on Banking and Currency, but the members of that committee found it impossible to agree on a report.

Finally, after a lengthy debate, a decision was reached to return to the Senate the House Bill and with it two others. One of these bills was endorsed by the Democratic members under the leadership of Senator Owen, the other by the Republican members who were joined by a Democrat, Senator Hitchcock. As finally passed by the Senate and later modified by the conference committee, the act bears more resemblance to the Owen draft than to any of the others.

In some quarters, the criticism has been heard that this piece of legislation has been rushed through Congress without the proper amount of consideration and debate, but it would seem that...
such criticism is unjust. This very subject has been before the
country for years. The same principle of reserve banks was em-
bodyied in the Aldrich bill, and the reports of the National Monet-
tary Commission have dealt with the subject. Congress and the pub-
lic at large have for a long time had the same principles in mind
when the question of currency was discussed. The testimony taken
by the Senate Committee on Banking and Currency, together with the
index, fills three large volumes, with a total of 3259 printed
pages. In addition to this and the reports of the National Monet-
tary Commission, the Pujo committee in the investigation of the
"Money Trust" has carefully considered the measure.

DISTRICTS. Under the new law, the United States has been
divided into twelve districts, in each of which has been estab-
lished a Regional Reserve Bank. The capital of each of these banks
must be at least $4,000,000, to be furnished primarily by the mem-
ber banks of the district. National Banks must subscribe, and
state banks and trust companies may subscribe, each to an amount
equal to six per cent. of its own capital and surplus. Such banks
thus subscribing to the capital stock will be known as "member
banks". One half of the subscription must be paid within a limited
time, the balance remaining subject to call. National banks must
comply with the provision of this act within one year or forfeit
their charters. In case the stock subscribed should be inadequate,
the stock may be offered to the public, and if that falls short of
the required amount, the balance will be paid out of the treasury
funds of the government.

1Conway and Patterson- Operation of the New Bank Act. p. 20
The following table shows the subscriptions to the stock of the Federal Reserve banks by national banks, state banks, and trust companies, with the population of each district.

<table>
<thead>
<tr>
<th>District No.</th>
<th>Population</th>
<th>No. of Capital and 6 per cent. banks</th>
<th>No. of Capital and 6 per cent. surplus sub.</th>
<th>1No. of Capital and 6 per cent. banks</th>
<th>No. of Capital and 6 per cent. surplus sub.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Boston</td>
<td>6,557,841</td>
<td>446 $165,529,010 $9,931,740</td>
<td>446 $165,529,010 $9,931,470</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. New York</td>
<td>9,113,279</td>
<td>478 343,693,437 20,621,606</td>
<td>479 344,793,437 20,687,616</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Philadelphia</td>
<td>8,110,217</td>
<td>800 216,340,212 12,980,412</td>
<td>801 216,550,213 12,993,013</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Cleveland</td>
<td>7,961,022</td>
<td>724 192,147,258 11,528,835</td>
<td>726 193,697,258 11,621,835</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Richmond</td>
<td>8,519,313</td>
<td>475 105,064,483 6,303,868</td>
<td>484 109,054,683 6,543,281</td>
<td></td>
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</tr>
<tr>
<td>6. Atlanta</td>
<td>6,695,341</td>
<td>372 77,256,913 4,641,415</td>
<td>382 78,379,663 4,702,780</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Chicago</td>
<td>12,630,383</td>
<td>984 211,068,338 12,664,100</td>
<td>999 219,198,760 13,151,925</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. St. Louis</td>
<td>6,726,611</td>
<td>434 86,717,981 4,843,079</td>
<td>445 103,655,397 6,219,323</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9. Minneapolis</td>
<td>5,724,893</td>
<td>687 78,361,081 4,702,864</td>
<td>687 77,381,081 4,782,864</td>
<td></td>
<td></td>
</tr>
<tr>
<td>11. Dallas</td>
<td>5,310,561</td>
<td>726 92,003,123 5,520,187</td>
<td>732 93,901,523 5,634,091</td>
<td></td>
<td></td>
</tr>
<tr>
<td>12. San Francisco</td>
<td>5,389,303</td>
<td>514 130,423,422 7,825,405</td>
<td>529 135,258,732 8,115,524</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Total       89,045,616 7375$1,785,791,171$107,147,470 7546$1,531,648,369$109,898,902

1 Including state banks and trust companies that have applied for membership. 2

2Chicago Daily Tribune, April 3, 1914.
Each of these reserve banks is to have its own board of nine directors, six to be chosen by the member banks and three to be appointed by the Federal Reserve Board. The Secretary of the Treasury may order the deposit with the Federal reserve banks of the general funds in the Treasury of the United States. They are to act as fiscal agents of the United States. The secretary may also use member banks as depositories, but may not use banks for such who are not members of the system. Reserve requirements of banks joining the system are lowered, while a part of the reserves are required to be kept on deposit with the reserve banks, in their own vaults, or both. Earnings are to be divided between member banks, a surplus fund for the reserve bank, and a franchise tax to the United States. Branches may be established within its district by any Federal reserve bank.

REDISCOUNTS. The chief work of the reserve banks will be the rediscount of commercial paper. Paper of not more than ninety days maturity may be placed with the reserve banks by the member banks for the purpose of rediscount, so that the reserves of the latter may be increased when needed. The rate of discount will be fixed by the Federal Reserve Board. This is without doubt one of the most important provisions in the bill. Let us consider how it is to operate.

In the fall of the year the banks in the central West need more money in order to meet the demands made upon them by the movers of crops. It is then that the banks in that section of the country must have a greater supply of money to meet this demand. With the new law in operation, the deposit of good commercial paper with the reserve bank of which the bank seeking the money is
a member means the rediscounting of that paper, and the automatic replenishing of the member banks reserves to meet the demand.

CONTROL. The control of this new banking system is by far the most important feature of the act. The success or failure of the measure as a means of remedying our financial problems, because so much responsibility and control is placed in the hands of the reserve board.

The Secretary of the Treasury, the Secretary of Agriculture, and the Comptroller of the Currency are to act as "The Reserve Bank Organization," Whose duty it is to determine upon the location of each bank, the number of banks to be placed, and the extent of the district. At the time that the law was passed, there was no comptroller, the office having been left vacant, so the responsibility lay on Mr. McAdoo, Secretary of the Treasury, and upon Mr. Houston, Secretary of Agriculture. These two men immediately began their work, and on the 26th of December, three days after the passage of the act, they issued an announcement desiring information concerning:

1. Geographical convenience, which involves transportation facilities and rapid and convenient communication with all parts of the district.

2. Industrial and commercial development and needs of each section, the general movements, of commodities, transfer of funds and exchange of credits from such transactions.

3. Established custom and trend of business as developed by the present system of bank reserves and checking accounts. In laying out the district and establishing the headquarters for reserve banks, every effort will be made to promote business conven-
ience and normal movements of trade and commerce.

The committee then began its hearings in the larger cities of the country. It listened to the arguments for and against the placing of a bank in such cities, then reviewed the evidence, and placed the banks where it thought best. The result of the committee's deliberations has already been seen. Not a little surprise was caused by the instituting of a bank at Atlanta instead of New Orleans; one at Dallas, Texas; and one at Richmond, Virginia, instead of Louisville, Kentucky. A great many people were also surprised at the placing of twelve banks at the start. Many entertained the idea that it would be better to start with eight, and to wait until business and banking readjusted itself to the change before any more were opened.

With the operation of this new act, the Federal Reserve Board has supreme control. It is to be composed of the Secretary of the Treasury, the Comptroller of the Currency, and five other members appointed by the President of the United States by and with the consent of the Senate. Each of the five members receives a salary of $12,000 annually, exclusive of traveling expenses. The sum of $7,000 per annum is added to the present salary of the Comptroller. The control by this board is very broad. It may examine the accounts and require reports from each reserve bank, and publish a weekly statement for all reserve banks. It may require one reserve bank to rediscount the discounted paper of another, so as to shift the money from one to another; suspend the reserve requirements of both the reserve and member banks; supervise the issue and retirement of Federal reserve notes; and change the number of reserve and central cities or reclassify the existing ones. It may create new
reserve districts or rearrange the present ones; appoint three of the nine directors of each reserve bank, and suspend or remove any officer or director of such bank; grant to any national bank, by special permit, the right to act as trustee, administrator, or registrar, and to perform any of the miscellaneous duties falling naturally under the jurisdiction of a supervising body.

The Federal Advisory Council is to be composed of a member from each district, chosen by the board of directors of the reserve bank located therein. This council may confer with the board on general business conditions; make oral or written representations to the board; and call for information and make recommendations upon several specified matters.¹

If the Federal Reserve Board is conservative and has the foresight to check too much advance in business, there is little chance of inflation. If it makes loans easy and interest low, and does not attempt to check business expansion, there is a probability of inflation. The success of the new system will depend largely on the board.²

Thus we see that indeed a very great amount of responsibility lies with the board, in fact the board is the one which holds the reins of the situation.

The question is often asked as to wherein the political character of the Federal Reserve Board is essentially changed from the House bill, since a new administration during its terms of office can change the character of this board.

When a new administration comes in, it places the Federal

¹Conway and Patterson, Operation of the New Bank Act.
²N.A. Weston, Lecture on Banking Law.
Reserve Board of seven members, a new Secretary of the Treasury, and possibly, a new Comptroller of the Currency, and during the first year nominates a new member of the board. Then for two years the new administration is in the minority.

If in that time the conservative members of the board, appointed for ten years, have not been able to educate their new associates to their methods of control, it is time for a seasonable change, and the administration may then prevail. Behind this are the regional banks with their six out of nine directors elected by member banks, and in addition there is the Advisory Council, elected by the Federal reserve bank directors, one for each Federal reserve district. Under these restraining influences it is safe to say that it would take two administrations to change the character of the board completely, and if the board were rightly constituted at first, it would by practical education convert radicals to conservatives.¹

EFFECT ON BUSINESS. The introduction of the new system means a very marked change in banking methods and in business. A closer scrutiny of paper, new location of reserves, discounting privileges, more rigid examinations and modifications of accounting methods, are among the most important changes for the banks. All these have a great effect on business. No matter how reasonable these changes appear, conservatism and prejudice must be taken into consideration. Trade movements may not exactly conform to the new requirements, and a necessary adjustment will have to take place. This is one argument in favor of the establishing of many districts at first, in order that business may find its

new channels and, like a river, cut deep in its bed. However, it will not be necessary to again distribute by further placing of any new banks.

PAYMENT OF INTEREST ON DEPOSITS. Although the Federal reserve banks are not forbidden under the act to pay interest, it hardly seems probable that they will do so. Under the new system there can be no competition between the national banks for the business of holding the reserves of the country banks as has hitherto been the case, because under the law, the member banks must deposit their reserves with the reserve bank. This means also that because of the abundance of funds that the reserve bank may accumulate through the operation of the new law, they will not need to strive as they have in the past for the deposits. No doubt the banks will keep an amount above the requirement for the purpose of exchange, but this will be done not at the solicitation of the reserve banks, but in the interest of the depositing banks themselves. This fact has caused a great deal of comment and discussion among the bankers of the country, and in a great many instances has caused the banks who have been profiting by the payment of this interest to look at the new bill with some displeasure.

"Why," asks Professor Weston, "should any of the banks be interested in getting control of the stock when they do not get any surplus, but only the six per cent. dividend on their stock?" And again, he asks, "What is there in the new law to prevent the banks from paying interest as do the present banks?" This brings us once more to the subject of control by the Federal Reserve Board. The management of the system is, in reality, in the hands
of the bankers themselves. Their representatives, as should be the case, constitute a membership of the majority of the board, and if they should so decide, interest may be paid on their deposits. If the new law, however, is tending toward that of the foreign banking system, and such seems to be the case, it is doubtful if such interest will be paid, for it is contrary to the policy of the great central banks of Europe to pay interest on their deposits. \(^1\)

Such is brief is the new law.

It will be impossible to describe all its features here, but a few specially important points need to be considered. The question of inflation and contraction has been a topic of absorbing interest ever since the development of our currency system. This question has never had more attention or debate than at the present time, when the dangers of inflation or contraction may be more or less impending. Again, we should give some time and reflection to the effect which this new law will have on our many state and savings banks, and the trust companies, as well as the many private banking institutions which have become, in many quarters, all-powerful institutions. Let us then give our attention to the question of inflation under the new law.

"The first period of inflation has already been felt throughout the civilized world," says Mr. C. W. Barron in the Wall Street Journal. "It is the proper inflation of confidence begotten by the fact that American bank reserves, the United States Treasury reserves, and the nearly two billion of gold in the United States, are to be unshackled under the new bank act for the commerce and finance of the world." Not in years has been seen

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\(^1\)Conway and Patterson, Operation of the New Bank Act. p 62.
such an outpour of investment money, and so sudden a transformation in finance, as has followed the passage of this act. The only thing which stops the greatest development is the refusal to grant credit to American railroads, and by that the curbing of our greatest service-transportation.

The amount of gold held by the banks of the country would prove but small help in time of panic. This was well illustrated in the panic of 1907. But under the new law, the gold reserve will not need so much attention. The loans can, through the Federal reserve banks command cash to pay every depositor on demand. Bonds held by the banks in their reserves can be sold in a market without every other bank competing for this sale.

But there is a real danger in inflation. Under the new law, the cash requirements drop $260,000,000.\textsuperscript{1} This is in a measure controlled by the season of inauguration of the new system. If the system be put into practice in late spring or early summer, there could be a second outpouring of money for bond investments. If the inauguration be postponed until fall, it will be within the power of the Treasury, by withholding its moneys from the bank, to advance the money rate curb such investment.\textsuperscript{2}

The United States Treasury in a large measure commands this power of inflation. The 150 or 200 millions of money held by the government which has been withheld from the banks improperly as it belongs to the public might cause as much expansion by suddenly depositing it in the reserve banks as might as large an importation of gold from a foreign country. The transfer of this money must come slowly and gradually. Still another

\textsuperscript{1}Wall Street Journal, March 13, 1914.
\textsuperscript{2}C. W. Barron, Wall Street Journal.
source of inflation is the improper administration in connection with the issue of the Federal reserve notes. These notes should and no doubt will be used as a reserve. Should they be issued indiscriminately in forcing expansion, it may mean a sudden depreciation and disaster not only to the banks under the law, but to the whole country. This last chance for inflation is in all probability remote, because with the present circulation, it will be considerable time before such Federal reserve notes will be issued.

Senator Root, in a speech before the Senate assailed the administration banking and currency bill, and charged the Democratic Party with attempting to force upon the country the financial heresies which the electorate has three times repudiated at the polls. The feature of the speech was the prophecy that the present measure would give rise to a tremendous inflation, following which would be wholesale liquidation of American securities held by Europeans, and enormous gold exports.¹

This speech which assailed the provisions of the bill must, however, be taken with a grain of salt. Doubtless politics played a great part in the attitude which the senator took. This is only to show, nevertheless, that that condition is made possible under the new law.

METHODS OF CHECKING INFLATION. If a tendency to overexpansion of business in one of the reserve districts occurs, the tankers in that district are primarily responsible, and their duty lies in the necessity of carefully inspecting every loan application, and in some cases of raising the rate of loans. This may

¹Financial Age, December 20, 1913.
be a case of discrimination, but that is a power of the banker, and his conservative interest compels such discrimination. If the banks in the district become careless or use poor judgment, the Federal reserve bank of that district must take a hand. It is admitted that the officials and directors are careful and experienced bankers, and through their discretion and advise will be able to forestall any such overexpansion. As a last resort, the rates of rediscount can be raised, and the commercial paper which is offered can be very carefully scrutinized.

Then the Federal Reserve Board, ever standing watch over the banks, will apply its authority and watch carefully the developments in this district. If there is over-expansion, it can use its authority to reject applications for notes, raise the rate of interest that must be paid by the reserve bank that receives them, and insist upon a higher rate of discount to be charged the member banks within that district. The board can remove the officials in case of gross negligence or can call for special reports and examinations. If outside help is needed, it may be obtained from the reserve banks by permitting them to rediscount for the one which is in distress.2

Again allow me to quote Professor Weston. "If the Federal Reserve Board is conservative, and has the foresight to check a too great expansion in business, there is little chance for expansion and inflation. If loans are made easy and over-expansion is not checked by means of its power, there is a real probability of inflation. It is up to the board."1 Thus, again, we see the

1 Professor N. A. Weston, Lecture on the New Bank Act.
2 Conway and Patterson, Operation of the New Bank Act.
power which the board alone holds in its hands.

Now let us for a moment consider the effect which the new law will have upon the state banks and trust companies which have developed to so large an extent in this country in the past few years.

In the past, the national banks have possessed some advantages over the state banks. National banks have had preference over the state banks in their right to note issue. They have had the help of the Federal government and the United States Treasury. They have been the depositories of the surplus government funds, and they have been fostered by the uniform banking law. But while the national banks have been the depositories for the government, the payment of interest on such deposits and the necessity of purchasing government bonds has in a measure offset the advantage.

One great advantage that the state bank has had over the national banks is its liberty of loaning on real estate. But taking it all in all the state banks have been sidetracked for the national ones.

With the new law, the name "Federal Reserve Bank" gives the national institutions a distinct advantage. It carries a great weight with people to feel that the government is behind the national banks, and there are a great many people who are attracted by the considerable amount of sentiment which attends the name "national bank."

Very noticeable tardiness and reluctance has been shown by the state institutions in entering the new system. The advantage of their entrance to the banks themselves are many.
is in a great measure dependent on the success of the system and the reserve banks. There is the additional prestige that will come from Federal supervision, with the strict examinations that are conducted by the Federal officials, and the rigid reports that must be made in response to the calls of the comptroller. No matter what the disadvantages, this advantage will doubtless be of value in attracting business.

Without a doubt, the greatest advantage to entering the system is that of rediscount. The section in the law provides that the banks in the system will discount only that paper offered by member banks. If the banks can come to believe in the advantage of rediscount, they will have at hand a means of securing prompt action in time of need, and through their membership will have access to the concentrated reserves of the whole United States. Each bank will be able to help its member banks and, by rediscounting its paper, the transfer of money and credit from one reserve bank to another will be easy. Quite in contrast are the state banks, which are in reality individuals; when panic occurs, or stringency exists, these banks are unable to get outside help. This advantage is without doubt the greatest of all, and it is the very thing that the banks, in fact all the banks need, in the better administration of their duty to themselves, to their depositors, and to the community.

On the other hand there are disadvantages to the entrance of state banks into the system. To some institutions, the

requirement that the capital of the state banks that enter must be equal to a amount for national banks in cities of the same population will be a distinct hardship. The small capital which some states allow a bank to start with is in a measure offset by the fact that a large amount of the deposits are time deposits, and the new law requires only a five per cent. reserve against them. The rigid and strict examinations perhaps will hurt these state banks some, but in the case of the New York State Banks, their examinations have always been even more close and rigid than those of the national institutions.

The condition of loans may also prove a disadvantage to the state bank. In some cases they are permitted to lend to an individual as much as even fifty per cent. of its capital, while the new law will not allow to one person or individual a loan of over ten per cent. of the capital. And again some state banks will have but little paper which they can discount at the reserve banks.

Probably the most important factor influencing the action of the state banks will center about the possibility of collecting checks and drafts at par. The banker who will not have the opportunity of clearing with the clearing house will be at a great disadvantage. They will be very forcible if the Reserve Board requires that the Federal reserve bank shall act as clearing house for the banks in its district.

The following is the statement issued by the National Association of State Bank Supervisors in a meeting held at Chicago January 19, 1914:

"Realizing that our country was in need of currency reform, we recognize the Federal Act as a distinctive step forward in currency reform; Therefore,

"Be it Resolved, That we will co-operate with the Federal Reserve Bank in its efforts to obtain the best possible results from the operation of said bill;

"Resolved, Further, That in order to maintain the financial standing of our country and to meet certain needs in different parts of the nation, we are of the opinion that there is a large field of usefulness for banks in both state and national systems."

The following is an extract from a letter to state bank correspondents of the Bank of Buffalo, N.Y. signed by President Elliott C. McDougal:

"We cannot see a single advantage to be gained by a state bank which enters the Federal reserve system, and we see a number of distinct disadvantages in addition to the ones already mentioned in this circular, such as the certainty that dividends in the stock investment cannot exceed six per cent., the uncertainty as to what that will be, the addition of another set of examinations which we now have each examination to the four year, the possible conflict between the regulations of our State Banking Department and of the Federal Reserve Board which

might place a state bank in a very embarrassing position, and others.

"We hope that every State banker will take the time to read over the entire bill, and that each will do his own thinking, and make up his own mind as to the merits and demerits of the bill as applied to his own bank."

The following is an extract setting forth the advantages and disadvantages of the system on the state banks of Michigan:

"Outside the questions of advertising and the low reserve requirements under the new currency act, the benefit of the act will be more pronounced only during the periods of tight money, or what may be termed money panics; and it is hard to conceive how these can occur in any ordinary times with the currency law in force.

"It is also time that many of the smaller state banks in Michigan will be more or less reluctant to come under the terms of the currency law on account of additional expenses, of extra examinations and the added annoyance, and the work of sending two sets of reports, one to the Comptroller of the Currency, as provided for in national banks, and another to the State Department.

"Another objection to coming under the law is the fact that after once becoming stockholders, there is no avenue by which they can surrender their membership or sell their stock, unless they are forced to do so by the Federal Reserve Board on account of non-compliance with their requirements.

"It is true that under section 85 of the currency law a state bank cannot act as a depository for Postal Savings unless it becomes a member bank."

These letters and opinions in a measure show us how some of the state bankers feel toward coming into the new system. After the plan is perfected, there may be a decided change in the attitude of those who are at present against the entrance of their banks into the system.

Conclusion.

The panic of 1907, the causes for it and the results which followed have been reviewed. We then discussed the remedy needed for the prevention of a reoccurrence of such a condition of affairs. We have followed the preparation and the passage of the Act of May 30, 1908, and have drawn our conclusions as to its merits and disadvantages. We have then seen the measure prepared by Chairman Nelson W. Aldrich of the National Monetary Commission, and we have seen the disapproval the measure created in Congress.

We have stopped for a moment to review the conditions of our currency and banking, and to suggest need for the improvement for those conditions. The last measure, known as the New Bank Act, has then been presented and discussed as to its merits.

These provisions represent the legislation along our currency lines from the beginning of the year 1908 until the New Bank Act passed in December, 1913.

In conclusion it may be said that our country seems to be at present "on its feet" as far as banking and currency questions are concerned, and if we continue to improve, there is nothing to prohibit the United States from being the greatest commercial and financial nation in the world.