







ECONOMIC ESSAYS

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ECONOMIC ESSAYS

BY

CHARLES FRANKLIN DUNBAR

LATE PROFESSOR OF POLITICAL ECONOMY IN HARVARD UNIVERSITY

EDITED BY

O. M. W. SPRAGUE

ASSISTANT PROFESSOR OF ECONOMICS IN HARVARD UNIVERSITY

With an Introduction

BY

F. W. TAUSSIG

HENRY LEE PROFESSOR OF ECONOMICS IN HARVARD UNIVERSITY

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CONTENTS

	PAGE
INTRODUCTION	vii
I. ECONOMIC SCIENCE IN AMERICA, 1776-1876	I
II. THE REACTION IN POLITICAL ECONOMY	30
III. THE ACADEMIC STUDY OF POLITICAL ECONOMY	52
IV. RICARDO'S USE OF FACTS	68
V. SOME PRECEDENTS FOLLOWED BY ALEXANDER HAMILTON	71
VI. THE DIRECT TAX OF 1861	94
VII. THE NEW INCOME TAX	116
VIII. EARLY BANKING SCHEMES IN ENGLAND	135
IX. THE BANK OF VENICE	143
X. ACCOUNTS OF THE FIRST BANK OF THE UNITED STATES	168
XI. DEPOSITS AS CURRENCY	172
XII. THE BANK-NOTE QUESTION	188
XIII. THE SAFETY OF THE LEGAL TENDER PAPER	207
XIV. THE NATIONAL BANKING SYSTEM	227
XV. CAN WE KEEP A GOLD CURRENCY?	248
XVI. THE CRISIS OF 1857	266
XVII. THE CRISIS OF 1860	294
XVIII. STATE BANKS IN 1860	314
XIX. THE ESTABLISHMENT OF THE NATIONAL BANKING SYSTEM	330
XX. THE CIRCULATION OF THE NATIONAL BANKS, 1865-1900	346
INDEX	365

INTRODUCTION

CHARLES FRANKLIN DUNBAR was born at Abington, Massachusetts, July 28, 1830, and died at Cambridge, Massachusetts, January 29, 1900. For nearly thirty years, from 1871 until his death, he was Professor of Political Economy in Harvard University; and it was during this period that he prepared the essays printed in the present volume.

Professor Dunbar did not enter on his academic career, however, until he had passed the age of forty. The best years of his early manhood were given to work of a very different sort. For ten years he was editor of a daily newspaper; a phase of his life little known to those who afterwards felt his influence as teacher and author, but one in which his success was no less marked.

After graduating from Harvard College, in 1851, he engaged for a short time in business; health failing, spent a year at farming; then entered on the study of the law, and was admitted to the bar in 1858. Meanwhile, contributions from his pen had appeared in the *Boston Daily Advertiser*. In 1859 he became part owner and associate editor of that newspaper, and soon was sole responsible editor. From 1859 to 1869 all his energies were given to its editorial and business management.

These ten years witnessed the most perilous and momentous events in the country's history. The times were trying for all men, and not least so for a high-minded man in charge of an important daily newspaper. Rapid decisions were called for on great questions; news of vital concern had to be gathered, sifted, presented; the conflicting tides of opinion in the community had to be at once followed and guided. The *Advertiser*, as conducted by Professor Dunbar, was a model newspaper, and deserved its position as the most influential journal in New England. It stood stoutly for the cause of the North, and never abated its unflinching faith in the justice of that cause and in its ultimate triumph. Its

support of President Lincoln and his associates was firm, yet not slavish. Professor Dunbar was by nature conservative and judicial, and both sides of a disputed question presented themselves to his mind. It is probable that on many of the measures resorted to during and after the Civil War he had his own doubts and reservations. But those were times for united action, and such the Advertiser stood for. Its editorials, written without exception by him, show a warmth and exaltation of spirit very different from the measured tone of the scientific papers printed in the present volume. And thus they show an aspect of the man not so conspicuous to the reader of these sober and judicial writings: a capacity for great enthusiasm and a fervid love of the right.

The conduct of a daily newspaper, however far-reaching it may be in its influence on public affairs, rarely gives rise to contributions of permanent value to science or literature. To this rule Professor Dunbar's editorial career offers no exception. No one would have been more averse than he to a reprint of selections from his writings in the Advertiser. Yet in another sense these writings have a permanent value of the highest sort. Here is a record from day to day of the history of the United States during its most dramatic and trying decade — a record prepared or supervised by a man of great sagacity, of unswerving patriotic spirit, of scrupulous truthfulness, and of high skill in exposition. To the friends and associates of Professor Dunbar, his editorials still have a value, in that they show the intellectual and moral qualities of the man. To the future historian, wishing to come close to the march of events when our own still vivid recollections of the Civil War shall have faded away, they will have a much higher value. They reflect in the mirror of a clear and well-tempered mind the impressions of every day's events in those ten years of fierce combat and slow recovery.

The financial and economic events of the period were of the most extraordinary kind. A huge national debt was incurred; paper money was issued to an excess that caused great and sudden depreciation; a wide-reaching system of excise taxes was rapidly created, and as rapidly swept away; a high protective tariff was set up, and unexpectedly retained; millions of slaves became freedmen, and the entire industrial organization of the

South was revolutionized. Professor Dunbar's attention was necessarily given to all phases of the country's history, but the financial and economic phenomena enlisted his special interest. He gathered a fund of experience such as few economists have been fortunate enough to possess. He learned much in the later years of his scholarly life, and settled on conclusions and principles which were not accurately defined in his mind during his newspaper career. But it may be doubted whether any research was so productive or any experience so profitable as the unremitting observation and reflection during these years of varied economic history. Scholarly as his work was in later life, and recondite as were some of his researches, he never became a closet economist. Whether discussing contemporary proposals for legislation on the currency, or the history of banks in past centuries, he kept a close view of the working of economic forces in their concrete details.

The best years of his life and the best of his strength were given to the Advertiser. It is probable that he never recovered completely from the strain then endured. In 1869 his health seemed sapped, and he was glad to dispose of his interest in the paper and to withdraw from its management. Fifteen years later, when he had been long settled in his academic post, he was suddenly called on to conduct it again, during a brief period of stress. In 1884 the Republican party nominated for the presidency Mr. Blaine, whom many independent Republicans could not conscientiously support. The Advertiser had then come into the hands of friends and associates of Professor Dunbar's. Over night, a decision had to be reached whether to support the nomination or to bolt. The bolt was voted; whereupon the editor, who would not abandon Mr. Blaine, resigned on the spot. Professor Dunbar was asked to step into the breach, and did so without hesitation. Stanch as he had been in support of the Republican party during its days of storm and stress, he was equally stanch in opposing it when it fell into ways he thought evil. Immediately after the election of 1884, he resumed undivided attention to academic duties.

Shortly after his retirement from the Advertiser, in 1869, he was asked by President Eliot, then just entering on his career as head of Harvard University, whether he would accept a professor-

ship of political economy in that institution. He doubted his qualifications for the post, and for a time would give no answer. He finally assented, but first gave two years to travel and study in Europe. He was formally appointed to his professorship in 1871, and entered on its duties in the fall of that year.

As his hesitancy in accepting the appointment showed, Professor Dunbar was keenly alive to the need of adequate equipment for his new duties, and unduly modest as to his own competence. At that time it would have been a rare chance to find a man better equipped. Systematic training in economics, such as is now offered in a dozen American universities, — and is so offered, it may be added, largely as a result of the growth of economic study in Harvard University under Professor Dunbar's own guidance, — was then unknown in this country and in England, and was barely begun in Germany. Any appointee to a professorship in the subject must then have been a self-made economist. There were, it is true, not a few persons, with more or less repute as writers on economic topics, on whom, rather than on the little-known editor, the choice of the Harvard Corporation might have fallen. Yet that choice proved a singularly fortunate one. Professor Dunbar was by temperament a scholar, open-minded and judicial, averse to the superficial treatment of any topic, and with interests that looked far beyond the horizon of the day. He possessed, also, what men of scholarly bent often lack, both executive capacity and sound judgment, and thus became an invaluable coadjutor and counsellor in the tasks that lay before the new administration of the University. Not only was he the natural leader in the organization of the instruction which most directly concerned him; he took also a large part in the rapid transformation of the institution from a small college with loosely attached professional schools into a great and consistently organized university.

For many years after his appointment Professor Dunbar was virtually engaged in equipping himself as a teacher of economics. Cherishing high ideals of scholarship, he delved in the earlier and later literature of his subject. He became widely read in the classic writers of England and France. It was not until a later period that he turned to German writers also, who indeed hardly deserved attention in so great degree at the outset of his

academic career. He knew his Locke and Hume, Quesnay and Turgot, Adam Smith and Malthus and Ricardo and Mill, not to mention Say, Senior, Storch, Rossi, Bastiat, and the whole host of minor writers. Perhaps he gave an undue amount of time to some parts of this reading. There was in him not only a strong historical bent, but a streak of antiquarianism. A lively curiosity of this sort sometimes led him, in later years as well as during this formative period, to follow clues and unravel minor tangles, which after all lay apart from his dominant interests and diverted him from his main work.

Not less characteristic than this absorption in the general literature of economics was his complete abstention from the discussion of current questions of economics and politics. His experience as editor had informed him of every detail in contemporary history, and had habituated him to constant and prompt discussion of questions of the day. It would have been natural that, as professor, he should continue such discussion. He never did so, and consistently rejected all proposals to contribute to periodicals on current topics. No doubt this was due in some degree to weariness of work of the sort: ten years of newspaper writing had sated him. In part, also, it was due to innate conservatism of judgment. But most of all, it was due to his ideal of the duties of the University teacher. Such a teacher should be, as he believed, a leader in thought and in investigation, elucidating the principles on which the solution of current problems must depend, contributing by slow accretions to the mass of information on which the advance of knowledge must rest, and leaving it for others to spread abroad and apply the results of the scholar's research.

While thus engaged in equipping himself more fully for his duties as professor, he was also soon drawn into the administrative work of the University. For such work he was eminently fitted, and his strong sense of loyalty to the University and to its head led him to enter on it, if not with zest, at least with strong interest and willing spirit. In 1876 he was elected Dean of Harvard College, and remained in that post until 1882. When the enlarged and remodelled Faculty of Arts and Sciences was organized in 1890, he became its first Dean, and so acted until 1895. In addition, he served repeatedly on committees, and his

aid and counsel were unfailingly asked when any large question of policy was under consideration. Of such questions there was a plenty throughout his academic career. President Eliot found in him a warm friend, as well as a staunch supporter and wise counsellor, and frequently called on him for conference and advice. The great measures of that brilliant administration,—the extension of the elective system, the increase and broadening of the requirements for admission, the liberal and manly policy in dealing with undergraduates, the elevation of the professional schools, the creation and fostering of advanced instruction and of the Graduate School,—all enlisted his support, and all brought a drain on his time and energy. The labor he was thus called on to perform was cheerfully assumed and borne, yet was felt to be a distraction from the scholarly work which he regarded as the vital part of his academic duties.

The various circumstances described in the preceding paragraphs—the ten years of newspaper work, the period of conscientious preparation for the professor's duties, the repeated pressure of administrative work—account for the comparatively small amount of Professor Dunbar's publications. In 1876 he contributed to the *North American Review*, then still a scholarly repertory, the article on "Economic Science in America," which is the first of the papers reprinted in the present volume. After this modest beginning there was a long period of silence. For the use of his classes in the University, he soon began to collect documents and put together materials; and out of these grew important works. The financial history of the United States had of necessity enlisted his attention while editing the *Advertiser*, and he early prepared careful lectures on this subject. For use in connection with the lectures, he printed privately, in 1875, a selection of the laws of the United States on currency and finance. His researches steadily widened, and as the instruction in the University grew, he gave an independent course on the financial history of the country,—a course remembered with admiration by a long series of grateful students. For use in this instruction he published in 1891 the volume of "Laws of the United States on Currency, Finance, and Banking" (Boston: Ginn & Co.). To the average reader, and even to some hasty fellow-scholars, this had the appearance of an easy task: a simple reprint of matter from the statute-book. But the

selection of all the important laws, the rejection or compression of the less important, the unearthing of vetoed bills and other historical documents, the cross-references to apposite sources, — these show the author's scholarly qualities at their best. The volume is characteristic in another way. It was Professor Dunbar's undeviating habit to turn to the primary sources of information, to statutes, official documents, the writings of contemporaries. He trained his students likewise never to content themselves with secondary sources. Hence he prepared for their use collections of documents such as this volume contained, modestly putting in the background his own skill and labor in selection and preparation.

The book by which he is best known to the general public grew in a similar way out of his teaching. Side by side with his general economic reading, he began at an early date to give special attention to the subjects which most attracted him, — the theory and history of currency, banking, and public finance. Finding no serviceable book to put into the hands of his students, he prepared something on banking, as he had done on financial history. In 1885 he printed for the use of students, again privately, certain chapters on banking. Expanded and revised, these were published in 1891, under the title "Chapters on the Theory and History of Banking" (New York: G. P. Putnam's Sons). A second edition, again revised throughout, was in course of preparation and well advanced at the time of his death, and was carried to completion by the editor of the present volume, Dr. O. M. W. Sprague. The little volume shows Professor Dunbar's qualities at their best, and deserves its place as a classic on the subject. Planned originally for the use of college students, it retained in the successive editions the directness and conciseness of a book addressed to those new to the topic. Yet, alike in the exposition of principles and in their illustration by concrete example and by history, it goes to the root of things, and leaves the most competent critic with no sense of difficulties skimmed over. A wide range of learning is shown in the notes and the historical sketches, yet with no parade, and with rigid exclusion of irrelevant matter.

In 1886 the University was enabled, by the gift of an adequate guarantee fund, to authorize the publication of the *Quarterly Journal of Economics*, of which Professor Dunbar was at once appointed editor. The establishment of the *Journal* opened virtually a new

phase in his career. For the remaining years of his life he gave to it a large share of his time. The task of editing was congenial to one of his reserved temperaments; and a taste for workmanlike effects made him take a satisfaction in the niceties of typography and appearance, as well as in solidity of contents. His guiding principle as editor was the sound and simple one of conducting a journal for investigators, a medium of communication for those who had something to contribute to the advance of knowledge. He succeeded from the outset in making for the Journal a distinguished place in the literature of the subject, and in securing notable papers from scholars the world over. Through it he exercised an important influence in stimulating the remarkable advance of economic science which took place in the United States in the decade after its establishment; and Professor Dunbar was content with what he had here achieved, and found in it some solace for his failure to carry out plans for independent publication.

His own contributions to the Journal, however, were important both in quality and quantity. As it happened, the teaching staff in the department of economics at Harvard University was enlarged at the time of the establishment of the Journal, and he was enabled to turn over to younger hands the instruction in parts of the subject of which he had grown weary, and to devote himself to others that had always chiefly interested him. His duties as editor at the same time impelled him to put together some results of his researches. But for this pressure, much more of the work he had planned would probably have been left undone. Great modesty and a high degree of indifference to the world's applause combined with lack of physical vigor in making him slow to put pen to paper. Fortunately, the obligations which he felt as editor led him to contribute with some degree of freedom to the columns of his Journal. The present volume is made up chiefly of those contributions. They tell their own tale as to the quality of his mind and the range of his interests. Those on current problems,—on the lessons of our legal tender currency, on the remodelling of the national banking system, on the income tax,—naturally attracted most attention at the time of their publication, and, in the slow progress of reform, will be read with profit for years to come. But their author took greater satisfaction in the papers on less familiar topics, such as those on the

Bank of Venice, the Precedents followed by Alexander Hamilton, and the history of the Direct Tax in the United States. He had a just pride in doing a task thoroughly, — in putting on record once for all the definitive results of exhaustive inquiry.

These papers, though each is in a sense complete in itself, are yet fragments from larger work. Those on the finances of the United States are the outcome of prolonged investigation, covering the whole range of the subject, which was expected to lead to a systematic history. Unfortunately Professor Dunbar allowed himself to be deterred from this project, for which no one was so well equipped, by the publication of a pretentious but highly unsatisfactory book by another hand on the same subject. He had pushed his way into the literature on the history of banking; and here also the essays on the Bank of Venice in the present volume, and the chapter on the Bank of Amsterdam in his book on Banking, represent only a portion of his learning. He had gathered a large and interesting store of contemporary material on the Assignats of the French Revolution, and had noted the peculiarities in the course of the depreciation of that curious issue of paper money. He had followed the history of commercial crises through two centuries, with special regard to the supposedly regular recurrence of these industrial storms, and had begun the preparation of a careful monograph on the question of their periodicity. He had made an exhaustive study of the financial administration of Alexander Hamilton; but of this also nothing was put on record except the essay on the Precedents followed by Hamilton. He had conducted at the University systematic courses of instruction on still other topics: on the theory and methods of taxation; on financial administration and public debts in the leading countries; and on the economic history of Europe and America since 1763. On the subject-matter of these courses he was led both by an alert intellectual curiosity and by conscientious devotion to academic duty, to carry his work much farther than was called for by the strict needs of teaching. He cannot be absolved from the blame of having in some degree scattered his energies.

Among the notes and papers found after Professor Dunbar's death, some were in such a stage of completion as to warrant their publication. He had begun a history of banking in the United States since 1860, and of this the first three chapters were

virtually completed. They are printed in the present volume, and illustrate adequately the style and the method of his maturest days. Of quite a different kind are the accounts of the crises of 1857 and 1860. They were prepared at an early stage in his academic career; certainly as early as 1875, and not improbably before 1876. That Professor Dunbar left these papers in his desk for over twenty years without taking any steps toward printing them, indicates that he was not disposed to give them to the public; and, indeed, the mode of treatment is not such as he would have followed in later years. Yet they are contributions of no mean value to the economic history of the United States and to the history of crises, and are accordingly included in the present volume, notwithstanding the author's evident doubts as to their suitability for publication.

Professor Dunbar was by nature reserved, and as to his own work unduly modest. With his reserve went a quiet dignity which was often mistaken for coldness. Even those who enjoyed his closer acquaintance sometimes found him silent and uncommunicative. But in intercourse with intimate friends this veil disappeared, and he became no less warm-hearted than charming. He had a keen sense of humor, enjoyed alike to hear and to tell a good story, and saw the mirthful side of every subject. These attractive lighter qualities unfortunately showed themselves little in his dealings with students. With classes of mixed undergraduates he never was a highly successful teacher. He hesitated to commit himself on those large questions, the most difficult to answer, which arise in a survey of the subject as a whole, and he was thus less effective and stimulating than one who was willing rashly to plunge into the discussion of fundamentals. On the other hand, he was an ideal teacher on the special topics to which he confined himself in the later years of his life. He had a remarkable gift of clear and well-ordered exposition, and a remarkable command of apposite language. The rounded stateliness of diction which marks his writings showed itself also in his lectures. Here, with a moderate number of selected students, his sound judgment, his judicial temper, his nice discrimination, his thorough information, were fully appreciated. Those who had the privilege of his instruction under these favorable conditions felt for him a reverent admiration, and took from his lecture rooms noble ideals.

During the last ten years of his life Professor Dunbar's work was much interrupted by ill-health and waning strength. It was probably a sense of physical weakness that led to the slowness and hesitation with which, notwithstanding years of experience in writing, he took pen in hand for literary work. He had always to nerve himself to this task; though when once it was entered on, the result was invariably happy and seemingly spontaneous. No doubt the same sense of weakness was in some degree the cause of the scattering of his energies, to which reference has already been made in this sketch. He found it easier and more interesting to begin on new subjects and follow new clues than to persist in bringing to a close investigations already well advanced. And yet, all in all, in view of the difficulties he had to surmount, the surprising thing is not that he did so little, but that he should have succeeded in achieving so much.

The editing of the present volume has been in the hands of Dr. O. M. W. Sprague, who was Professor Dunbar's assistant during the last years of his activity as teacher. For those papers which had already been published, Dr. Sprague's task was the comparatively easy one of arranging them in proper order. But for those which were left unpublished, especially the three chapters on the history of banking in the United States, much remained for him to do, in verifying and completing the references, and in bringing the manuscript as nearly as possible into the form which the author would have wished. All credit for the volume as it stands belongs, after the lamented author, to Dr. Sprague.

F. W. TAUSSIG.

ECONOMIC SCIENCE IN AMERICA, 1776-1876 ¹

THE century which has elapsed since our independence was declared exactly covers the period for which the science of political economy has been a systematized branch of human learning and research. Before the publication of Adam Smith's "Wealth of Nations" in 1776, we have, indeed, discussions of detached topics, and even attempts here and there to throw the whole into connected form; but, after all, the economist finds the foundations of the science, as it stands to-day, laid deep and solid for the first time by Adam Smith; the great men who have since carried forward the work have declared themselves his followers, and in developing and extending the science have kept to the lines of discussion which he laid down with such vigor and insight a century ago.

The science which is thus coeval with our nation has been studied with zeal and with measurable success in most parts of the world. New principles have been evolved, tested by the abundant experience of modern industry, and added to the body of ascertained truths. Unceasing discussion has enforced constant revision of the whole work, with increase of firmness and consistency as the issue of every threatened revolution. The field properly occupied by the science has been surveyed and its limits determined, even to the disappointment of overambitious economists or of a too expectant public. No other moral science has equally engaged the attention of public men, and no other, it is safe to say, has equally influenced public affairs, whether by the correct or the incorrect application of its principles. Nor has any nation had the monopoly of honors gained in this new pursuit. Adam Smith, Ricardo, and Mill have secured the leading position for England; but France and Germany, and perhaps Italy, have made contributions of lasting importance to the subject, and

¹ *North American Review*, January, 1876.

have never been without their full proportion of active and judicious investigators. Notwithstanding the priority of England in some remarkable advances, the centre of interest in economic discussion has not always rested with her; it has at times been in France; it is now, probably, in Germany. In short, the science has been made a common possession by the efforts of all.

When we come to inquire what part our own country has taken, and what contribution it has made in building up this science, we are struck at the outset by the fact that the growth of the United States has been a circumstance of prime importance in the economic history of the world during the century. It must be placed in the same rank with the brilliant succession of discoveries in the industrial arts, or with the extensive improvement of government and social organizations, as one of the half-dozen great influences which have changed the face of the civilized world. Without entering into the details of a comparison, to which every reader is likely to have his attention sufficiently drawn during the present year, we may here note a few of the facts which have given to the development of this country so great an influence upon that of the rest of the world. Beginning with the statement of mere area, the organized states of the Union now occupy a territory larger than the whole of Europe, outside of the Russian Empire. The improved land of these states, measuring two hundred and ninety-five thousand square miles in 1870, cannot be much less than the total improved surface of England and Ireland, France and Prussia, together. Of this vast field of production, we may fairly say that the whole has been brought into the circle of international exchanges and added to the available resources of mankind within this century, so insignificant were its relations with the rest of the world a hundred years ago. Moreover, the products to which this territory is adapted by nature are such as have a singularly direct and important bearing on the welfare of other countries. How great an industrial revolution has been wrought by cotton, and what the nineteenth century would be without that fibre, of which we produce more than half of all that comes to the markets of Europe and America, it would be hard to say; but the memory of our Civil War is still fresh enough to tell us what universal disaster must follow the interruption of our supply, and what a chain of consequences, involving the well-being, the peace, the institutions, and

even liberty of millions of men, have followed from the addition of the cotton-plant to the agricultural products of the South. Of different but hardly inferior significance in the economy of the world is our supply of gold. The astonishing expansion of industry and commerce for which the close of the wars of Napoleon seems to have given the signal, which has stimulated and been stimulated by our growth, is one of the great phenomena in the history of mankind. This expansion, however, must have been checked at the most critical period, had not fresh discoveries of gold supplied the enlarged medium of exchange required by the new scale of transactions; and of this series of discoveries, the second in importance in recorded history, California made one of the chief and also the earliest. From that time the United States have continued to be the first in importance of the sources of gold; and were this our only economic relation to the rest of the world, the influence of our rise as a nation upon the general well-being must be admitted to be direct and powerful in an extraordinary degree.

Tobacco, one of our earliest staples for export, has become not only an article of great moment in the revenue systems of several leading nations, but stands in a peculiar relation as one of the few luxuries which enters largely into the consumption of the poorer classes of all countries, thus requiring, as it were, a social importance far beyond its simple pecuniary value. And of tobacco, the United States are now the leading source of supply for England, France, and Germany. To turn from this to petroleum, one of our newest staple articles of export, and now the third or fourth in importance on our list, it may be doubted whether to the majority even the ludicrous incidents of the discovery do not continue to be more familiar than the reflection that by the timely introduction of a cheap and excellent artificial light an immense boon was conferred upon a large part of the civilized world. And last among those economically important natural products to which we shall refer are the cereals. Our capacity for the supply of these, although of secondary importance in the markets of other countries, has made it possible for us to sustain an increase of population which, for years, has been cited as the standard example of maximum natural growth. This abundance of cheap food has also made it for our interest, simultaneously with this rapid natural increase of numbers, to invite from the Old World

an immigration on a scale so vast as to constitute in itself an economic phenomenon of no mean order, the result being the relief of the older countries from a serious, if not dangerous, pressure of numbers, by the transfer to our shores of more than nine millions of people, or a number equal to the whole population of Great Britain at the date of our independence. And the population thus established on our soil, whether native born or of immediate foreign extraction, has proved to be no inert mass, but, from the start, has been active and resolute to a fault, in improving all material advantages and in pushing its way to a place among the great powers of the modern world. Mineral resources of remarkable variety, and of extent not even yet fully measured, together with fortunate conditions of physical geography, have seconded these efforts and often enabled us to enter into sharp competition with the longer established industries of Europe. To excellent natural facilities for communication has been added a railway system of seventy-five thousand miles, being little less than half the railway mileage of the world, and going far to neutralize the disadvantages of great distances, which, in some directions, threatened to hamper our growth. A mercantile marine, which even in its present depressed condition is not far short of the greatest on the ocean, and is of nearly double the magnitude of its next competitor, helps in part to connect this vast internal network with the general commercial system of the world. So great, however, is the volume of our exchanges with other countries, that scarcely one-third of it is transported by our own shipping. With the mother-country, especially, our commerce has grown, until it overshadows that of every other nation with whom she carries on a trade either of export or of import. What a growth this has been is shown by the fact that the steam-tonnage now annually cleared for New York alone from the United Kingdom exceeds the total tonnage of ships annually cleared for all parts of the world down to the close of our Revolution.

In the process of development indicated by these few leading facts, the United States, by a natural and steady though rapid movement, have taken among commercial nations a place not lower than the second, and likely soon to become the first,—the second or first place it must be remembered, in a changed world, and in a scale of magnitudes hardly comparable with those of

1776. We have advanced to the front among competitors who were themselves all rapidly advancing. But, with improved facilities for intercourse, the economic ties between countries have been vastly multiplied and strengthened, and to hold a leading position in commerce now implies a direct connection with the progress of others and with their material well-being, immeasurably closer than has ever existed before. Every fresh conquest over nature made by us belongs to the family of nations also, and every loss suffered by us is also their loss. Infinite mutually dependent interests unite us with Europe and with the very antipodes. Every pulsation in the financial system is felt alike on each side of the Atlantic. A crisis in London has its instant counterpart here, and the great revulsions which periodically sweep over the commercial world may begin, almost as chance may dictate, in New York or in Vienna.

The value of the triumphs of material development achieved by the United States is not to be underrated. They represent but one side of human progress, but their influence on interests of a higher order is immediate and powerful. The world cannot yet dispense with the stimulus which the search for wealth gives to some of the pursuits and institutions which most elevate and enoble civilized life. Doubtless Carlyle is right when he says that "America's battle is yet to fight. . . . Their quantity of cotton, dollars, industry, and resources I believe to be almost unspeakable; but I can by no means worship the like of these." But these have been one of the great factors in producing whatever of progress and hope the world has gained in our age. If not to be worshipped, they are still not to be despised, for from them comes, as must be admitted, much that is itself worshipful. Even our merely material growth may then fairly be a subject of pride, so long as we remember that it is itself only the means for higher ends.

Standing in this relation to the general advance in wealth which the world has made, it might have been thought in advance that the United States would be prompt in investigating the laws which govern all economic progress. The philosopher who could have foreseen in 1776 the amazing career of the weak and scantily peopled colonies which then took their place as an independent power, might easily have been persuaded that the new science,

then having its birth and treating of "the nature and causes of the wealth of nations," would be taken up by this people with especial animation and success. "Here," he might have said, "is the beginning of an inquiry into the nature and causes of that which will chiefly occupy the new nation. Others in their maturity or decadence may prosecute this inquiry in the hope of discovering the means of escape from impending evil; this people will pursue it with the enthusiasm of strengthening youth. Success in this investigation and a wise application of its results will account for the splendid triumphs in the acquisition of material wealth, which are to distinguish the first century of independent national life." How far the imagined anticipations of our philosopher have been verified, and the reason for their failure so far as they may be found to have failed, is the object of the review on which we now enter.

The condition in which the breaking out of our Revolution found the study of economic science in this country is well exemplified by the writings of Franklin. Of all our public men of that period he was the one whom we should perhaps most naturally expect to find dealing with this class of subjects, and, if not profoundly investigating the causes of phenomena, at least deriving from observation and reflection sound and consistent rules for practical guidance. His activity in the political discussions of more than half a century, and his natural fondness for every inquiry respecting material well-being, seem to mark him out as the American who must deal with political economy if any one did, and the one who could rise to the level of the national thought in economic speculation, if he did not soar much beyond it. Franklin wrote upon topics of this class from his twenty-third year, and probably wrote as well in his twenty-third year as he ever did. The questions of currency then raised in every colony by the paper issues of the colonial governments he had occasion to treat of at several different times. But the support which he gave to issues of that kind rests on no well-defined systematic body of opinions; indeed, his discussion of the continental currency, in some of his letters, raises questions as to his clearness of perception in morals as well as in political economy. He is quoted with admiration by writers of the protectionist school, and he might equally well be quoted by their opponents. He was in fact a man

of expedients rather than principles, often sagacious in dealing with immediately practical questions, but satisfied with the crudest speculations as to the operation of causes in any way remote. His economic writings were edited for Mr. Sparks's collection of his works by the late Judge Phillips, himself an economist of no mean capacity; and the annotations of the editor afford ample evidence that he found it no easy task to present with respectful comment and due admiration the mass of ill-digested reasoning placed in his hands. That Franklin read much of the writings of others on questions of political economy is not to be inferred from his works. Smith's "Wealth of Nations" is cited in a paper on the increase of wages in Europe likely to be caused by the American Revolution, written shortly after 1780, when Franklin was abroad; but the citation is made to settle a fact, and not to further the discussion or elucidation of a principle.

Of Franklin then it must be said, that he not only did not advance the growth of economic science, but that he seems not even to have mastered it as it was already developed; and little more can be said for any of our public men or writers during the period of Franklin's activity. We find no one well versed in economic theory and entering upon speculative inquiries of real value until we come to Alexander Hamilton. That great man, whose remarkable career was finished at the point when most men are just ready for action, was a reader and inquirer in political economy in his twentieth year. In his twenty-fifth year, in such leisure as the camp of the Revolution afforded, he matured a scheme for a Bank of the United States, and became a correspondent of Morris on that subject. And, finally, at the age of thirty-four, he produced, as Secretary of the Treasury, his great reports on the Public Credit, on a National Bank, and on Manufactures, the most powerful and comprehensive discussion of the national finances ever made under our government, and the subject, it may be remembered, of one of Mr. Webster's noblest periods. Those reports bear the evidence throughout of much reading and reflection upon the experience of nations, and of careful meditation on the speculations and theories of previous writers. Examination of the report on Manufactures, in particular, will show that in some parts of it, in his selection of topics and even in the order in which they are marshalled, Hamilton was

influenced by his familiarity with Adam Smith. The writings of the French economists were probably known to him at this time, as they certainly were a few years later, and some of the doctrines of this school, as well as Smith's concessions to them, received from him a successful refutation. Both the knowledge of economic questions and the power of dealing with them exhibited by Hamilton in these discussions warrant us in setting him down as a writer who, under other conditions and freed from the pressure of public business, might have been expected to make some positive contribution to the development of economic theory. But his few crowded years left him little opportunity for such pursuits, and it would now be hard to say that he left any impression on the thought of the world, by his dealing with this subject. His reports have continued to be the arsenal from which the advocates of special measures have again and again drawn forth weapons now well worn; but systematic political economy cannot be said to owe to him any recognized principle, any discovery in method, or indeed any influence save the stimulus which his example must always afford to the student of financial history.

If Hamilton did not permanently influence the economic thought of the world, there is certainly no other statesman of that period for whom such a distinction can be claimed. Among Hamilton's great contemporaries none followed the discussions of the new science with more interest than Jefferson and Madison; but neither of these statesmen was comparable to Hamilton in his mastery of the subject. Jefferson had that fondness for it which he had for all philosophical speculation, kept himself informed as to all new publications abroad, was instrumental in bringing some of these before the American public, and corresponded with some of the leading French economists of his day; but in his own discussions of economic questions it is difficult to find any firm ground of logical principle, and impossible to find any addition to what had been previously ascertained and better comprehended by others. Madison, with interests less diffuse than Jefferson's, had a much firmer hold upon this subject. He appears to have followed its current literature with close attention, and to have reflected upon principles and to have applied them, with great although not uniform force, in his reasoning upon public questions. It is interesting to find Madison — and, indeed, Jefferson

also — giving in an early adhesion to the doctrines of Malthus on population, and defending them by arguments from the experience of the United States. But Madison could make as little pretension as Jefferson to having added any results of original investigation to the work of others. His merit was not as an economist, but as a statesman who conscientiously prepared himself for the duties of public life by following this necessary branch of a statesman's studies. Of the other public men of this early period of our history we need mention only Robert Morris and Gallatin; and of these eminent practical financiers the latter only has any claim to notice in connection with scientific theory. The memorial drawn up by him and presented to Congress, in 1832, from the Philadelphia Convention in favor of tariff reform, is a full and strong statement of the arguments against protection, and exhibits familiarity with the results of theoretical discussion, as well as with the practical side of the question; but the complete oblivion which now covers the document shows how narrow and temporary is the influence to be credited to it. His pamphlet on "The Currency and Banking System" is also a comprehensive and sound discussion of these topics, but has ceased to be much referred to, except for historical purposes.

Of the great men of the next generation, Mr. Calhoun was doubtless well qualified by nature for this field of investigation, and displayed a strong inclination to enter upon it; but, unhappily, every mental power and every pursuit at last became subservient with him to a narrow sectionalism, which finally frustrated all hope of sound fruit from a laborious life. The electric power with which Mr. Clay acted upon the emotions of men was not coupled with any special capacity for the research of principles; and while his name is inseparably connected with the "American system," his argumentative defence of that system is practically forgotten, — so much easier was it for him to give vogue to an effective name, than to give a scientific basis to the thing itself. Mr. Webster discussed with great power many questions involving general principles of political economy, but he never cared to apply his intellect to the foundations of the science. Indeed, in one of his letters he says: "I give up what is called the 'science of political economy.' . . . I believe I have recently run over twenty volumes, from Adam Smith to Professor Dew, of Virginia; and from

the whole, if I were to pick out with one hand all the mere truisms, and with the other all the doubtful propositions, little would be left." Whatever else may be said of this passage, it absolves us from the further explanation of Mr. Webster's failure to contribute to the world's advancement in economic science. Of the contemporaries of these three great men, the other champions on whose words listening senates once hung, in the fierce contest over tariff and bank, no name can now be recalled as having any claim to connection with the development of the science of which we speak. Lowndes, Crawford, Wright, Berrien, McDuffie, Benton, and the others may yet shine in our political history, but they are unknown in political science.

And if we examine the roll of statesmen of the generation which closes our century, what better success is met? We find, indeed, the names of some men who have skilfully managed interests of vast magnitude, and of others, not in great number, who have shown a competent scientific knowledge; but we may safely challenge the mention of one who has added to the stock of economic principles with which the world was already acquainted, or has given any essential assistance in their elucidation. As a class our public men have confined themselves, like Franklin, to the sagacious application of rules of thumb. So far as they have dealt with the science at all, it has been made for them by others; and they have not aided in making it. Indeed, the promise held out by Hamilton's great example, of the thorough examination of questions in the light of ascertained principles, has seldom been fulfilled, even by our highest officers of administration. Few things, in fact, are more noticeable in our recent political history than the extreme fragility and brevity of the reputations acquired, either in administration or in legislation, by most of our public men who have assumed to deal with this class of subjects.

If we turn from the statesmen to the scholars of the United States, the result is not more satisfactory. Down to the year 1820 no American produced any treatise on political economy which the world has cared to remember. Such books of that period as come to light, upon industrious search in forgotten corners, are crude, unsystematic, full of empirical notions, and are now intellectually obsolete. The philosophical study of the subject, to which Adam Smith gave an impulse abroad, was, in fact, late in making any

public appearance on this side of the Atlantic. The increasing interest in it is shown by three editions of the "Wealth of Nations" (Philadelphia, 1789; Hartford, 1811; *ibid.*, 1818), and by the reprinting of Ricardo's great work (Georgetown, 1819) only two years after its original publication. But when we remember that on the other side of the Atlantic this period was marked by the appearance of works so important, and in some cases of such lasting influence, as those of Malthus, Say, Ricardo, and Sismondi, the poverty of American thought upon the subject is striking, even if we allow, as we must, for the infancy of the country and the consequent small number of its literary class. In the twenty years which followed the period of which we have just spoken, a tolerably rapid succession of treatises by American authors was given to the public. Raymond (1820) brought to the discussion zeal and ingenuity, but such looseness of method and want of precision of ideas as to defeat his efforts and destroy the value of his work, — which, indeed, from its confusion of definition and want of system, seems a late growth of the generation which preceded Smith, rather than one of that which followed him. Alexander H. Everett, fresh from the influences of a long residence in Europe, and of personal intercourse with some of the leading economists of the world, published (1822) an answer to the essay of Malthus on Population, which holds a place among the best of the many attempts made in this direction; but his dialectic skill was not able even to supply the opponents of the Malthusian doctrine with a common standing ground, and still less to prevent the doctrine from being accepted in its essentials by the great majority of economists who have followed, and even by many who imagine that they reject it. Dr. Cooper, of South Carolina, issued a treatise (1826), of which McCulloch says that, "though not written in a very philosophical spirit, it is the best of the American works on political economy that we have met with," — an encomium measured with judicious care. Dr. Cooper's chief success, in fact, was in reproducing in systematic form the results attained by the English economists, with whose works he was well acquainted; but he did nothing in original speculation. Willard Phillips produced a treatise (1828) in which, treating the whole structure of Malthus and Ricardo as unsound, he sought to take up the subject where Adam Smith had left it. He treated it with an abundant knowledge of

industrial and commercial facts, and with a mind well trained for speculative inquiry; but it was complained, even by a friendly contemporary critic, that he reared nothing in place of that which he sought to remove. Rae's book (1834) has been pronounced by high authority to be a valuable discussion of the subject of production; but as the work of a Scotchman settled in Canada, and originally intended for publication abroad, we can hardly count it as an American contribution. President Wayland's book (1837) is the only general treatise of the period which can fairly be said to have survived to our day; and this, it must be admitted, owes whatever value it has to its manner of presenting for easy comprehension some of the leading English doctrines, — of which, however, it may be doubted whether the author ever fully recognized the bearing. Vethake's treatise (1838) is now little known, its more valuable portion having served its purpose, like the works of Cooper and Wayland, of bringing before our public some of the results, at that time unfamiliar, which had been reached by writers not then well understood in this country. Other writers of this period, like Dew, Newman, Tucker, and Potter, can be dismissed even more summarily, so transient was their influence and so completely forgotten are their works.

The years which followed from 1840 down to the war for the Union were for natural reasons much less prolific of works on political economy than the period just noticed. The stimulus given to the study of the science by the extraordinary advances made in it by the great English investigators had ceased to be active; questions of currency, as we shall presently see, had fallen into a subordinate rank; the tariff question, after a furious party struggle in which all considerations of political science were lost sight of, seemed to have been settled; and the great sectional controversy began to fill all minds, to the exclusion of every other public question. A few text-books appeared, recasting familiar material; as, for example, the well-known treatise of Professor Bowen (1856), in which he threw into connected form a long series of articles and lectures produced by him in the preceding ten years, and Bascom's convenient *résumé* of economic theory (1859). To these we must add Stephen Colwell's work on "The Ways and Means of Payment" (1859), the production of an author who had few equals as regards his acquaintance with economic literature,

but who in this, his chief work, appears to have been led into unprofitable subtleties, which have failed to influence appreciably the opinions or studies of others. Beyond these works, however, — and omitting for the present a writer whom we must notice more at length further on, — our literature now has little to show in this department except pamphlets and occasional essays of limited interest, for the years in which the wonderful phenomena of the California discoveries were occurring in our own country.

In the period which includes and follows the war we have a few works like that of the late Amasa Walker (1866), with its earnest but not always conclusive discussions of currency, and the vigorous treatise by Professor Perry (1866), — both designed for use as manuals, and claiming but little attention as statements of original thought. In general it must be said of the last ten years, that while they have witnessed a marked and salutary revival of interest in economic discussion, the most absorbing questions which have caused this revival have been quite too rudimentary to lead to fresh development of principle. Whether we shall have more paper, or shall return to specie, are questions calling not for research so much as for skill and force in rhetorical treatment, which may carry axiomatic truths into unwilling or otherwise unrecptive minds. It is true that the question whether our fiscal policy should look to continued protection or to ultimate freedom of trade involves more really controversial matter; but this has been so far overshadowed and complicated by the question of currency, that it neither has produced nor seems to us likely to produce for some time to come any marked originality of investigation.

It might perhaps have been enough for our purpose, if, instead of passing in review this series of American writers on political economy, we had simply called attention to the fact that, with few exceptions, the works produced in the United States have been prepared as text-books by authors engaged in college instruction, and therefore chiefly interested in bringing principles previously worked out by others within the easy comprehension of undergraduate students. The success with which this work has often been done and its value, we shall not question; but clearly it is not by such means that discoveries in abstract science are likely to be made or to be announced to the world. It should occasion no

surprise, therefore, that of the considerable list of American writers on the subject, so few have produced any impression out of our own country, or have been able even at home to give to the study any strong impulse. Not only has no American school of writers on political economy been established, if we except that which we are about to notice, but no recognized contribution to the development of the science can be pointed out in any way comparable to those made by the French writers, or to those which the Germans are now making.

The writer to whom we have referred as offering in some respects a possible exception to these general remarks is Mr. Henry C. Carey. It cannot be said that Mr. Carey has not engaged attention outside of his own country, for his works have been translated and circulated in nearly every important language of Europe, and Mr. Mill on several occasions pays him the distinguished tribute of singling him out in an especial manner from a throng of opponents. Nor can it be said that he has won his place by following others, for his system aims at nothing less than revolution in the leading doctrines of political economy, and he certainly bids fair to stand next to Malthus and Ricardo as a provoker of controversy. This exceptional position has been attained as the result of a long and laborious career as a writer. Mr. Carey's first publication, in which he appears as an advocate of free-trade, with an economic theory based on a new doctrine of value, dates from 1835. His denial of Ricardo's doctrine as to the law of production from land and his conversion to the theory of protection followed a dozen years later. The final elaboration of his system in opposition to what he is fond of calling the British school appeared ten years later still, in 1858; and hardly a year has passed since without some addition to the long line of his works on this class of subjects. This series of publications has had a distinct and not inconsiderable effect. Bastiat not only borrowed Carey's law of value and presented it in a brilliant paraphrase, but seems to show Carey's influence throughout his eager search for harmonies in the economic world. In Germany, where the way was no doubt prepared for him by the labors of Frederic List, Mr. Carey has found a large class of readers, whose numbers are explained by Dr. Dühring of Berlin, the most active German writer of this school, by pointing to the American author's early

sympathy with the Germans and his prediction of their intellectual leadership of the world; although a more substantial ground of explanation might be found in his more than German readiness to refer to the coördinating power of the state, as a specific for social or economic discords.

But while we may admit that the system elaborated by our countryman is likely to be, as Dühring says, "a ferment of the strongest kind" in the discussions of this generation, we must not forget that to lead a school is not necessarily making a contribution to the science. Not much of Mr. Carey's work, we are confident, will be found wrought into the political economy of the future. His doctrine of value gives epigrammatic form to some important general truths, but does not supersede the usual conception of value as the ratio of exchange or purchasing power of commodities, or enable us to dispense with the use of that conception in dealing with a wide range of questions, both theoretical and practical. His doctrine as to the law of production from land, which is presented in fundamental contradiction of the English school, is chiefly a statement as to historical development, which does not touch the essential point of Ricardo's theory; and while he denies the whole of that theory and the law of Malthus as to increase of population, his reliance upon a conjectured physiological law as an ultimate limit to the increase of numbers, shows the difficulty which he has found in avoiding as a logical conclusion the tendency to increasing pressure upon the means of subsistence pointed out by those writers. And it is upon his speculations as to value, production from land, and population that, as we apprehend, his claims to be regarded as a permanent contributor to the science would be rested,—not upon his later discussions of protection, the major part of which follows from the three lines of speculation just named, nor upon his theorizing as to money, in which his priority might be disputed by a series of writers, from John Law down. That Mr. Carey, by his ardent attack, compels a wholesome revision of positions and arguments there is no question; that he has checked some incautious generalizing we have no doubt; but that he has overturned any previously accepted principle of leading importance, still more that he has established any new and valuable principle originated by himself, is a claim which, in our judgment, cannot be made good.

In thus recognizing Mr. Carey's position as a writer of exceptional importance, we are confirmed by observing that he is the only American author noticed by Dr. Roscher in his exhaustive "History of National Economy in Germany." But it must be admitted, we think, that Mr. Carey's following, in our own country, has had a more local character than might have been expected from his wide reputation. The work of E. Peshine Smith (1868), Dr. William Elder's "Questions of the Day" (1871), and Professor Thompson's "Social Science" (1875) are representative, not only of the views of his school, but almost of its geographical limits in the United States. The conclusion at which we have arrived, however, as to Mr. Carey's own position with respect to the development of economic science, frees us from the necessity of considering more particularly those writers who have followed but have not advanced beyond him.¹

The general result then to which, as we believe, a sober examination of the case must lead any candid inquirer, is, that the United States have, thus far, done nothing toward developing the theory of political economy, notwithstanding their vast and immediate interest in its practical applications. It is not an agreeable duty to declare a conclusion so little flattering to patriotic sentiment; but to arrive at it as a truth forced upon the mind by the history of economic science is still less agreeable. And what explanation, it will be asked, is to be given for a failure apparently so much at variance with what our material condition, the general intelligence of our people, and the growth of intellectual activity among us, might lead the inquirer to expect? The answer to this question will be easier, if we briefly consider the circumstances under which one of the leading public questions having an economic bearing has been discussed and acted upon in this country.

The question of paper currency, when it first came before the people of the United States for settlement under the present Con-

¹ It is impossible to make any serious mention of Mr. Greeley as a writer on political economy, although his name is sometimes included in a full catalogue of Mr. Carey's school. And we have not included the name of Mr. Colwell, because, while he, no doubt, agreed with Mr. Carey in many points, we observe that in a note to the translation of List's "National System of Political Economy," p. 335, he more than intimated dissent from Mr. Carey's theory of rent; and Mr. Carey's system, with that theory struck out, would not be recognizable by its author.

stitution, in 1790-1791, was already complicated in a manner which made its thorough investigation doubtful. Whether such paper should be issued at all, whether it should be regulated by the general government or the states, and whether the proposed national bank should control the paper issues of the country, or should be content with simply pouring its own into the general mass, were questions the decision of which was in a manner forestalled by the existence of banks of issue established several years before under state authority, and not easily disturbed by the new government. And the approach to the fundamental question as to bank paper was still further embarrassed by the political turn which the discussion took in its early stages. The advocates of a liberal construction of the Constitution, and those of a strict construction, arrayed their forces for battle over this question as soon as it appeared. Nothing, indeed, could be more natural; but nothing could be more unfortunate for the proper settlement of an economic problem. All scientific questions were made subordinate to the political question at the outset. The party who dreaded to see the natural government too strong were committed in advance, in opposition to a measure which for them was part of a general political system, and in large sections of the country hostility to the bank became hostility to banking. And the division of opinion upon this line, rather than upon abstract principle, was promoted by the supposed opposition of interests between the commercial states and the agricultural. Of thirty-nine votes for the bill chartering the first Bank of the United States, all but six were from states north of the Maryland line; of the twenty votes against the bill, all but one were from states south of that line. How far the political side of the question of banking overshadowed the scientific is clear from the manner in which it was discussed by Mr. Jefferson, from whom one of the great parties took its tone for years. That statesman's treatment of the question of currency, and, indeed, of other economic questions of which the relations happened to be political, would to-day be universally recognized as beneath the level of both his intellect and his knowledge. His intense democracy, and his extreme dread of any proposition based on English models or English opinions, incapacitated him for any genuine discussion of this subject in its larger aspects. And to what length the ignorant

bigotry of many of his followers carried the hostility to banks, which was instinctive with him, the political history of our first half-century amply testifies.

The prudence and good judgment with which the first Bank of the United States was conducted are now seldom questioned: and the real service which it rendered, in its twenty years of existence, toward giving a stable foundation for our finances, at a time when the state banks and their issues were in actual chaos, is not more doubtful. But the bank owed its existence to the Federal party, and with the downfall of that party the renewal of its charter became impossible. Late in the War of 1812, an empty treasury brought the government of the day to the support of a new bank charter, as an expedient of the moment. Banks, said Mr. Webster, in sober admonition, cannot give the means of supporting an expensive war. "They are useful to the state in their proper place and sphere, but they are not sources of national income. The streams of revenue must flow from deeper fountains." But so urgent was the demand for a bank, on grounds of merely temporary policy, that Mr. Madison, who had opposed the charter of the first Bank of the United States, vetoed, as dilatory, one bill chartering the new bank, because it required the institution to begin on the basis of specie payments. Happily, the return of peace settled this weighty question for us, and the second Bank of the United States was chartered, to begin as a specie-paying bank, on the first day of January, 1817.

But whatever influence the new Bank of the United States might have had in directing the public mind to broader views of the question of currency, had it been left to itself and had its management continued to be sound, its circumstances did not allow such influence to be exerted by it. Political hostility was excited against it, and, six years before the expiration of its charter, war was formally declared against it by President Jackson. We, of the present generation, are in some respects losers from the total and probably final disappearance of that personal loyalty to great leaders, which marked our politics forty years ago and gave to them a glow of generous enthusiasm; but in some respects we are also gainers. The overwhelming individuality of one man is not likely again to convert a high question of economic policy into a mere struggle between "Jack-

son and the bank," in which the rival clamors of personal adherents and personal foes shall drown all considerations of scientific or political principle. Such, however, was the ignoble character of the contest which led to the final overthrow of the second Bank of the United States. The financial revulsion which followed that contest, and was in part its natural consequence, established for years in the minds of a great political party the notion, — it could hardly be called an opinion, — that paper currency of any sort is sure to work ruin. Under the domination of this party the general government in 1846 made specie its only currency, and left the paper, the currency of the people in three-quarters of the states, to take care of itself. That this measure for the protection of the Treasury was judicious, supposing it to be settled that the paper was to remain free from all control, few are now disposed to deny; but it involved an abdication of power over the part of the circulation which was of immediate importance to the mass of the community, and a confession of the insolubility of a great public question, which hardly has its parallel.

The effect produced on our statesmen by thus drawing a line which left this whole subject in the exclusive province of state legislation, was disastrous. From 1846 to 1862 the study or discussion of currency and finance formed no part of the training of men for national politics. In the legislatures of the states questions of this class were dealt with by men of inferior order, or by those who were only anxious to make their mark and go up into a broader field; but they had ceased to be national questions which could repay the political aspirants to national office for any considerable expenditure of time or thought. Congress had nothing to do with the currency, except to settle the weight and fineness of the coin, and government finance resolved itself into paying all demands in gold from a treasury which generally overflowed, and borrowing upon easy credit in an exceptional case of difficulty. It is not surprising that, when the war for the Union compelled the government to deal comprehensively and at short notice with questions of finance and currency in their most threatening form and on a gigantic scale, we had no leading man in public life who could speak upon them authoritatively or command general attention. The bald confessions of unfamiliarity with what had become the vital topics of the hour are a humiliating

part of the record ; but what other outcome from our public history was possible? We need not characterize in detail the consequences of this misfortune. Victory came in season to avert the ruin with which the gross violation of the plainest economic principles threatened the nation, and the task of repairing the mischief and returning to specie was set before us. For eight years, however, it was overshadowed by the business of Southern reconstruction, and was habitually treated by men in public life as a topic of the second order, which could wait for settlement at a more convenient season, and as to which perhaps one need not yet make up his mind. The financial catastrophe of 1873 suddenly brought the currency question to the front, as one which must be answered if we would secure the return of stable prosperity ; and the number of men, either in legislative or in executive position, who were then able to show that they had fairly investigated it and thought it out in the light of scientific principles, might almost be counted upon the fingers. The discussions which followed showed that the mass of public men were dealing with it, either with the audacity of unconscious ignorance or with the timidity of that which is conscious. The published debates exhibit our Congress for two sessions laboring painfully with sophisms which other countries disposed of half a century ago, and finally resorting to action which fails to be mischievous only because it has thus far been nugatory. The majority still drift upon the sea of doubt, without compass and without any directing impulse save such as may come from the veering gusts of popular feeling ; and it is with this as the prevailing condition of opinion among the majority of our most conspicuous leaders on both sides, that we finish the first century of our national existence.

But that our statesmen have been incapable of taking any consistent action upon the currency question, and that every material interest is thus placed at the mercy of chance, is not, to our mind, the most serious evil resulting from this state of things. What appears to us most threatening is the sceptical turn thus given to opinion among the mass of our people. What is the ordinary voter to think of a subject which he himself finds dark, and as to which those whose opinion he is apt to follow either talk antiquated nonsense to him, or tell him that nothing is settled? Add

to this the fact that one-half of the present political generation have come upon the stage since we abandoned specie, and have had no other experience to enlighten them, and we cannot wonder that the currency seems to the mass a subject on which mankind have learned nothing, and that the plainest proposition of reason confirmed by history may any day be talked about as "an open question." The scepticism of searching inquiry is not to be feared; but the incredulity of ignorance multiplies tenfold the difficulty of the task of restoring the financial health of the nation.

In the case of the currency question, then, it appears that the subject from the first came before our public men in a form which seemed to make its political bearings too important to be subordinated to any scientific treatment. The same might be said of the tariff discussion, which, apart from its inevitable complication with individual interests, has never failed also to present itself in such sectional or party relations as to make its settlement turn largely upon far other considerations than those of general principle. Whether this complication has been the result of some untoward chance, or has come from the errors of our statesmen themselves, we need not now inquire; in either case the effect is the same. Under our form of government these two questions of currency and tariff cover most of the space within which those charged with national affairs have been called upon to investigate and apply economic laws. No doubt, important topics lie within the domain of state legislation; but there the adoption of any general theory, however sound, has been impracticable from the nature of the case. It is a part of the price which we necessarily pay for the advantages of our federal system, that under it questions of essentially general interest, such as those of taxation, education, or poor-relief, are classed as merely local, and are therefore not subject to any one controlling authority. With the two great questions of national economy, then, prejudged or inextricably bound up with other issues, it is hardly surprising that our statesmen should have neglected the investigation of this subject, so that it is to-day easier to find well-read economists among our men of business than among public men of equally good general education, although the inducement to such pursuits should not properly be any stronger in one case than in the other.

It is necessary, however, to look deeper than this for the reason of the general sterility of American thought upon this subject, and the failure of our scholars as well as statesmen to contribute our share in the progress made by the world. For the explanation we must look to the causes which have made the progress of the United States so slow in philosophy, in the pure mathematics, and in abstract science generally, in philology, in the more recondite historical investigations, and in the higher generalizations in physics. Our position as a nation charged with the business of subduing a new world, and the rapid material development which has attended our success in this work, have given to our life for the greater part of the century an intensely practical aspect. Practical objects, and pursuits which are believed to be practical, have occupied the first place, almost as a necessity of our external conditions. It has been well remarked that some of our best achievements in natural sciences have been in those directions in which the promise of some material gain has afforded the stimulus, — as, for example, in economic geology, to which so powerful an impulse has been given by our eagerness to know the resources offered by our vast territory. Under such an influence as this it is but natural that the moral sciences should develop slowly. Nor could we expect that among these sciences political economy should outstrip the others. Broad as are its applications in the actual affairs of life, it is mastered and fruitfully studied best as an abstract inquiry. The thorough student soon finds that it is necessarily an investigation as to the direction which human volitions will take under given conditions, and that for its successful prosecution he must first direct his attention to the mind itself, finding in the complex phenomena of society the test but not the grounds for his conclusions. Especially has this been the necessary character of the study during the last century, while the work to be done was that of determining the fundamental principles of the science. Such a pursuit, at any rate in the stage from which it has hardly yet emerged, must needs appear remote from the present interests of a nation like ours, and could not offer an attractive field for scholars under the influence of a young and vigorous national life. Thus it has happened that not a few of our inquirers have either been unwilling to recognize this essentially abstract character of the investigation, and so have vainly sought to re-

model the science, or else have strained its conclusions by the attempt to give them a practical bearing in advance of what their development would allow. In either case the wrong road has been taken, and the result has been failure and disappointment. Hence, too, the occasional aspirations for an American political economy, or for a peculiarly national economy under any name, ending in nothing but fresh proof of the impossibility of stating the application of any scientific law under special conditions, until the nature of the law has first been thoroughly investigated, abstraction being made of all accidents of time, place, or disturbing influences.

Indeed, the strongly practical direction given to every pursuit in American life has not only served to turn our statesmen and scholars away from work in the field of political economy, but has also given a marked character to such work as they have done in that field. In the application of settled or accepted principles to special questions, particularly to questions of importance in politics, many of our writers have shown great skill. Examples of this kind of success in a narrowed field of definite practical relations may be found in the writings of Hamilton and Gallatin already referred to, in Henry Lee's report written in 1827 for the Boston committee in opposition to an increase of duties, in the valuable reports of Mr. Wells on the revenue system, in E. B. Bigelow's strong presentation of the protectionist argument, and in Grosvenor's application of the crucial test, "Does Protection Protect?" It is hardly too much to say that our best work is to be found in our pamphlets and occasional essays, and not in our systematic treatises, so powerful has been the stimulus of practical objects, and so weak the inducements to abstract philosophical inquiry. To the same influence must we ascribe the exceptional success sometimes attained in statistical inquiry, from the famous report of John Quincy Adams in 1821 on weights and measures, to some important discussions by Dr. Jarvis, and the admirable work done by General Walker on the census of 1870.

The fact must be taken into account, moreover, that deficiency in our comprehension of scientific reasoning and conclusions is perhaps less readily realized in political economy than in any other science. That its vocabulary is drawn from the language of popular discourse, and is therefore peculiarly liable to equivocal

use and consequent vitiation of the whole process of reasoning, unless strictly guarded, has not only been an abundant source of misconception and error among economists themselves, but causes those who are unfamiliar with the subject to think that they have mastered its terms long before they can fairly claim any such mastery. The conceptions with which political economy deals are also subjects of everyday contemplation, on which every one must needs reason more or less, and as to the bearing of which in their broad scientific relations self-deception is peculiarly easy. The senator who calmly announced a couple of years ago that he had given his leisure for an entire fortnight to the currency question, and had thus been enabled to sound its depths, presented, after all, only an egregious type of the difficulty with which in this subject one acquires the knowledge that he knows nothing. This does not spring from any peculiar obscurity to be found in the subject itself, but from the fact that in dealing with it the mind is apt to begin with the tendency to misapprehension to which we have referred, which must first be overcome; just as the Copernican theory had to make its way against the supposed ability of every man to determine its falsity by the seeming evidence of his own eyes. And while this is not a peculiarity of the study of political economy in our own country or our own language, but everywhere impedes its progress, it is easy to say that among a people who are predisposed to neglect, or to examine only superficially, whatever does not offer directly practical results, a science which under the most favorable circumstances is subject to such embarrassment, must lend itself with especial readiness to the prevailing disposition. Americans are disposed to neglect the higher mathematics as unpractical; but they do not imagine that they understand the subject. Political economy they are disposed to neglect for the same reason, and all the more because they flatter themselves that they already have it at command.

The failure of the American mind to aid in the development of political economy is not then necessarily the result of any lack of original adaptation, but a natural effect of our environment. And we must observe that while material conditions have thus led to the neglect of the science, they have also led our people, scholars as well as others, into some serious misconceptions as to the

direct bearing of economic laws. From our holding the position, unique among the great powers, of a people developing a rich and virgin territory, the conclusion often seems to be drawn that if the operation of such laws be not actually suspended in the United States, they can at any rate be disregarded with comparative safety. Few men outside of Congress or off the political stump will maintain the absurdity that for a new country like ours there is a different set of such laws from those which obtain in the Old World; but there is an unquestionably great amount of mischief done by the knowledge that the lusty growth of the nation will repair the injuries caused by economic blunders. Whatever follies our statesmen commit, the bounty of nature and the rapid increase of numbers incident to this stage of our growth soon cure the evil; its traces are soon overgrown, and we seem to ourselves to have suffered nothing. "Are we not richer and our states more populous than ever?" it is asked; "how then can we be said to have lost?" And it is not surprising that the sense of risk to be incurred by the mistakes of ignorance should be weakened, when it is found by experience that few such mistakes can bring our national expansion to an actual stop. "Where the concerns of a nation are conducted in a deep, strong, favorable current of the national energies and impulses," writes a critic in this review of the last generation, "progress may be made, notwithstanding the mismanagement of the sails, oars, and rudder. This is precisely and preëminently the case in the United States, where the spontaneous, productive, onward energies are in greater activity than in any other country." The idea thus frankly avowed, that the management of our resources is of little account, so long as we find ourselves sweeping along with the current of growth, has been for years the habitual consolation of our public men, if not an article of their faith. That it easily leads to indifference as to the monitions of economic law is sufficiently obvious.

How complete our disregard of economic law has been, and how little we owe our brilliant advance in wealth and power to the wisdom with which we have used our fortunate position, may easily be seen. The manner in which the currency, the life-blood of industrial circulation, has from the first been left practically to shift for itself has already been noticed. As a consequence

there is no evil incident to a vicious currency, from the inability to procure the means of exchange for daily transactions on the one hand, to the wildest abuse of depreciated paper on the other, to which our body politic has not been subjected. And that the vigor of youth has enabled it to survive such disorders and even to recover its thriving condition has only seemed to give fresh encouragement to rash experiments on its endurance. In the matter of protection to manufactures neither protectionist nor free-trader would be willing to take the responsibility for the general result; for in fact neither has been able to secure adherence to his system. Six radical changes of our customs tariff, six reversals of policy, have occurred in the last sixty years. The present tariff, dating from 1861, already approaches the extreme of longevity, and, if we may judge from the past, must soon follow its predecessors, each of whom once appeared as strong and as firmly established as itself. In these successive revolutions we have seen industries artificially excited to a premature and unhealthy activity, and we have seen them laid waste by the withdrawal of the stimulus. Who can measure the misdirected labor, the destroyed capital, to repair which we have fallen back after each change of tariff upon those natural resources which no folly of management could exhaust! If we turn from the tariff to our internal taxation, where the adoption of sound principles has rarely been embarrassed by sectional or political considerations, the state of things is still more extraordinary. Down to the year 1861 the United States appear to have learned nothing as to taxation. Their burdens were generally too light to cause serious uneasiness, except in some cities, and the average legislature is tolerably well steeled against the complaints of city interests. Since the year 1861 the rapid increase of taxes in every form has attracted the attention of our people, but they are not yet sensible that their methods of taxation are antiquated and the machinery inefficient, that their systems lead to extraordinary inequalities, and often rest upon theories which fail of being ridiculous only because of their flagrant injustice. Ingenuity in preventing the escape of any taxable person or thing has been carried to a high point; the art of adjusting the burden so that it may be most easily borne has never been studied by any state legislature or by Congress. That our people have been able to

endure this neglect of one of the first duties of good government, is due solely to the abundance of their resources, which for the present are able to withstand the effects of such waste by taxation as, in a country with lower profits, would be a serious check upon industry. Here, again, we rely for impunity on the rude health of youth. And as a final illustration of our easy-going defiance of sound principle, we may cite the continuance of slavery as the industrial system of the Southern states, until its unexpected destruction by war. Nothing can be more certain than that slavery was an economic blunder of the first magnitude. It notoriously stunted the social development of the communities where it existed, checked all tendency to diversification of employments by discouraging all pursuits except those least advanced, and craved, for its successful working, constant transfer of its exhausting cultivation to fresh soil. Leaving out of view its moral aspect, there can be no doubt that slavery, economically considered, was the most efficient system yet seen for simply taking the cream from productive powers which under wise management are of unlimited duration. What this perseverance in a wasteful use of our resources has cost us, directly and indirectly, may be partly seen by comparing the splendid natural advantages of the Southern states with their present impoverished condition.

It may doubtless be said that we are not the only people who in the past century have committed errors of this kind and on a great scale. But we are the only people who with a light heart have trusted to the energy of growth to insure us against the effects of present mistake, and have therefore steadily neglected to cultivate one of the most important branches of the science of government. As a consequence, we find ourselves to-day absolutely incapable of following out, for example, such a firm and judicious course of management as that by which France is reëstablishing her finances on a solid basis, after a calamity in which all but the name of the French nation seemed to have disappeared. Not forced like others to count closely with our resources, we have in effect forgotten how to count with them at all, and are every day confessing our inability to deal with a practical problem, which has been promptly answered by others, far less favored, either in material or political conditions, than our-

selves. That under such circumstances we should have added nothing to the world's knowledge of political economy is not surprising. The surroundings have not been incompatible with the prosecution of such a study, but they have not been such as to promote it. For that purpose something more is needed than the mere presence of great resources and of rapidly increasing wealth. The profound significance of the investigation as bearing upon the right use of resources must be realized, as it has not been among us, before we can expect that it will be pursued with much effect. Elsewhere this lesson has been impressed upon statesmen and scholars by the sternness of nature or the approach to the limits of her bounty, or by the necessity of dealing with the consequences of generations of misrule. But it is a lesson no more easily learned by a nation in the full luxuriance and strength of its early growth, than is that of obedience to the laws of physical health in the first flush of youth.

As the result of our failure to reckon closely with forces which will finally assert their presence, we find ourselves, at the close of our first century, falling manifestly short of the development to which our exuberant vitality might easily have carried us. In every case it was with seeming impunity that we offended against the laws of our well-being; but as the consequence of the whole, our statisticians are now accounting for missing millions of population, and for the slackening of the growth of wealth. The youth to which we owe our power of ready recovery from the effects of all transgressions is also passing away, and it is with a sort of angry surprise that our people note their increasing sensitiveness to the penalties with which economic error is visited. This leads us to the remark, in conclusion, that most of the conditions to which we have ascribed the failure of the United States to contribute to the progress of political economy, being incident to the earlier stages of national life, may henceforth be expected to act with diminishing force. The period of the most rapid development of wealth once passed, we may expect the practical pursuits of life, or those which now seem to be such, to become less absorbing, and the tendency to enter upon deeper and more abstract investigations to strengthen. Already in our older states, which are farthest removed from the special conditions which characterize the United States as a whole, we may trace the effects of this

tendency in their increased devotion to sound learning and the arts for which the newer states, still in the hurry of swift growth, seem to have little leisure. As this movement strengthens, we may expect to see the moral sciences generally rising towards that proportionate development with respect to physical science which obtains in older countries, and among the moral sciences political economy advancing at least as rapidly as any. To this we shall be driven by material considerations as powerful as those which have thus far restrained our progress in this subject. As our condition approaches more and more to that of old countries, our ability to rely upon the increasing abundance of our resources to cure all mistakes will disappear, and the mistakes themselves will become obviously costly and formidable. In our case, indeed, they may easily become more formidable in their consequences than elsewhere; for in the coming century an economic blunder in the United States will be a blunder on a far more portentous scale than those of the past, and will work out its consequences among political elements which will admit of no trifling. Already our public men are appalled by the responsibility of answering such a question as is set them by the currency. But in such a country as we may reasonably believe this will be fifty years hence, and with the dangerous forces now growing within our democracy fairly developed, such a question will be for the men or the party to whom it is offered for answer a very Sphinx's riddle, and failure to solve it will mean political death. It will then no longer be possible for statesmen or scholars to ignore or neglect those economic laws which determine the consequences of our actions. The same unflinching operation of historical causes, which in other countries has led to every great step yet made in the progress of economic thought, will produce its effect here. This action may be hastened by the shock of some crisis in national affairs; but if not, the same result must come in the fulness of time. The regular course of our development must, at a point not far distant, disclose to us an imperious necessity for investigating the laws of material wealth; and that point being reached, we may confidently expect that the United States will no longer fail to contribute their due share to the advancement of this branch of knowledge.

THE REACTION IN POLITICAL ECONOMY¹

SIXTEEN years ago, Professor Cairnes was guided, in choosing the subject for his opening lecture at University College, London, by seeing the signs of a belief among the educated public that "political economy had ceased to be a fruitful speculation." Six years later, it was noted that in the speeches at the Adam Smith Centennial, celebrated by the English Political Economy Club, there were indications that a similar sense of frustration and of limited hope as to the future had made its way even among economists, and this at the traditional centre of the English school. And a few years more have now brought into full activity what is variously described as a reaction or a revolution, in which a determined body of dissentients from the old political economy are striving, in every leading country, for some sort of reorganization of the science and its method, upon principles rather vaguely defined, but generally declared to be in peculiar harmony with those which have given new life to almost every other branch of learned investigation.

To the present writer, this movement appears to be no revolution, but a natural reaction, probably salutary, and destined to promote ultimately a rapid but still orderly development of the science, upon the lines laid down by the great masters of what is called the deductive school. The real import of the movement appears to him to be often misconceived, partly from a negligent consideration of the scope and proper limitation of the old economics, and partly from failure to observe the course pursued by the greatest masters of the new. It is proposed in the present article, therefore, to review briefly the position held by the deductive school, to consider some of the shortcomings by which the way for reaction has been made easy, and to show what appear to be the characteristic tendencies and real drift of the new move-

¹ *Quarterly Journal of Economics*, October, 1886.

ment. In doing this, ground must be traversed which is so familiar to many readers, that nothing but the frequent and sometimes apparently studied neglect of its existence can be the writer's sufficient apology.

Little space need be given to the formal description of the method used by what will be called here the deductive school. The authentic statement of that method is found in Mill's "Logic," in the concluding paper in his "Essays on Some Unsettled Questions," and also in Cairnes's "Character and Logical Method of Political Economy." As stated by these consistent followers of the Ricardian doctrine and conscious preservers of its continuity of development, the method starts from a few simple premises, collected by observation of the nature of man and of his environment, draws from these premises a series of logical conclusions, verifies these conclusions by fresh observation and comparison, and thus ascertains certain relations of cause and effect, which are termed laws. As an example of the application of this method, to be considered a little more in detail, Mill's "Principles of Political Economy" will be taken, not only as the most convenient, but because it presents the full and rounded statement of a system of leading doctrines, partly thought out in the "Wealth of Nations," and then given in the rough, with little effort for orderly statement, in Ricardo's writings.

Mill has undertaken to investigate the production and distribution of wealth, or, in other words, the nature and the results of the efforts, which it may be assumed that men living in civilized society will make, to provide the material goods by which the satisfaction both of physical and of mental wants is in large measure secured. These efforts, he takes it for granted, will be made by preference along the lines of least resistance. They will be made also under the conditions of a natural tendency to increase of numbers, and of the application of labor to natural agents, which, when pushed beyond a certain point, no longer yield a proportional increase of returns. These data Mill finds sufficient for the establishment of a considerable body of general propositions as to the use of labor and capital in production.

But, for the investigation of the laws of distribution, it becomes necessary to have further data respecting the organization and methods of the society in which the distribution takes place. It is true that "whatever mankind produce must be produced in the

modes and under the conditions imposed by the constitution of external things, and by the inherent properties of their own bodily and mental structure"; and so a great body of truths as to production are as applicable in a communistic Utopia as in the United States or Great Britain. But, in dealing with distribution, something must be premised as to the ownership of the natural agents and of the goods produced, and something also as to the freedom with which goods and services can be contracted for or exchanged. Mill, therefore, writing with reference to modern western civilization and for modern readers of the western nations, assumes at this point, as further premises, the private ownership of property, both real and personal, and the existence of a free competition. These assumptions import no judgment as to the necessity or the special excellence of the conditions assumed, nor does Mill ignore either the possible advantages of other conditions, or the fact that they may exist. His assumption as to private property is followed by a digression as to other systems, applicable to property in general or to real property in particular, in which the opinions expressed by the writer as to some fundamental arrangements of the society around him are generally thought to be heterodox. His assumption as to competition is made with a full recognition of the fact that, even where competition finds the fewest obstacles, its effects are often greatly modified and limited by the prevailing habits of the community; and here again follows a digression, filling several chapters, in which are considered a variety of social conditions, ranging from slavery to cottier tenancy, under which competition cannot be said to act. Plainly, it is only as an observed fact, general enough to give shape to the mass of economic relations in the western nations, that the existence of private property is assumed; and it is in the modern tendency of competition to overcome the resistance both of institutions and of custom, and to be the prevailing rule of dealing, that Mill finds his warrant for assuming its free action as a premise for reasoning upon distribution. The warning, however, that competition in any given case acts, as it were, in a resisting medium of greater or less density, and that conclusions based upon its possible maximum of effect are to be modified *pro re nata*, is given by Mill, not once for all and to be forgotten either by writer or reader, but repeatedly, and is enforced at several stages of his discussion.

It is obvious that the process thus described is a study of the action of a certain force under given conditions, — the force being selected for consideration, not as being the sole spring of action, but as one generally found in operation, and the conditions being such as are usually presented by modern civilized life. The process is understood to be thus strictly limited, because of the complexity of the motives and external conditions by which the production and distribution of wealth are affected. A single great force is studied by itself, because this is believed to be a necessary preliminary to the study of its action when in composition with the other forces, which, although of secondary importance as regards the purpose in hand, are, nevertheless, to be finally included in any complete investigation; and this isolation of the force first brought under examination is affected by hypothesis, because it cannot be effected by experiment, as in physical science. Even if we suppose, then, that some other force or motive might better have been selected as the primary object of study, — a supposition warranted by the conclusions of few economists of any school, — it would still remain true that the adoption of this process by Mill is a strictly logical and philosophical method of arriving at important truths affecting a great department of human activity. Even if other methods should be found, more rapid or far-reaching, this would still be a scientifically defensible method of investigating the action of economic motives.

This method is said, however, to be indifferent to facts, and, since it proceeds upon assumed premises, to lead to the evolution of a system having no necessary relation to the external world. Fairly considered, the verification of results reached by deductive reasoning should call for as patient collection and as conscientious sifting of facts as any other use of observation. But, beyond this, it is from facts that the suggestion must come of all such secondary influences or forces, which modify the action of the primary force investigated by the economist; and it is from the study of facts and of their evidence as to the conditions under which such secondary influences act, that we must proceed in determining the law of their action. For example, Ricardo's law of rent is a deduction from simple premises respecting the effort to employ capital with the best profit on lands differing in productiveness or convenience. But, in reasoning upon rent or the value of land in any given

country, Ricardo's law is found to give the clew, indeed, — but a clew to be followed through special conditions, often of wonderful variety. To the originally simple case of economic rent are added the modifications arising from customs of dealing between owner and occupant, from the speculative holding of land, or from changes in its uses, or revolutions in transportation. And these new conditions are the necessary objects of close study, as supplying the material for fresh reasoning, if the economist, following the deductive method, seeks to advance his knowledge of cause and effect — that is, his knowledge of economic law — beyond the elementary state. So far from facts being a matter of indifference or being of only occasional use, in the deductive method, every one of the leading writers — Adam Smith, Malthus, Ricardo, the younger Mill, Senior, McCulloch, and Cairnes — either had special occasion for minute acquaintance with important classes of economic facts much reasoned upon by him, or shows the proof of special study of such facts.

The further charge, that the results arrived at by the deductive method have no necessary relation to the external world, no doubt has so much foundation as this, — that the truths arrived at are conditional truths. Deduced from certain premises by a logical process, they are undeniable; but, still, they declare only the effects of causes acting under specified conditions. So far from being of universal application, they are limited by their own complete logical statement to cases where the conditions originally premised are present, and not controlled by any others. It is even conceivable that no exact parallel to the hypothetical case should ever present itself, and afford the simple and perfect realization in practice of an economic truth. To use the familiar illustration, in every actual case there might be some allowance needed for perturbing forces or friction. Still, few will deny that truths, even in this abstract form, if rightly apprehended and used, must be of the highest service in helping to understand the march of human affairs.

It is a necessary consequence of the conditional nature of the truths arrived at by the deductive process that their use as guides of conduct is subject to strict limitations. No doubt, the temptation to treat abstract truths as universally applicable, without qualification, has often proved irresistible. Still, the warning

against this misuse of them is found in their statement. "The economist's conclusions," says Senior, "do not authorize him in adding a syllable of advice," — a negation which, it must be added, proved offensive to McCulloch, who was little disposed to let any opportunity for profitable exhortation pass unimproved. Plainly, Senior, in theory as well as in his own public service, regarded the results of the economist as contributory to practical judgments, but seldom as sufficient therefor in themselves. Taken in connection with the special facts which surround any question, — the facts historical, social, psychological, or physical, which create special conditions, — economic truths are theoretically as essential as any others for the formation of sound opinions, and are also, taken by themselves, as insufficient. This limitation of their practical effect as supplying a part, but only a part, of the grounds of action, is of special importance, of course, in their bearing upon legislation. Economic laws, in strictness, deal with wealth; but the object of legislation is welfare. Or, as Adam Smith says, when dealing with a special case, "Defence is of much more importance than opulence." Without multiplying citations upon this point, it is enough to recall Cairnes's declaration, often urged by him in different forms, that, "there are few practical problems which do not present other aspects than the purely economical, — political, moral, educational, artistic aspects; and these may involve consequences so weighty as to turn the scale against purely economic solutions."

This recognized limitation of the scope of economic conclusions, as applied to practical affairs, brings to view what is sometimes indignantly described as the divorce of political economy from all ethical considerations. The economist, it is charged, carefully ignores all higher purposes and duties, that he may devote his thoughts to the pursuit of wealth alone. But need it be explained that, in this alleged divorce, the only question really at issue is one of classification, — a question as to the drawing of a line for purposes of nomenclature between several fields of thought, all of which, it is admitted, must be traversed before action can be decided upon? When the economist restricts his discussion to something less than the sum of all the considerations of right and expediency which must weigh in questions of political action, his contribution toward the final decision may indeed be

pronounced important or the reverse, according to the judgment of the critic; but there is as little ground for the moral condemnation sometimes fulminated, as when one investigator declares his field to be physiology and not therapeutics, or another devotes himself to the mechanical and chemical properties of the rocks, and not to their geological relations. It is only when the economist undertakes to apply his conclusions in disregard of other aspects of the political or social questions before him, and treats these questions as problems in political economy only, that there is room for the reprobation of his neglect of ethical considerations; and, in this case, he is sinning against the law implied in his own method.¹ Much confusion and misplaced censure, however, upon other points as well as this, might easily be avoided, by keeping in mind more carefully the necessary distinction between a science and its applications.

But it is unnecessary to carry any farther this review of the characteristics of the deductive method. The method may be imperfectly applied by those who profess to use it, the conclusions reached by its means may be misinterpreted; but it is in itself a process of careful investigation of causes and effects, naturally tending to the establishment of that orderly body of verified truths which is called a science. It is, in short, a strictly scientific method of approaching our great set of problems presented by the life of man in society. Other methods of approaching the same subject-matter may conceivably be used, but it is pure arrogance to claim for any other that it is *the* scientific method.

It must be recognized as a fact, however, that political economy, as pursued by the deductive method, has seriously disappointed the hopes which formerly centred around it; and this not merely because of the extravagance of the hopes, but also by reason of its own sterility in results. To the present writer, this state of things appears to be the consequence, not of some discovered weakness or insufficiency of the method, but of the failure of economists to pursue the path on which they had entered. For this failure, the very nature of the body of doctrine, which was early established,

¹ A striking instance of a wide range of considerations taken account of by an economist, when engaged as a legislator in the discussion of a grave practical question, is presented by Mill's speech in the House of Commons, 17 May, 1866, on the Tenure and Improvement of Land (Ireland) Bill.

may perhaps afford a partial explanation. It has already been said that, in the system of principles stated by Mill,—and this means in the system obscurely suggested by Ricardo,—the primary object of study is a single great force, acting under given conditions. Among these conditions is a tendency to steady increase of resistance as society advances, resulting from the laws of population and of production from land. What have been called the dynamics of political economy must, therefore, with the growth of a community and in any given state of the arts, develop a gradually slackened movement, pointing to an ultimate cessation of advance at the point where the motive force shall be offset by the increased resistance; that is, to a state of quiescence, not necessarily unfortunate, but still demanding some new impulse as the condition either of further advance or of decline. This is the theoretical point,—far off, it may be, and postponed by every fresh discovery and the opening of new resources, but still conceivably attainable,—to which increasing numbers and declining profits point, as it were, by converging lines. Now, such a conception, of which traces may be found in Adam Smith, seems in a certain sense to finish the task of economic science. The movement of human society has been forecast. The goal toward which the great constant force tends is ascertained. What remains, it might easily be asked, except to elaborate the reasoning, to rivet the logic, and to present the elements of the calculation more clearly? It seems to have been some such conception as this, of a science completed and rounded and adequately describing the destined movement of every human society to its ultimate stage, that led Lord Sherbrooke, then Mr. Robert Lowe, to declare in 1876 that the work of political economy appeared to him to be about finished. And many a younger student, who has admired the logical strength and symmetry of the system, has wondered at the seeming meagreness of its content, as he has found himself suddenly confronted by what might be mistaken for the last possible deduction.

That, dealing with such a system, economists should fail to push as they might their investigations into causes, was, no doubt, all the more natural by reason of the oppressive influence of the few great names which adorned the deductive school during its rise. And yet the method by which economic science should be carried

into regions never penetrated by Ricardo was simple. It was only necessary to draw from the actual observation of affairs fresh premises relating to forces of what we have called the secondary order. There is a pregnant sentence in Mill's essay on definition, declaring that, in order to make political economy perfect as an abstract science, "the combinations of circumstances which it assumes, in order to trace their effects, should embody all the circumstances that are common to all cases whatever, and likewise all the circumstances that are common to any important class of cases." In other words, the framing and insertion of new premises, and the tracing of effects in the ever increasing complexity of conditions necessary in order to reach all those "common to any important class of cases," were the natural course of development. Upon this line Mill entered when, reasoning from the impeded flow of labor and capital from one country to another, he succeeded in adding to Ricardo's theory of international trade a theory of international values. Cairnes also took the same course, when he extended the same reasoning to the cases where competition is imperfect in domestic exchanges, either as between different parts of the same country, or as between different industrial strata or occupations in a given community. In the same direction of fruitful development were the inquiries which Cairnes made at different stages of his career, as to the unequal measure in which the prices of different articles respond to a common influence, — as, *e.g.*, to a cheapened supply of money, which is usually treated as affecting all alike and simultaneously; and other examples could easily be cited from the same suggestive writer.¹

Plainly, the system of political economy, as elaborated in the earlier part of this century, gave unlimited scope for investigation and expansion of this kind, and for the discovery of what have been called "derivative laws" of probable interest and importance. The very fact that, as already noticed, the system had to assume in the first instance, and in order to simplify its task, that competition acts uniformly, shows that the whole field of distribution

¹ Professor James says of the old economy that it satisfied a demand for "something perfect in its way. It was indeed a closed circle, but it had consequently no line of advance." To go on with Professor James's figure, however, the deductions from simple premises being closed, new premises afford the opportunity for new circles, of wider and wider sweep, limited only by the variety of human interests to be dealt with. See *Science Economic Discussion*, p. 42.

and exchange might be worked over, with new conditions drawn from observation, and with the promise of valuable results. Or, to take another region into which investigation by the deductive method might well have been carried,—that suggested by the familiar condition, “in a given state of the arts.” The improvement of instruments, processes, and institutions, by which production is aided and the resistance of nature is offset, is ordinarily treated by the economist as something fortuitous,—to be allowed for in a given case, no doubt, but showing no stated recurrence which can afford a basis for reasoning. Ricardo and his contemporaries naturally spent but little effort in speculating upon industrial and social changes, of which their time showed only the beginnings. Mill, writing when the changes had become revolutionary, saw that they were characteristic of the century, and that no term could be set to their extension. Still, in the greater part of his treatise, he was unable to do more than refer to them as transitory “counteracting influences,” on the succession of which no great amount of reasoning needs to rest. It is clear, however, that these influences, although in one sense transitory, are for our time practically constant. Inventions, the opening of new continents, the abolition of time and space, the economic rejuvenation of countries by social and political reform, follow each other in a long line and in a certain orderly movement. Reason compels us to reject the vision of perpetual advance; but, for these generations of the world’s history at any rate, industrial improvement, or that which tends in the same direction, is not an accidental, but, as nearly as possible, a permanent force, acting with the primary forces of which the economist treats, but constantly masking and for the time, perhaps, reversing their effects. Here, then, has been offered the opportunity for the economist to make useful application of his method, for investigating the movement of society in the ascending part of its orbit, and dealing with a mass of striking phenomena, far too complex for systematic study without the working hypothesis already in his hand.

It follows, from this view of the field open to political economy, as defined and studied by the deductive school, that the science, so far from having reached the end of its work, has before it a task which, as Cairnes says, is never to be completed, “so long as human beings continue to progress”; for “the main facts of the

economist's study — man as an industrial being, man as organized in society — are ever undergoing change." It follows, too, that, while the connection between assumed premises and the logical conclusion is immutable, so much of the economist's conclusions as are based on conditions peculiar to his own time must lose a part of their importance as years pass. To this extent, we may easily agree with the proposition so ably supported by Dr. Seligman,¹ that "the economic theories of any generation must be regarded primarily as the outgrowth of the peculiar conditions of time, place, and nationality," and that "no particular set of tenets can arrogate to itself the claim of immutable truth."

It must be added, moreover, that, if the development of political economy by its normal course had been pushed by the deductive school, the science itself would have been held closer to modern life and to the great problems which demand their answer from the modern world. Bagehot complains that the science "lies rather dead in the public mind," and that young men do not feel "that it matches with their most living ideas." This is a natural result of the omission to deal adequately and systematically with existing economic relations, in an age which is chiefly characterized by the multiplication and change of such relations; and it seems clear that the position which the deductive political economy held, even twenty years ago, need not have been lost, if its followers had pursued the natural course of widening their discussion of economic law, by drawing steadily from the fresh experience of the day.

What has happened in political economy, then, is a singular instance of a scientific inquiry stopped short in its path, it may be by the timidity — at any rate, by the failure — of those who had it in charge. In such a case, reaction is not only inevitable, but is probably the best hope of renewed activity and progress. Even if the reactionary movement itself should be misdirected or should run to excesses of its own, and should thus finally contribute nothing directly, the chances are still strong that it will be the stimulus of thought and of fresh investigation; and, from such revival, science, pursued by sound methods, has nothing to fear.

The reaction in political economy has come in the rapid growth of what is variously known as the German, the inductive, or the

¹ *Science*, 1886, p. 375.

historical school.¹ No one of these terms is well chosen. The new school can no longer be called German, for its influence is now so diffused as to be entirely independent of the place of its origin. To call it the inductive school, as is suggested by a natural antithesis, implies some radical change in methods of reasoning, often vaguely asserted, but generally disappearing in any attempt at precise analysis. Even the term "historical," which it will be convenient to use here, seems to imply some peculiar use of historical material for the discovery of economic truth, as distinguished from its verification or illustration, — a use not to be detected in the leading writers of the new school, whose pages bristle with the results of hypothetical reasoning.

In fact, so far as scientific method is concerned, it may be stated positively, that the leading writers of the new school do not agree in rejecting the deductive method, nor in adopting any other method inconsistent with this or ultimately exclusive of it. Use of deduction in some way and to some extent is admitted by nearly all, and is no doubt logically inseparable from the process commonly called inductive. Dr. Ely, no moderate supporter of the historical school, remarks that "the term inductive is to be applied to those writers who do not start out with *all* their premises ready made, but who include the induction of premises within the scope of their science, and proceed to use these premises deductively."² This statement would no doubt bring the greater part of the English school and their followers, including the leading writers upon method, within the fold of the inductive school, and illustrates the difficulty of drawing any line between the two which shall, in fact, mark any distinction except as to the degree in which one or another is disposed to draw new premises from observation.³ Schmoller, indeed, believing that the old

¹ Among the numerous statements of the history and tendencies of the new school, we may refer to Professor Ingram's remarkable article, "Political Economy," in the ninth edition of the *Encyclopædia Britannica*, and to Dr. Ely's study, "The Past and the Present of Political Economy," in the second series of Johns Hopkins University Studies.

² "The Past and the Present of Political Economy," p. 8.

³ A striking illustration of the real thinness of distinction as to method between the two schools is found in President Walker's comment upon Cairnes's statement of the deductive process, that "nothing could be added to this admirable statement of the logical method of political economy according to the so-called German school." "Political Economy," p. 15.

method and its results are alike obsolete, would postpone for twenty years the attempt to construct a system of principles; and this would unquestionably be a logical course to pursue, if the deductive method is rejected for inherent unsoundness, as often seems to be supposed. But leaders like Roscher, Wagner, Cohn, and writers in Schönberg's "Handbuch," who are recognized as representing the historical movement, accept and use conclusions which there is no pretence of having reached save by the old process of verified deduction. And Wagner's reply to Schmoller's contention that the old systematic dogma has been outlived is most emphatic.¹ He thinks it proper to object, he tells us, —

that this rejection in the lump goes too far. The old master of historical national economy in Germany, W. Roscher, with good reason, has not thus thrown the "old dogma" overboard. And such a step would be all the more questionable from the difficulty of knowing how to fill up the deficiencies; for, except some dry critical observations, there is nothing at hand which can take the place of the "old dogma." On the contrary, even the "historical national economists" make use, step by step, of propositions, *e.g.* in the theory of price and cost, which are either a part of the "old dogma," or follow as consequences from it.

It must be added that it is also quite clear that this acceptance of the old results is not a mere provisional arrangement, — a concession made *pro tempore*, as it were, while some new method is getting into working order. To take as an example the case of Wagner, such a supposition would be inconsistent with the terms in which he has laid down some of the leading doctrines of the English school,² and, which is more important, is also excluded by

¹ See the article, "Systematische Nationalökonomie," by Adolph Wagner, in *Jahrbücher für Nationalökonomie*, 1886, p. 245. A large part of this article will be found, translated, in the *Quarterly Journal of Economics* for October, 1886.

² In the article just cited, p. 246, Wagner enumerates, as the weightiest points of the old "Dogmatik," the doctrine of the limitation of production from land and the theory of rent, the doctrine of population, the doctrine of the limitation of production by capital, and with it the wages-fund theory, with a few modifications. All these, he says, are held in substance by Cohn, Roscher, Schäffle, and himself. On the Malthusian doctrine, see an important note in Wagner's "Volkswirtschaftslehre," i., 145. It is interesting to observe that, with respect to the wages-fund, Wagner's approval is given to "Mill's older doctrine," and not to the restatement made and confuted by Mill himself in 1869. For Roscher's position, see, *inter alia*, his "Grundlagen der Nationalökonomie," §§ 149-156, 242, 243. Compare also "Geschichte der Nationalökonomie in Deutschland," pp. 652, 909. In Schönberg's "Handbuch," it is noticeable that the article on the theoretically crucial subject of distribution (by Dr. Mithoff, of Dorpat) gives

his views as to the permanent function of the deductive method in economic investigation. Economic phenomena, in his opinion, are properly to be isolated by a hypothetical process, in order to determine their causal relations. "Only thus can they be rightly grasped and understood, and their connections and operative influences investigated."¹ Without examining more closely into the contrast which Wagner, as well as others, draws between the deductive and inductive methods, it is enough to note the fact that, in his judgment, both must be used, but in varying proportions. "The individuality of the particular investigator must determine that now one and now the other method shall be applied more or less than it is by other investigators. This does not in itself present any occasion for praise or blame, but only the proper or improper application of each method in the concrete case, and the worth or worthlessness of the results secured by each investigator by the method which he uses."² Holding this broad ground as to the legitimate application of both methods, Wagner appears to view with equal distrust, not to say contempt, the extreme *Historismus* of some who are commonly reckoned as of the same school with himself, and the mere abstract dogmatism of some representatives of the old economics. Not by him, therefore, nor by the great writers of whom he may properly be taken as a leader and type, is countenance given to the pretension that a particular method in political economy is the scientific method, that its work alone is true investigation, or that upon its followers alone must rest the hope of the future. Some of Wagner's warnings, indeed, as to the mischief threatened by a spirit of exclusiveness and by "*Verschulung*" among scholars, seem to have been

what would be called an orthodox discussion of the subject, for which Ricardo supplies a great part of the material. The wild talk, so often indulged in, about the "iron law of wages," finds little support from this writer, and as little from Roscher, Wagner, and Cohn.

¹ "Die ökonomischen Erscheinungen gehören doch nur zu den socialen, sind aber nicht kurzweg *die* socialen. Sie müssen als etwas besonderes, wenn auch eng mit anderen zusammenhängendes erkannt, daher eben doch, methodologisch richtig, zunächst möglichst isoliert werden, wenn auch auf Grund eines hypothetischen Verfahrens in Bezug auf die kausalen und konditionellen Momente, unter denen sie zu Stande kommen. Nur so können sie richtig erfasst und verstanden werden. Als dann erst ist ihre Verbindung mit und ihre Beeinflussung durch andere soziale Momente zu erforschen."
Jahrbücher, 1886, p. 200. And see also p. 226.

² *Jahrbücher*, 1886, p. 241.

written with a side glance at tendencies visible in his own school in Germany and elsewhere.

The "new departure" in political economy then, as illustrated by this typical case, consists at most in the addition of historical inquiry to methods of investigation already in use. The extent of this addition, and its relation to economic theory, ranges all the way from the copious use of history to illustrate theory—as in Roscher's principal treatise—to the specific investigation of economic history, with the light afforded by long familiarity with economic reasoning, of which in English a brilliant example is given us by Thorold Rogers. But, after all, the difference between the old school and the new is essentially a difference of emphasis or of relative weight given to the historical side of the subject, and not a radical change of method in arriving at economic truths. The movement by which historical inquiry is thus brought more or less into the foreground, according to the intellectual tendencies or the opportunities of the individual, is, no doubt, an important reaction against the opposite tendency, which had stopped the progress of political economy. But such a movement can become a revolution only when the old method and its results are frankly abandoned, as is demanded by Schmoller and the most advanced section, in the expectation of reconstructing the whole fabric of the science by a new process. That this reaction has a close affinity with the intellectual movement which has given new life and meaning to the study of history and jurisprudence is undeniable. No doubt, the development of the industrial life of nations and of their economic institutions, and the causes which, in all that relates to material life, make one nation a different historical product from another, could have no complete exposition without the application of modern methods of research and comparative study. No doubt, too, the exposition of these subjects in the light of ascertained economic laws must be one of the conditions of the advance of social science and of wise legislation. All this, however, is far from carrying with it either the necessary unsettling of established doctrines, or the abandonment of the processes by which they have been established.

There is another important subject, however, on which the new school of political economy is better agreed, and as to which it is understood to be in strong opposition to the old economists. This

is the vast increase of the functions and activity of the state, now called for in so many quarters. The old political economy, it is declared, was "atomistic," and dealt only with individuals: that of the future must be social, and must take the given society, not the individuals composing that society, as its unit; society, as a conscious whole, has duties limited only by the possibility of actively advancing the general well-being of its members; its powers are to be adapted to this end, and, if adapted, are the justifiable, the most effective, and the necessary means of social advancement.¹ A great and not easily definable extension of the activity of government is thus contemplated. That there is a "law of increasing functions of government" may be an extreme opinion;² but, at any rate, the old presumption in favor of individual freedom is at least obscured,³ and for *laissez faire* is to be substituted a system of direct and pervasive, although carefully studied, interference. There is no doubt as to the loftiness of the ideal which such a system sets before the government of any modern state, or as to the qualities with which such a government must by some means be endowed, in order to approach this ideal. Such conceptions of centralized and all-sufficient power, we may add, are a natural effect both of imperialism and of democracy; and, hence, at this juncture in the world's history, we have a set of the tide from opposite quarters, in favor of extending the functions of government, quite as marked as the *doctrinaire* tendency of the last generation toward non-interference. Whether the present flow is permanent, or is destined to be followed by an ebb, it is at present an active influence in large sections of existing society, and gives a marked character to the political economy of the new school.

But to determine the relation of the new movement to the old political economy in this respect, requires some consideration of the place hitherto held by what is called the doctrine of *laissez*

¹ This demand appears in most urgent and, as it seems to the writer, questionable terms in Professor James's declaration that the State "must be continually interfering [to promote and create industry]; otherwise, progress would stop, and retrogression set in." "Science Economic Discussion," p. 43.

² See Ely, "The Past and the Present of Political Economy," p. 52; and Wagner, "Volkswirtschaftslehre," i., 308.

³ See Dr. Schönberg's language as to the decision between "freedom and unfreedom." "Handbuch," i., 48.

faire. There is plainly a broad distinction between the assumption of non-interference as one of the conditions of a problem on which we are reasoning, and a recognized principle or maxim that no interference with individual choice, under such circumstances, is justifiable or expedient. To take the case in which interference is most familiar, — in the reasoning upon international trade and international values, — the problem is to determine the mode of action of the reciprocal demands made by two trading countries. The reasoning must of necessity — in the first instance, at any rate — suppose the exchange to be free from any influences except those whose effect is under investigation; namely, the desires of the countries respectively to satisfy certain wants with the least effort, and the means of satisfaction offered by their respective industrial conditions and resources. To introduce the supposition of governmental interference by the levying of duties on the one side or the other, would obviously bring in a new element, not necessary to the essentials of the problem, and of infinitely variable action and intensity. The exclusion of such a supposition, however, carries no implication whatever as to the right or expediency of interfering; nor can the conclusions reached, after such exclusion, afford more than a part of the grounds on which to rest a judgment as to such right or expediency. And the distinction thus to be made in the reasoning as to international dealings holds good in the discussion of other leading topics. For example, in the discussion of domestic supply and demand and of price, it is assumed that the dealings are free from control or influence by any superior power; and, in discussing wages and profits, it is assumed that the competition of individual interests acts by itself. But, plainly, the question whether competition may be restricted by law or by combination, or should be free, must be answered by entirely independent reasoning. No answer is implied, or is approached, by that reasoning which merely seeks to ascertain the normal effects of the primary forces with which political economy has mainly occupied itself.

It seems, then, that *laissez faire* is no part of the logical structure of the old economic doctrine. The most rigid Ricardian may accept it or reject it, and equally without derogation from his purity of doctrine. And, if we inquire into the opinions as to particular cases of governmental action held by some leading econo-

mists of the old school, we shall find among them a singular and often forgotten indifference to the doctrine so commonly associated with the system which they built up. Adam Smith, as is often recalled in a different connection, gave his sanction to interference in the two test cases of the navigation acts and of protective duties in certain cases. Malthus supported the protective duties on British corn. Senior, dealing with such practical subjects as distress among the hand-loom weavers and the reform of the poor laws, reached conclusions and made recommendations often entirely inconsistent with any idea of *laissez faire*. Even McCulloch, anxious to uphold the maxim *pas trop gouverner*, still commended some legislation on factory labor, on the dwellings of the poor, and on employer's liability. Mill, first or last, suggested legislation as the cure for pretty nearly every evil not deemed positively incurable. In every one of these cases, — and the list might be extended easily, — it is clear that the writer had no principle, as regards governmental interference, which could prevent his recommending it, if he thought the object aimed at important enough, and the prospect of success good. And Cairnes finally went so far as to declare expressly that "the maxim of *laissez faire* has no scientific basis whatever, but is at best a mere handy rule of practice, useful, perhaps, as a reminder to statesmen on which side the presumption lies in questions of industrial legislation, but totally destitute of all scientific authority," or, as he said in another place, "a rule which must never for a moment be allowed to stand in the way of the candid consideration of any promising proposal of social or industrial reform."¹

It is plain, in short, that, not only logically, but according to the practice of leading economists,² the maxim of *laissez faire*, whatever validity we assign to it, has to do only with the practical applications of economic reasoning, and has no place as a part of the reasoning itself. It belongs in the same sphere with a great variety of other considerations, which must be weighed by the legislator and by the economist when he considers legislative proposi-

¹ See his essay on "Political Economy and *Laissez Faire*," "Essays in Political Economy," p. 244.

² But for a highly fanciful statement of *laissez faire* as an integral part of the deductive political economy, see M. Laveleye's article, *Revue des Deux Mondes*, July, 1875, p. 447.

tions, but which do not affect those relations of cause and effect known as economic laws. It is no doubt true that, for various reasons, the great majority of economists of the deductive school have in fact given so much effect to the maxim as to recognize a presumption in favor of non-interference, to be set aside only for strong reasons. In the familiar case of protective customs duties, it is no doubt true that their conclusions in favor of freedom have often rested upon such broad ground as to account for, if not justify, the common belief that a general doctrine of *laissez faire* lies at the foundation of the deductive political economy. Still, it is with perfect ease, and with no sense of logical inconsistency, that the German writers already noticed can adopt the most critical points of doctrine from the English school, and yet demand an increase of the state's activity, without apparent limit.

But behind this practical tendency in favor of a more effective use of the authority of the state, lies what seems to be regarded as the chief theoretical characteristic of the new movement, "the reunion of ethics with political economy." The power of society is to be directed by a keen sense of duties, scientifically defined and recognized. The obligation to consider other and higher aims than the mere enriching of the community, the duty of treating the laborer as something more than a certain amount of energy to be made effective by the administration of certain doses of capital, the constraint of Christian brotherhood, are to be enforced as a part of the teachings of political economy. And thus, it is declared, a new life is to be given to a science which has hitherto regarded man as living by bread alone. Without wasting time upon a needless defence of the older political economy, against charges certainly not based upon any real examination of the uses to which economic truth has been held to be applicable, it must be remarked that a good deal of the current talk of an ethical political economy appears to contemplate merely the infusion of emotion into economics. But, after all, can there be any doubt that even the most generous emotions must find their place, not in reasoning, but in the use of the results of reasoning? Is there any doubt that our sympathy with the aspirations of the working classes in their centuries of effort, or our zeal for whatever shall bring the masses of society into the full light and warmth of modern civilization, is and must always be altogether foreign to the question as to

the causes which determine wages? Both in the pulpit and in the press, it sometimes seems to be assumed that really humane economists may be expected to avoid any conclusions which unpleasantly recognize the persistence of moral as well as physical evil. But, surely, there is no need of arguing that humanity and generosity, or their opposites, are not to be predicated of a string of syllogisms. And it is hardly more necessary to point out that even the enlightened conscience must find its place for action after reason has determined the conditions under which it is obliged to act. In short, the question what *ought* to be, or what we wish, must be kept clear from the question what *is*, if we wish for any trustworthy answer to either. Bastiat is a good example of what befalls an economist who permits his aspirations for great ethical and social aims to mix with his reasoning; and, in his case, we have, as the result, a set of harmonies which, it seems to be agreed on all sides, are admirable in every respect except consonance with fact.

So far, then, as relates to the determination of economic truth, we may be certain that the greater weight promised to ethical considerations by the new school will have no effect. It will continue to be necessary in this as in every other department of investigation, that the investigator should proceed with a single eye to the truth, and that reason alone should guide his inquiry as to scientific law, — in short, that the logical process should be logical, leaving to the emotions, conscience, and the higher law their own field of activity at another stage. It was a shock to Mr. Carey's sensibilities to find Senior declaring it the economist's duty to allow "neither sympathy with indigence nor disgust at profusion and avarice, neither reverence for existing institutions nor detestation of existing abuses, neither love of popularity nor of paradox nor of system, to deter him from stating what he believes to be the facts, nor from drawing from those facts what he believes to be the legitimate conclusion."¹ But, doubtless, even Mr. Carey would have found it difficult to present any other hopeful or even possible basis for scientific discussion. As little can the historical school, if it is to do any permanent work, allow either generous aspirations or social duties to interpose their influences, except in their due place.

¹ Carey's "Social Science," i., 196.

That such an influence has its due place before economic results are applied in practice, is not a matter of serious dispute;¹ and the whole question of the relation of ethics to political economy resolves itself, therefore, as was pointed out in the earlier part of this article, into a bare question of classification. Shall our nomenclature be such as to make the term "political economy" include the ethical sphere or not? To the present writer, the strict limitation of the term appears to be the preferable, as it has been the common, usage. But whether this usage is retained or not can make no difference as to the course really to be followed. However our classification may divide or group the topics relating to this order of thought, the process adopted for the elucidation of scientific law must of logical necessity be kept free from ethical considerations; and these considerations must, by equally stringent necessity, be taken into account finally among the grounds of action. "But, if the science is only to consider what is and not what ought to be," complains Laveleye, "it can neither propose nor pursue any ideal." To which it must be rejoined, that the business of a science is not to propose or pursue ideals, but to ascertain truths,—a work which ought not to be perturbed by aspirations any more than by any other form of prepossession. And, as truths once ascertained are to be used in due place and season, it is easy to see that the great aim, the advancement of society, is not set at risk by the strict regard paid to the definition of a science, as M. Laveleye seems to apprehend.

The new movement, then, on the whole, although represented by impassioned advocates as a revolution which is to sweep the ground clear and give the world a new political economy, is, in fact, a development of the existing science, under the influence of a strong reaction against tendencies which had prematurely checked its advance. So far as this development is historical in character, it means a fresh impulse given to the study of the social fabric, past and present, in its origin and its results, but not at present the adoption of any new method of investigation, even if, in dealing

¹ The extreme advocates of *laissez faire* are sometimes spoken of with a misplaced note of reprobation, as if they denied the existence of all moral considerations in connection with any question touching wealth; but clearly there is no necessary inconsistency between a full recognition of the moral aspect of a subject and disbelief in the right or power of government to act upon it.

with this subject-matter, any real change of method is practicable, — a point which may at least be held in reserve until further proof. And, so far as the new development is social or ethical, it means an increase of weight given to obligations which have been ignored oftener than denied, and the consideration of which can neither supersede nor control any reasoning, deserving the name of scientific, upon economic questions. The importance of the movement, even in this view of its scope, as tending to direct the attention of the economic world, for the present generation at least, to new problems, and perhaps to revive its interest in topics too easily neglected, can hardly be overrated. But this new direction of thought is, after all, not the absolute break of continuity so often proclaimed.

It is to be said, too, that such a movement as the present need not be regarded with a jealous eye, by those of us who still believe that the method of Ricardo and Mill and Cairnes is the best and even the only sure method, for threading the way through the mazes of conflicting motives which underlie economic phenomena. Even the excessive cultivation of fields heretofore neglected must be viewed by the adherents of the deductive school as not only natural, but hopeful. They will not deny that the current political economy needs to be brought into closer relation to the life of to-day; and, whatever else the reaction may succeed or fail in doing, it will certainly compel all economists to carry their researches deeper into actual phenomena. Moreover, so long as the investigation of truth, by whatever means, is the guiding purpose of the movement, its result must be the accumulation of material, rich and varied, to be brought ultimately into the service of science. And, even if dogmatism and the growing arrogance of a school secure the sway and wreck the possible career of the new economics, the old will at least have undergone a salutary discipline and received a new impulse.

THE ACADEMIC STUDY OF POLITICAL ECONOMY¹

THE last quarter of a century has seen a remarkable development of political economy as an academic study. For special reasons connected with the organization of the universities and of institutions for liberal education generally, this development is not so marked in France or England as it is in Germany, in the United States, or, perhaps, in Italy; but it has everywhere been sufficient to bring forward economic science, from its old position as the curious pursuit of a limited class of specialists, to a recognized place as a department of thought, the further exploration of which must be carefully provided for by any well-equipped academic body. In our own country in particular, no one of the moral sciences has made a more rapid or solid gain than political economy, either in the extent and importance of its scientific investigations, or in the dignity of method and spirit which characterizes its work, or in its educational value.

The reasons for this important advance, it is to be noted, are in some degree independent of those which determine the value of economic science for the professional educator and make it for him an important branch of liberal training. For him it is a study which is to discipline and open the mind, and prepare it to meet the problems offered by professional work or by active business. The educational value of economic study has, in fact, but little to do with the actual content of the science. Even if it were, as has been said, a mere discussion of "lunar politics" or of social relations under the rings of Saturn, although it would lose in interest, it would still afford one of the best means of training the reasoning powers to deal with the questions of complex causes presented to us in such infinite variety by human life.² In short, the value

¹ *Quarterly Journal of Economics*, July, 1891.

² See some excellent remarks on this subject by Professor Patten, of the University of Pennsylvania, in his paper on "The Educational Value of Political Economy," in the publications of the American Economic Association, vol. v., No. 6, p. 11.

of political economy as a dialectic would remain, although it found no immediate application in the society around us. Probably every earnest teacher of the subject feels an interest in his work, then, and has in view the attainment of objects, entirely different in kind from the interest and the purposes which, to the non-professional observer, would seem to be most natural.

But the interest with which the general public view the academic study of economics and the widespread demand for its extension, as well as the pressure of students for introduction to its elements and its methods, no doubt spring from entirely different considerations. It is the perception of the scope and importance of the questions with which political economy deals that turns the popular current so strongly toward it to-day. It is keenly felt that on the right answer of these questions must depend not only the future progress of society, but also the preservation of much that has been gained by mankind in the past; and it is inevitable that the community should desire to see such problems investigated under the conditions and by the methods which are found to be fruitful in other departments of study, and to have the younger generation trained for economic reasoning and investigation as thoroughly and assiduously as they are for the languages or philosophy or natural science. We say advisedly that "the community" desire to see this; for nothing is more striking than the interest which those who are called practical men often show in the prosecution and encouragement of this class of studies, in which nevertheless they take but little part directly. That the scientific man and the practical man are apt to lack each other's strongest qualities — and so are complementary to each other, but are rarely complete — is a notorious cause of misapprehension and waste of energy;¹ but in this case we have both working together, in their common eagerness to promote the investigation of economic questions, as they might for the promotion of the natural and physical sciences, which so readily fix the attention of the non-professional

¹ The remark of Mill may be recalled, that, "while the philosopher and the practical man bandy half-truths with one another, we may seek far without finding one who, placed on a higher eminence of thought, comprehends as a whole what they see only in separate parts, — who can make the anticipations of the philosopher guide the observation of the practical man, and the specific experience of the practical man warn the philosopher when something is to be added to his theory." "Essays on Some Unsettled Questions," p. 157.

observer. We can go farther, and say that public opinion in general, in the countries which stand highest in the intellectual scale, is catholic in its judgments of the results of economic investigation, tolerant of differing opinions, and fully awake to the essential importance of complete freedom of thought and of expression. Especially is this the case in Germany, which for some years past has succeeded in maintaining the first place in this branch of learning as in so many others. Complete intellectual independence has there been conspicuous among the favoring conditions of intellectual progress.

The universities have everywhere found themselves encouraged and even required, therefore, to take up the investigation of economics with vigor and to push it by scientific methods. The leading European universities, it is well known, have long been raising the standard of their equipment and encouraging research in this as in every other department of learning. But, limiting our observation now to American institutions alone, the last fifteen years have witnessed a complete transformation of their work in political economy. In the largest and most thoroughly organized of them, where time has generally been gained for an extended training, the independent examination of economic theories, the comparison and weighing of writers, the determination of the points at which important schools diverge, and the application in all cases of the logical test, which leaves no place for the mere authority of a name, have been carried to a point which even fifteen years ago would have been thought impossible.¹ The study of economic history in its most important fields has been prosecuted with success, contributions of recognized value have been made to the literature of economics, and students everywhere have learned to watch with interest the results of American investigation and scholarship. The work that has been done, it is safe to say, has been done with increasing thoroughness and fidelity. The tone of American economics, often supposed to echo only the English school to which the scholars of every country are proud to acknowledge their indebtedness, has been modified in a singular

¹ Without attempting an exact measurement of the increase of work which has taken place, it is probably safe to say that in the six or eight leading American institutions the number of hours of instruction given per week to economics has increased on the average six or seven fold since 1876.

way in favor of the free and continuous development of theory ; and the study and interpretation of economic history, discarding the easy *post hoc propter hoc* of the partisan, has become the laborious and impartial search for the facts which test theories and exemplify principles. No "American school" has been developed in this rapid progress ; but economic study in the United States, in the institutions of learning as well as outside of them, has had a serious part in the general movement of economic thought in the world at large.

This work has been carried on, as has already been said, by scientific methods and in accordance with a public demand that it should be so carried on. The question often raised whether political economy is in fact a science is not material here. Political economy at any rate aims to discover the forces which determine certain phenomena of society, their direction, strength, and mutual relations. It is, then, in any case a study of cause and effect, and as such must be studied in the scientific manner, whatever place may be assigned to it in the scientific hierarchy. The circle of emotions, hopes, and moral judgments springing from any economic fact may be boundless ; but the relation of that fact to its cause and its consequences is as certainly a question to be settled by appropriate scientific methods as the perturbation of a satellite or a reaction observed by the chemist. And undoubtedly the essential of the scientific manner of study is, that truth alone should be the object of pursuit, and that the methods of investigation should be such as from the nature of the subject-matter will lead to the truth most directly and surely. That the results obtained by such methods should be agreeable or the reverse, that they should accord with prevailing ideas or interests or be in opposition thereto, is altogether aside from the purpose in hand. Are the results true ? is the only test question to be recognized in such an inquiry. That the process of investigation or reasoning is not to be warped in order to make a given conclusion attainable, that any conclusion thus attained by illegitimate means is not only worthless, but noxious, follows as a matter of course when the truth for its own sake is made the aim.

The universities, in general, are aided in their efforts to inculcate the scientific spirit in economic students by a very important body of tradition and example within their own walls. The young

student of political economy, who is urged to carry on his investigation as one of scientific interest, and not merely of transient political concern, cannot help feeling the influence and catching something of the spirit of the investigators at work in other fields around him. The patience, thoroughness, and singleness of purpose which mark successful efforts in the great body of scientific pursuits set the standard for him. His own teachers may fall short of their own ideal of scientific method, they may even be untrue to it, and yet the observing student will feel the sweep of the great current which carries all genuine lovers of science toward the same end. This influence of the general intellectual movement has, moreover, been strengthened in no small degree by the change which has taken place in the methods of study pursued in political economy itself. The cultivation of the so-called historical method can never make political economy anything other than a deductive science, deriving its laws by logical conclusion from premises which are freed by abstraction from all non-essentials. But it would be idle to deny that the verification of conclusions by observation and the selection of new premises for further reasoning — in a word, that the thoroughness of the deductive process and the general scope of the study — have been advanced in a high degree by the improved methods of research and comparison, which have been made applicable in political economy as well as in other moral sciences. It would be difficult to find a writer upon economics, however severe his theoretical method, whose mental attitude does not show a remarkable change from the “stalled” condition in which his predecessors of thirty years ago found themselves. And the student finds in this extended range of interest at once a stimulus to the acquisition of the best equipment and training for independent research, and a safeguard against the mere absorption of an expounded system. So far as the true scientific spirit has made its way, the student in economics, as elsewhere, more and more follows Bacon’s injunction, to “read, not to contradict and refute, nor to believe and take for granted, . . . but to weigh and consider.”

So much being premised as to the spirit and method at present governing the academic study of economics, in the leading institutions in all countries having any important place in the intellectual

world to-day, we have next to remark upon the singular derogation from scientific methods implied in the demands frequently made in the last few years in the United States for some different and special treatment of the burning question of protection or free trade. That this question should be singled out for such demands is no doubt due to the fact that, especially since 1880, it has become political to a greater extent than for many years previously. As a political question, it is often treated by partisans in the heat of discussion as if its solution were the chief, and sometimes as if it were the only, aim of political economy. It would not be difficult to cite public speakers, very high in station, who have been altogether unable to recognize any other subject of interest in the economic field: whereas, it must be remarked for completeness of statement, international trade has to compete for attention, in any general survey of that field, with such broad and absorbing questions as those relating to money, land, labor, and socialistic reform, all of which antedate the free-trade controversy and are likely to disappear only with human society itself. These questions are all intrinsically as important as the question between a high tariff and a low one, and every one of them probably concerns our material interests in even greater degree, and with our material interests others still more vital. But on no one of these subjects has dogma yet fairly crystallized into political platforms, and they are, therefore, still recognized, by most of the world, as the proper subject-matter for unbiassed scientific inquiry; and the answer to be given by science is still looked for with interest, if not with hope.

The call for exceptional treatment of the question between protection and free trade is, in effect, a demand that upon a controverted point, as to which scientific opinions are not at one, political economy shall be made to give its answer in a particular, predetermined sense. This is the real purport of the complaints made by scores of public speakers in the canvass of 1888, and frequently repeated by the press, as to the supposed tendencies of the instruction in political economy in a large part of the American colleges and universities. The complaints, in most cases at least, did not relate to methods of training or investigation; for they were manifestly made without knowledge of the methods pursued. The gist of the complaints was that certain specified results of reasoning had been reached, — results not set down as eccentric and possibly

indicative of individual lack or balance, but commented on as showing necessarily and of themselves a certain bias in the academic mind generally. In short, the attempt was made to judge of a body of scientific inquirers by reference, not to their processes, but to their opinions upon questions still *sub judice*. This was not far different from requiring of them the profession of a creed.

In some cases, the requirement of a creed has gone still farther, if very widespread report may be trusted. In more than one state university, and in some minor institutions within the last few years, it has been understood the purpose has been avowed of filling existing vacancies only by the appointment of men holding a particular set of opinions upon the vexed question. It has long been an open secret that, at an earlier date, one important school of public economy was founded with the express provision that it should avoid the judicial attitude of a scientific body and establish an active propaganda of the views of its founders.¹ It would be hard to find a parallel for such intolerance of scientific investigation and substantial indifference to truth as these cases disclose, in any institutions of equal standing, when dealing with any other subject claiming scientific rank. Indeed, the closest parallel to be found is that presented by the denominational theological schools, in which, a creed being required by the rigor of the case, any pretensions on the score of scientific character naturally take an altogether subordinate position. It is, in fact, difficult to imagine any corresponding requirement made of a professor of geology, or chemistry, or mathematics, and nearly as difficult to imagine it in the case of a philosopher, historian, or jurist. The case may indeed be cited of a seminary in South Carolina, the trustees of which, a few years ago, were so ill-advised as to displace a professor on the avowed ground that he was an evolutionist;² but this transaction was too much obscured by the *odium theologicum* to be important in the present connection.

¹ The secrecy which was judiciously maintained as to the text of the original instrument in this well-known case makes it impossible to cite the exact language here. It is understood that wiser counsels have ultimately prevailed, and that the impossible terms of the original foundation have been relaxed so as not to be inconsistent with the dignity of self-respecting scholars, or with the enjoyment of scientific reputation by the school itself.

² See the *Nation*, October 2 and December 18, 1884.

More plausible, but not more defensible in reason, than the requirement of a creed is the suggestion not infrequently made, that upon a subject like this it is the duty of a fully equipped university to have instruction given upon both sides of the controverted question, and by instructors selected for this purpose, — not selected, therefore, as being the best available persons, irrespective of their opinions upon this matter, but selected because of those opinions in order to represent opposing theories. Any individual dealing with such a question, it is maintained, must have his opinions formed. Let his desire to preserve a judicial impartiality in training and directing his students be, then, as great as it may, his own thought as to the conclusions to be reached, it is said, must needs give a bias to his instruction, and in any case must be evident to his hearers, carrying authority in their minds and thus tending to educate them exclusively to his views. Therefore, it is concluded, both sides should be presented with conviction by those who are qualified and anxious to set their respective opinions in their best light, and the ingenious student should be permitted to make his choice of results freely. There can be no doubt that what is called a "joint discussion" thus permanently established in a university would be a highly attractive exhibition, and that by its aid a study sometimes found arid might easily be made entertaining. But here, again, there is probably no other subject in the academic range concerning which such a proposition would not instantly be covered with ridicule — no other subject, with the possible exception of theology, in which the incongruity of establishing a man to preach a doctrine and calling this the promotion of science would not be instantly perceived. There may, indeed, be the case in which two expositors of a given subject by fortunate chance present it in different aspects, and true investigation may gain thereby; but this is something radically different from the proposition which we are now considering, to establish a permanent polemic between men selected as advocates, not to say as partisans.

The reason of this incongruity is not far to seek. Let us suppose by way of illustration that, by some change of public opinion, the socialistic movement should reach the political stage of development, and some proposition involving the main principle should find its affirmative or negative in all the party platforms. Nothing could be more natural than for the socialists to declare that, for the

right investigation of their system, the presentation of it by convinced socialists is absolutely necessary, that justice to their arguments cannot be expected from those who still cling to the old order of things, and that debate between advocates will best elucidate the truth. Indeed, the socialists might well set up to-day the demand for special representation upon the staff of any large university, if the importance of the question raised by them, its inevitable claim for an answer, and the risk of prepossession against them, are sufficient grounds for such representation. But among sober-minded seekers of truth — and we have no concern with anybody else — there would be little doubt that, in any such case, the process of systematic representation of adverse views would be the conflict of prejudices rather than a true investigation, and that it bears no likeness whatever to the careful and reasoned methods by which any scientific inquiry advances from step to step. In short, the method of treatment would be felt to be incongruous with the subject-matter. The same would be true of every question of economics, so far as it is a fit subject for academic treatment. The subject-matter is in every case a relation of cause and effect, requiring to be studied with a single eye to truth of result; but the proposed method effectually excludes the probability of such study on either side of the question, by presupposing advocacy, when the process of investigation plainly ought to be kept as free as is humanly possible from every disturbing influence.¹

After all, however, the question must remain, What is the proper treatment of the disputed topics which necessarily come to view in the scientific exposition of political economy? As has been said above, these topics are not few in number, although few of them have reached the political stage. The economic and social effects of private ownership of land; the effects and the claims for preference of different methods of taxation, direct or indirect, upon property real or personal, and proportional or progressive; the choice between government currency and bank paper, and between the gold standard and the free coinage of silver; the

¹ There is, of course, paid representation of opposite opinions, and perhaps upon essentially scientific propositions, whenever a court hears a case argued by counsel; but this method of informing the highly trained mind of the court of all the considerations that can be presented on either side, as a preparation for its decision, has no analogy to the case of the university, where the minds addressed are, from the nature of the case, not yet trained, and the work in hand is not decision, but training.

choice between private and state ownership of public works; the powers and duty of the state with respect to combinations of capital on the one hand and of labor on the other; the fundamental question of all, as to the organization of society upon the basis of individual property rights or upon that of communism, qualified or complete, — such questions as these, no less than that between protection and free trade, fill the public mind, frequently divide enlightened opinion, and call for investigation by processes, if they can be found, as scrupulously scientific as those of mathematics. On some of these questions the judgment of the best trained economist may well be in suspense. On some of them, and perhaps on most, every earnest scholar is likely to have his opinion formed, and in that case, although his mind should still remain open for fresh light, is tolerably certain to feel his interest strongly engaged on the one side or the other. Such is the inherent difficulty of treating by scientific methods any subject which has a direct bearing upon the action or well-being either of society or of its individual members.

Nothing need be said here as to the necessity of impartiality of judgment, for that is of the essence of any scientific method. As little need be said of the frequently suggested claims of sympathy or patriotism, for these have their place in an inquiry of an entirely different order from the search for economic truth. It is to be presumed that the guide in such a search preserves at any rate the consciousness of impartial purpose, and aims to keep his mind free from all influences foreign to the matter actually in hand. Giving him the benefit of this presumption, what is he to do with the occasions which lie all along his path for the statement or suggestion of individual opinion upon questions like those referred to above?

At this point we must recall the distinction often insisted upon by economists, and as often forgotten by them as by anybody else, between economic laws and the application of those laws in practical administration and legislation. The economic law, the deduction of pure science, is simply the statement of a causal relation, usually between a small number of forces and their joint effect, possibly between a single force and its effect. For the statement of that relation the case has been freed from every disturbing element, and with the result, it is hardly necessary to repeat, of

giving a proposition which, however important, is only conditionally true. The laws of value, in their simplest generalization, are true only under certain assumed conditions of complete competition. The law of rent is a fine example of a law of never failing operation, which, however, is not usually seen with its conditions in the absolutely simple state in which the economist, for the purposes of reasoning, imagines them. But, when we come to the application of economics to legislation, we enter at once into a region of necessarily confused conditions, and also become conscious of objective ends often having little or no relation to any economic doctrine. For any purpose of legislation, the social and industrial conditions of a country — such as they have been made by long past history, by newly kindled enterprise, or by sudden calamity — have to be a guiding consideration. The present needs of a people have to be weighed, perhaps, against what might seem to be its ultimate advantage; and what is socially or politically possible has to be accepted as the limit.¹ The objects aimed at by legislation may also be entirely different from those suggested by simple economic deductions. For the purposes of the legislator, even the certainty of economic loss which is indicated by some unquestioned principle may be an entirely immaterial consideration, to be set aside as of no weight in comparison with the object in view, or as merely the cost which he can afford to pay for some great uneconomic gain.² We can even conceive the economist as deliberately contravening, in view of the general conditions of the case, what would seem to be the natural conclusion from his own doctrine, — as, for example, we may conceive a be-

¹ Mr. Keynes observes that "in a few departments, such as those of currency and banking, we meet with cases where, having determined the economic consequences of a given proposal, we practically have before us all the data requisite for a wise decision in regard to its adoption or rejection. But more usually — where we pass, for instance, to problems of taxation, or to problems that concern the relations of the state with trade and industry, or to the general discussion of communistic and socialistic schemes — it is far from being the case that economic considerations hold the field exclusively. Account must also be taken of ethical, social, and political considerations that lie outside the sphere of political economy regarded as a science." "The Scope and Method of Political Economy," p. 55. It may be doubted, however, whether, even in such departments as currency and banking, simple cases are so easily found as is here implied.

² And so Adam Smith says, "As defence, however, is of much more importance than opulence, the act of navigation is, perhaps, the wisest of all the commercial regulations of England." "Wealth of Nations," Bk. IV., ch. ii.

liever in the single gold standard advocating, in the present state of the world, international bimetallism, or *vice versa*. It is common, therefore, to hear the questions of legislation, which are to be determined in view of a confused mass of conditions, perhaps not closely related to each other, spoken of as "simple questions of expediency," with the suggestion, implied if not expressed, that economic science has nothing to do with them. Questions of expediency alone they cannot be, for they all involve the action of economic forces; but they undoubtedly are mixed questions, involving considerations of expediency, it may be of highly complex character, and therefore not to be determined by any purely scientific test.¹

Here we reach a distinction of some consequence with reference to the proper treatment of the great disputed questions. The investigation of economic law is a strictly scientific inquiry, as much as the investigation of the law of gravitation, and the determination of economic law falls within the competence of the university. Indeed, one of the great objects for which the university exists is to train minds for such inquiry and to further the advance of knowledge in precisely such obscure departments. But on the mixed questions of legislative policy and expediency, it is not the province of the university to pronounce. They indeed involve questions of science, as they involve much else; but their solution is not an act of the scientific judgment. It is, on the contrary, an act of the political judgment, enlightened by the aid of economic science, of jurisprudence, of the study of human nature itself, or whatever else may serve to clear up the matter in hand. The historical narratives in which the great questions of the past lie embedded are no doubt objects of university study, and the unravelling of their tangled threads affords a valuable training, by means of a subject-matter of unfailling interest; but it is no part of the business of the university to pronounce *ex cathedrâ* upon the policies which may find in such narratives some illustration, but which must after all rest upon indeterminate and probably transitory conditions. So, too, the great financial and industrial questions of the day supply the best of material for

¹ Compare the common remark that "freedom of trade is good in theory but not in practice," which is a manner of saying that conclusions, scientifically correct in the speaker's opinion, must be applied with careful regard to extraneous conditions.

practice in the analysis of complicated problems and in the collecting and weighing of evidence; but in all this it is the acquisition of power in the dealing with problems, and not the solution of any practical question, that is the real matter in hand. The university may, and if successful in its true functions will, supply scientific data for the use of all who are concerned in the settlement of legislative and administrative questions; but, when to these data are added the many others which form a part of the basis for all practical decisions, the further declaration of opinion from the university chair becomes an *obiter dictum*, not necessary in the strict performance of duty, and raising some difficult questions of expediency.

The distinction here taken between strict scientific questions and mixed questions of science and expediency, it is true, is not usually observed. In a loose use of language, we are apt to speak of any question involving economics as an economic question, and to treat it, possibly until judgment is given against us, as something to be settled by scientific reasoning alone. But is there one such question which the wise legislator will dispose of in this manner, or as to which the considerate economist, whether in the chair or out of it, will give on scientific grounds an unreserved judgment? It is only by extending the definition of political economy itself, so as to include a vast region of politics and ethics, and thus destroying the possibility of all scientific precision, that we can describe as economic questions a great mass of those which commonly pass for such. This confusion of boundaries is no doubt often ventured upon, and with the eager student the temptation to it must always exist. Nevertheless, the line between political economy and the allied subjects appears to be drawn by reason and necessity, as well as by authority; and, being drawn, it brings with it the distinction here made between the question of science and those of practice.¹

¹ Professor Marshall observes that "it is not the function of a science to lay down practical precepts or to prescribe rules of life. The laws of economics, as of other sciences, are couched in the indicative, and not in the imperative, mood: they are statements as to the effects produced by different causes, singly or in combination. They are not rules ready for immediate application in practical politics." And in a note, remarking upon the tendency of some writers, especially in France, to enlarge the scope of political economy so as to make it include practical politics, the same writer adds: "Of course an economist retains the liberty, common to all the world, of express-

The teacher of political economy must be supposed, however, as has already been remarked, to have his views upon the questions which lie beyond the strict limit of scientific conclusions; and as one who is much occupied with the subject-matter in one of its aspects, and so is familiar with its importance, he may be expected to hold his opinions with strong conviction and interest. But, in his capacity as teacher, is he to express these opinions or to withhold them? The way to an answer to this question may be partially cleared, perhaps, if we consider the general relation of instructor and student, as regards their respective conclusions upon the subjects of their study in common. In no moral science is there a body of truths, as in the exact sciences, capable of demonstration by a process which shall exclude the possibility of difference of judgment between instructed minds. The great service done by the instructor in moral sciences is, as has been said above, to train the mind of the student to scientific reasoning. That the student should learn to reason truly is of far more consequence than that he should perceive and accept any particular truth; and the real success of the instructor is found, not in bringing his students to think exactly as he does, — which is unlikely to happen, and indeed unnatural, — but in teaching them to use their own faculties accurately and with measured confidence. Even within the strict bounds of science, then, the instructor is little concerned with the greater or less uniformity of conclusion among his students, and is not properly concerned at all with anything like the propagation of his own views. He is interested in making his reasoning process clearly understood; but this is because of the value of the logical process itself, and not for the sake of producing conviction in the particular individuals addressed. There is no duty laid upon the instructor's conscience to satisfy every doubt and to inculcate certain propositions as absolute truth; but it is his duty to show how to practise clear analysis and just discrimination in scientific reasoning, and, if he has done this with success, he may well be content.

And when we come to the questions of applied economics, the questions in which science and political expediency both have their

ing his opinion that a certain course of action is the right one under given circumstances. And, if the difficulties of the problem are chiefly economic, he may speak with a certain authority. But so may a chemist with regard to other problems, and yet no reasonable person regards the laws of chemistry as precepts." "Principles of Economics," i. 89.

part, we come to a class of possible decisions which, according to the view here taken, it is distinctly the duty of the university instructor not to press upon his students. Dealing with such questions, as he must in order to make a comprehensive survey of his own proper field, it is his business to carefully disentangle the scientific considerations from all others, and to show their limitation as determined by the supposed conditions which underlie the scientific reasoning. But it is not his province to strike the balance between all the conflicting interests and arguments, scientific, political, and ethical, which actually present themselves for consideration. Still less is it his business to enforce the conclusions which, upon such balance being struck, appear satisfactory to his own mind; for if as regards the questions of pure science he has an object in view more important than mere conformity of belief even in the best established truth, still more on the debatable ground must he give a subordinate place to such conformity. Indeed, looking solely at his relation as instructor, the assent of his pupils upon questions outside of the scientific range becomes as irrelevant as their agreement with his preferences in party politics or with his religious beliefs.

This, however, is not the same thing as to say that the instructor should suppress his opinions on the class of mixed questions now in view. His dignity may forbid a course which might be interpreted as concealment; and there are, moreover, few men whose weight of authority is such as to compel any extraordinary caution in the declaration of their minds. As a citizen, taking his part in the affairs of the community, the instructor has occasion to form opinions and to act upon them; and it is his right in that relation to do what he may to lead others to act with him. In the university, however, he is under other obligations; and there it is for him to decide, how far, with his habit of mind and his temperament, he can give expression to judgments lying beyond his proper sphere, and yet related to it, without injury to the severe neutrality of science which he is bound to preserve within that sphere. It may well be that no two men could follow with advantage the same rule in this respect. It has sometimes been said of this or that teacher of economics, in the friendly comment of former pupils, that after long intercourse the teacher's opinion upon some great question of the day was still unknown to the pupil. The bearing of such com-

ments is equivocal, depending very likely upon conditions of which no observer, however close, can judge. If the teacher's silence as to his own opinion was the result of fear of misconstruction or dread of controversy, his timidity deserved small praise. If he was silent because this appeared to him the only way to preserve the judicial attitude prescribed by his position, he may have laid down a stricter rule for himself than was necessary, and so, after all, may not have attained the highest success. If he was silent because the importance of holding his students to strictly scientific analysis and deduction, in which they would find their best training and most solid results, was always uppermost in his mind, and because any individual opinion upon questions of a secondary order was therefore unimportant for his purpose and as it were intrusive, then, indeed, the comment is complimentary. But it is only the teacher himself who can determine whether it really does thus mark the self-forgetful devotion of his best powers.

RICARDO'S USE OF FACTS¹

IN the current criticism of the economists of the old school, frequent mention is naturally made of what is understood to be Ricardo's fondness for mere theorizing. In a general way, it is admitted that he was a man of affairs; but, as a writer upon economics, he seems to his critics, and no doubt to a large part of his readers, like a man writing in a cave, the course of his thoughts not being at all affected by the actual transactions of life. And yet he did himself suppose that facts had their part in determining his conclusions. He expresses the hope, in the preface of his principal work, that it will not be deemed presumptuous in him to state his opinions upon the questions therein treated, after having given his best consideration to the subject, after the aid derived from some eminent writers, "and after the valuable experience which a few late years, abounding in facts, have yielded to the present generation." Nevertheless, in the treatise which follows, facts are rarely cited in proof or otherwise; and even the illustrations are imagined cases put by the writer.

This characteristic of Ricardo's treatise is best explained by recalling the circumstances under which the book was written and published. It is now before the world as the author's formal exposition of his system; and, as an exposition, it confessedly leaves much to be desired. But it is to be remembered that it is at least doubtful whether the author originally wrote for publication. McCulloch's statement, probably made upon the best information, is express, that Ricardo hesitated to publish, and was unwilling thus to risk a high reputation. "Ultimately, however, he was prevailed upon, by the entreaties of his friends, to allow his work to be sent to the press."² That James Mill was one of these persuasive friends, we have upon the authority of John Stuart

¹ *Quarterly Journal of Economics*, July, 1887.

² See also *Annual Biography*, 1824, p. 374.

Mill, who speaks in his "Autobiography" of Ricardo's work as "a book which never would have been published or written but for the entreaty and strong encouragement of my father; for Ricardo, the most modest of men, though firmly convinced of the truth of his doctrines, deemed himself so little capable of doing them justice in exposition and expression that he shrank from the idea of publicity."

It appears from these notices not unlikely that Ricardo's book was written, not for the public eye, but as a statement of opinions made for his own purposes, and that its publication was an after-thought of his friends. And this view of the case is confirmed by the structure of the book itself, which is a series of monographs scattered over the field of political economy, such as a thoughtful man might commit to writing when clarifying his own ideas on the subject, but is by no means a systematic exposition, even such as a writer of so little rhetorical pretension as Ricardo might be expected to produce. This appearance of being a fragmentary collection of essays is even more strongly marked in the original edition than in the later ones, to which the author was induced to make some important additions.

Writing, probably, with little reference to any large circle of readers, Ricardo contents himself in these irregularly connected chapters with a simple statement of the operation of causes. He may here and there refer to an historical case in which a cause discerned by him operated; but such reference is not necessary for his present purpose, and is made by exception, and not upon system. If he wishes to illustrate, he finds it easier to frame a case, as men will do in discussion nine times out of ten, by saying, "Suppose a commodity of 1000*l.* value rises to 1200*l.*, or falls to 800*l.*," and so on. "My object," he says, "was to elucidate principles; and, to do this, I imagined strong cases, that I might show the operation of these principles."¹

But, in his pamphlets, Ricardo was generally writing for a different purpose, and with distinct reference to the reading public. The occasion required a different method of treatment, and thus a certain sidelight, as it were, is thrown upon his mental processes and his equipment for discussion. The range of subjects covered by his pamphlets is limited to the currency and to free trade in

¹ See Ricardo's letter in the *Edinburgh Review*, January, 1837, cited by Bonar.

corn, these being the questions which pressed the hardest upon English economists in the fourteen years of his activity; but the method pursued is significant. In his principal work, his discussion of money and the allied topics, and of all that bears on the effects of free corn, is of the same cast as his discussion of other subjects. We have the same severely logical statement of abstract principles and the same use of imagined cases for illustration, with nothing whatever to show any special study of facts or acquaintance with practical affairs. In the various pamphlets on the currency, however, and in that on protection to agriculture, which is the practical sequel of an earlier theoretical essay on the effects of a low price of corn, he shows that behind the abstract discussions of his book lay a great reserve of facts and observations, ready to be drawn upon whenever the task in hand seemed to require. The same thing is true of his many speeches in Parliament, as reported in Hansard from 1819 to 1823. The subjects of the speeches are chiefly connected with the currency, the national debt, taxation, and agricultural distress. But the discussion throughout rests upon the knowledge of a keen-sighted and experienced observer, skilled in the scientific interpretation of phenomena. So far is he in these speeches from neglecting fact for theory, that it would be easy to cite important cases in which he went beyond the opinion of the House, by sacrificing the close application of theory in deference to the unusual conditions then affecting important questions.

With regard, then, to questions which Ricardo had occasion to treat before an audience or for a considerable circle of readers, we find that he was thoroughly equipped, and that he made ample use of facts for illustration, verification, or the premises for argument, although, in his chief work, the same questions are treated with a singular exclusion of all reference to the actual world around him. It is fair to assume, then, that under like circumstances he would have treated other questions also in the same practical way; and that what appears in his treatise as a complete separation of theory and fact does not indicate the mental habit of the author or the limit of his resources, but is only the peculiar cast given to the treatise by the special circumstances of its composition.

SOME PRECEDENTS FOLLOWED BY ALEXANDER HAMILTON¹

THE system of finance established under Alexander Hamilton's administration of the Treasury of the United States has been represented as a slavish imitation of the English system or as an astonishing piece of original invention, according to the political leanings of the critic. In the following pages the present writer proposes to consider the apparent origin of some parts of Hamilton's work, and incidentally to observe the light which is thus thrown upon these conflicting allegations of imitation and originality.

It is worth while to remark at the start that, under the early practice of our government, the Secretary of the Treasury occupied a position more nearly like that of an English Chancellor of the Exchequer than the present spirit of Congress would allow. The arrangements for securing his responsibility² were defective; but the responsibility itself, not only for administration, but for guiding the course of legislation, was recognized. The early communications of the Secretary to Congress often presented something like a budget, with a statement of the measures necessary for its working, and any new proposition became a government measure. The method began almost from the first to show its incompatibility with the thorough separation of legislative and executive functions aimed at in many of our arrangements; but, nevertheless, it made the financial system with which the government set out substantially Hamilton's system, as Congress expected and intended.

¹ *Quarterly Journal of Economics*, October, 1888.

² Madison stated the nature of the responsibility as follows: "There will be responsibility in point of reputation, at least a responsibility to the public opinion with respect to his abilities; and supposing there is no personal responsibility, yet we know that men of talents and ability take as much care for the preservation of their reputation as any other species of property of which they are possessed." *Annals of Congress*, June 25, 1789.

The purpose of Congress to throw upon the Secretary the burden of shaping the financial course of the government appears in the first steps taken on the subject of public credit. The act establishing the Treasury Department became a law on the 2d of September, 1789; and the nomination of Hamilton as Secretary went to the Senate on the 11th.¹ The demand for action "for the revival of public credit and the advancement of the national honor" had already been brought before the House by the petition of public creditors living in Pennsylvania;² and their petition, on the day when the Treasury bill became a law, was referred to a committee, consisting of Madison, Vining, and Boudinot. This committee contented itself with recommending a mere declaratory resolution that provision for the national creditors was necessary, and that the subject should be considered at the next session. When this report came before the House, however, on the 21st of September, a resolution was added and adopted, directing the Secretary of the Treasury to prepare a plan and report it to the House "at its next meeting." That this addition was made as the result of some consultation and settled policy is made probable by the adoption at the same time of a new resolution, directing the Secretary to apply to the executives of the several states for statements of their public debts and the amount of securities of the United States held by them, and to report the information to the House at the next session, plainly contemplating the possible assumption of state debts as a part of the plan of finance to be prepared. Without entering upon this vexed subject, however, it is enough now to point out the specific demand thus made upon Hamilton for a comprehensive scheme, just ten days after his appointment as Secretary. This was the contemporaneous interpretation of the clause in the Treasury act, which declares it to be "the duty of the Secretary of the Treasury to digest and prepare plans for the improvement and management of the revenue and for the support of the public credit."

¹ As early as May 27, Madison thought that, when the department should be established, the Secretary would be Jay or Hamilton, and that "the latter is, perhaps, best qualified for that species of business"; and June 30 he wrote that "Hamilton is most talked of." "Letters and Writings of Madison," i. 472, 484.

² See *Annals of Congress*, August 28, 1789. The majority of these petitioners joined the next year in a remonstrance against the funding act. "American State Papers, Finance," i. 76.

When Hamilton, in accordance with this resolution, took up the problem of creating public credit, with all that such creation implied, he was barely thirty-two years old. He cannot be said to have had any special training for finance. He had been a reader on economic and financial subjects, had been an interested observer of financial measures, had taken some share in financial discussion, and had undergone the rapid educational process to which practical politics always subject the statesman. In his case, with his marked natural capacity and his good equipment of learning, this process had no doubt carried him far; but his experience had never reached the actual management of affairs on a large scale, as scales were measured in those days, nor the shaping of important financial legislation. He took up his problem, then, as a public man often must, relying upon his general training, observation, and judgment to lead him to a safe conclusion. It appears certain that he relied upon no adviser better versed than himself in practical affairs. He appears to have made a few inquiries of a general kind, not suggestive of his own purposes;¹ but there is a strong probability that his own mind was made up early as to some leading features of his scheme, and that the friends finally taken into his confidence were not invited to share the responsibility of devising and deciding.²

It is a strong proof of the sobriety of Hamilton's judgment that, in determining his course under these circumstances, he sought for the most part to adapt to his purpose methods and agencies which had been tested by experience; for that is the great characteristic of his "Reports on Public Credit and on a National Bank." There is little of the effort to invent or to work out theories leading to some novel expedient, by which an ambitious man so often seeks to exhibit his originality of device and improve his chance for fame. On the contrary, Hamilton seldom shows a disposition to go beyond the range of already tried

¹ For example, see his letter to Madison, October 12, 1789, in Hamilton's "Life of Alexander Hamilton," iv. 60.

² It is to be noticed that Wolcott, although in the Treasury, writes to his father November 3, 1789, "What arrangements are in contemplation with respect to the public debt, I have not been able to learn;" and as late as January 10, 1790, when Hamilton's plan was waiting to be presented to the House, Wolcott seems not to have been well informed as to the rate of interest to be proposed. Gibbs, "Administrations of Washington and Adams," i. 23, 35.

expedients, except when required to do so by the conditions of his task. His fondness for disquisition, perhaps, in a measure justifies Mr. Adams's reference to his published documents as "essays which, under the name of reports, instilled much sound knowledge, besides some that was not so sound, into the minds of legislature and people."¹ He had, moreover, great fertility in ingenious intricacies and fondness for them, as was shown in several of his later and subordinate financial propositions. But, in laying down his general plan for a financial system, he appears to have held his natural tendency in check for the most part, and to have acted with a consciousness that the matter in hand was too grave and its relations too comprehensive to allow him to travel freely beyond the line of tried and known expedients.

And this explains his steady reliance upon the results of English experience. At that day, the statesman who looked for example to guide him in finance could hardly find it anywhere except in English or Dutch methods. France, after a long course of folly, had declared her bankruptcy in the year in which Hamilton's administration began. Spain could give no lessons except in the squandering of great opportunities and resources. Russia and Austria were both struggling with inconvertible paper and financial discredit and distress. The smaller states of Germany and Italy neither had important results to show nor were much known. And, of the two most familiar and most instructive cases, there can be no doubt that the experience of Holland was in most respects less likely to be applicable to the conditions of the United States than that of England. Unless, then, the financial organizer were resolved to disregard the lessons to be learned from foreign finance, he must of necessity draw those lessons chiefly from English practice. What Hamilton's favorite study would have been if France had been financially as fortunate as England, we need not inquire. France had not been thus fortunate, and even an Anglophobist could have looked in but one direction under the circumstances.

The features of Hamilton's scheme which we may advantageously compare therefore with the English precedents are his scheme for funding the debt in order to determine and moderate its immediate burden, his plan for a sinking fund, and the charter

¹ Henry Adams, "Life of Albert Gallatin," p. 268.

of the first Bank of the United States. These measures stand together, as those by which the public obligations were to be defined and met, and national and private interests were to be united for mutual support. The assumption of the state debts and the settlement of accounts with the several states also held an important place in the system, but the considerations involved were so special that these measures do not fall within the range of our inquiry. The system of credit also rested upon the hope of a sufficient provision of revenue; but this Hamilton sought wherever he could find it, and under such limitations in the choice of his measures as made their origin a matter of little significance.

Taking up first in order the plan for funding the domestic debt, proposed by Hamilton in the "Report on Public Credit" of January 9, 1790, we have the measure which was declared to be devised for the purpose of mystifying the public and establishing a perpetual debt in imitation of what was understood to be the English policy. Premising that the Secretary assumed as probable that the interest of money in the United States "will, in five years, fall to five per cent, and in twenty to four," he proposed to fund the heterogeneous mass of securities and claims, which made up the domestic debt, as follows:—

First.—That for every hundred dollars subscribed, payable in the debt (as well interest as principal), the subscriber be entitled, at his option, either

[1] To have two-thirds funded at an annuity or yearly interest of six per cent, redeemable at the pleasure of the government by payment of the principal, and to receive the other third in lands in the Western Territory, at the rate of twenty cents per acre; or,

[2] To have the whole sum funded at an annuity or yearly interest of four per cent, irredeemable by any payment exceeding five dollars per annum, on account both of principal and interest, and to receive, as a compensation for the reduction of interest, fifteen dollars and eighty cents, payable in lands, as in the preceding case; or,

[3] To have sixty-six dollars and two-thirds of a dollar funded immediately at an annuity or yearly interest of six per cent, irredeemable by any payment exceeding four dollars and two-thirds of a dollar per annum, on account both of principal and interest, and to have, at the end of ten years, twenty-six dollars and eighty-eight cents funded at the like interest and rate of redemption; or,

[4] To have an annuity, for the remainder of life, upon the contingency of living to a given age, not less distant than ten years, computing interest at four per cent; or,

[5] To have an annuity for the remainder of life, upon the contingency of the survivorship of the younger of two persons, computing interest in this case also at four per cent.

In addition to the foregoing loan, payable wholly in the debt, the Secretary would propose that one should be opened for ten millions of dollars on the following plan :

[6] That, for every hundred dollars subscribed, payable one-half in specie and the other half in debt (as well principal as interest), the subscriber be entitled to an annuity or yearly interest of five per cent, irredeemable by any payment exceeding six dollars per annum, on account both of principal and interest.¹

No doubt the appearance of great complication is given to this scheme by the ingenious arrangement for leaving to the creditor his choice between several methods of funding, equivalent in value, but having different attractions for the investor. With a domestic money market as yet untried and with public credit still to be created, it may well have appeared dangerous to Hamilton at the end of 1789 to stake his success upon the possible popularity of any single form of investment. Still there can be no doubt that Congress judged wisely in rejecting this part of his scheme and in adopting a method of funding based on his third proposition.² The bolder course of proposing uniform terms of exchange to all the creditors proved to be free from the risk which Hamilton sought to avoid, the form of securities adopted proved to be satisfactory to investors, and the number of classes of new securities to be created was somewhat reduced. The proposition as given above remains a striking instance of Hamilton's chief foible as a financier — his fondness for ingenious and nicely calculated expedients, sometimes admirable as mathematical *tours de force*, but elaborated beyond the real needs of the occasion.

Taking the first three of Hamilton's propositions, there is little in them to remind us strongly of the English precedents, except the use which is made of variety in the terms of redemption. The English legislation had already made the three per cent consols and the reduced three per cents redeemable at par upon a year's notice. The four per cents had been irredeemable for ten years, and the fives for thirty. As a refinement upon this variation in time, Hamilton fixed a limit to the rate of redemption, guaranteeing the creditor against payment except by small instalments, instead of securing him against payment for a definite time. This limit

¹ "American State Papers, Finance," i. 20. ² *Senate Journal*, July 16, 1790.

upon redemption Hamilton used to increase the weight of his offers, as English financiers had used the limit of years; and Congress adopted it for the first and last time in the Funding Act of 1790,¹ when they gave the creditor (1) for his principal two-thirds in six per cents bearing present interest, and one-third in sixes not bearing interest until 1801, neither series being redeemable except by payments limited to eight per cent for principal and interest in any one year, and (2) for his interest three per cents redeemable at pleasure.

Whether Hamilton adopted from any quarter, or indeed maintained at all, a policy of permanent public debt, is a question which it is convenient to postpone for the present. So far as the terms of redemption proposed by him bear upon this point, however, it may be said here that his first proposition was for a security perpetual in the sense in which the larger part of the English funded debt was perpetual, having no fixed time for maturity, but redeemable whenever the government might find redemption convenient, — temporary or perpetual therefore according to the financial strength of the debtor. Of the securities redeemable at a limited rate, described in his second and third propositions, his four per cents had the longest life secured to them; and these, if redeemed by a series of annual payments of five per cent for principal and interest, would last for forty-one years from the beginning of the series, calculating the interest at four per cent for the whole period.

When we come, however, to Hamilton's fourth and fifth propositions, we have plainly an expedient drawn from the life annuity system, which the English government had used as a method of borrowing at intervals from the time of William III., and which the Dutch government had practised still earlier. Here, again, Congress acted wisely in avoiding a plan better adapted to the habits and wants of an old community than to those of a country just emerging from colonial and frontier life; and the proposition stands as an additional proof of the tentative character of Hamilton's early propositions and the difficulty which he found in fixing his judgment as to the nature and demands of the coming money market, on which the fate of his effort to establish public credit must depend.

¹ Act of August 4, 1790, "Statutes at Large," i. 138.

The least creditable of Hamilton's propositions is that in which, "as an auxiliary expedient," he proposed a loan on the plan of a tontine, with the right of survivorship among those entitled to the annual payments:—

To consist of six classes, composed respectively of persons of the following ages:—

First class, of those of 20 years and under.

Second class of those above 20, and not exceeding 30.

Third class, of those above 30, and not exceeding 40.

Fourth class, of those above 40, and not exceeding 50.

Fifth class, of those above 50, and not exceeding 60.

Sixth class, of those above 60.

Each share to be two hundred dollars; the number of shares in each class to be indefinite. Persons to be at liberty to subscribe on their own lives, or on those of others nominated by them.

The annuity upon a share in the first class, to be	. . . . .	\$8.40
Upon a share in the second,	. . . . .	8.65
Upon a share in the third,	. . . . .	9.00
Upon a share in the fourth,	. . . . .	9.65
Upon a share in the fifth,	. . . . .	10.70
Upon a share in the sixth,	. . . . .	12.80

The annuities of those who die to be equally divided among the survivors, until four-fifths shall be dead, when the principle of survivorship shall cease, and each annuitant thenceforth enjoy his dividend as a several annuity during the life upon which it shall depend.¹

No action was taken by Congress upon this ill-advised scheme; but it is important to observe that its details appear to have been adjusted upon the plan of the English tontine of 1789, which had been brought out by Mr. Pitt a few months before the date of Hamilton's report.² The classification of subscribers is the same in the two, differing from either of the other English tontines and from the Irish and French as well.³ In short, it appears that, in

¹ "State Papers, Finance," i. 21.

² On June 10, 1789. See "Parliamentary History," xxviii. 161.

³ The English tontine of 1789 was under the act of 29 George III., c. 41. A payment appears to have been made to one survivor in the fiscal year 1887-1888, according to "Finance Accounts" (in Parl. Doc., 1888), p. 42.

The annuities proposed by Hamilton were somewhat higher for classes four, five, and six than those in the English scheme. This change was probably made because the terms of the English tontine were found not to be sufficiently attractive, so that the subscription was not filled. See for this and other English and Irish tontines, "Report on Public Income and Expenditure" (Parl. Doc., 1869), ii. 571; for the French cases, Leroy-Beaulieu, "Science des Finances," ii. 288 [1st ed.].

his uncertainty as to the kind of investments which would prove acceptable in the United States, Hamilton here grasped at the freshest expedient brought to him by his foreign advices, committing himself to a proposition which shows little of the business-like calculation found in most of his recommendations to Congress.

It was no doubt a common belief among Hamilton's opponents that, in shaping these propositions, he had devised a scheme which threatened the country with a perpetual debt. This, it was charged, was the natural result of a weak deference to English precedent and of political theories of English origin, which looked to the strengthening of the central government by all possible influences, whether pure or mercenary.¹ That the concentration of debt and of revenue under federal authority would give instant support to the general policy of Hamilton and his party there was no pretence of denying, and it was perhaps natural that the opposition should believe that a debt which was used to strengthen the government at the outset would be treated as one of its permanent buttresses. The magnitude of the funding operation tended to confirm this idea. That Hamilton's opponents had no definite counter-proposition² appears to have been due in great measure to the belief sometimes expressed, and sometimes tacitly operative, that the debt weighing upon the general and state governments together was too great to be dealt with. To fund the debts of the Confederation at their face, without any attempt at scaling them down, and to assume a great mass of debts incurred by the states for the common defence, was to bind a formidable burden upon a government which was then collecting an independent revenue for the first time.³ What chance of ultimate redemption can there

¹ Jefferson, in his letter to Washington, September 9, 1792, says that Hamilton "wishes it [the debt] never to be paid, but always to be a thing wherewith to corrupt and manage the legislature." Jefferson's "Works," iii. 464. And twenty-five years later, writing the introduction to his "Anas," he says in a famous passage that Hamilton's financial system "had two objects: 1st, as a puzzle, to exclude popular understanding and inquiry; 2nd, as a machine for the corruption of the legislature." *Ibid.*, ix. 91.

² As an example of the suggestions made by individuals may be cited Maclay's advice, to establish a revenue sufficient "to discharge a reasonable interest, proportionate to the market price of the public debt, until the whole is extinguished by the western sales." "Debates in the First Senate," p. 259. Maclay's idea of "a reasonable interest" appears, from p. 171, to have been three per cent.

³ Gallatin, in his "Sketch of the Finances" (1796), treats the ability of the government to carry this weight as something still to be proved. The objections to the assump-

be, to what else than a permanent and probably increasing national debt can such a scheme be expected to lead? was the anxious inquiry of men whom we have no right to charge with mere political hostility to Hamilton or with indifference to the national honor. A few years settled all such questions. The changed relations of the whole commercial world brought such an increase of national wealth as no man could have foreseen in 1790; and, by the irony of fate, it was Hamilton's opponents who reaped the benefit.

Hamilton's answer to all such apprehensions and the effective justification of his policy are to be found in his habitually sanguine estimate of what might be expected from the growth of the country. In 1781 he wrote to Morris that, if the United States should succeed in the war, their population would double in thirty years, and they would be out of debt in twenty.¹ In his "Report on Public Credit," he thought that no country would be able to borrow from foreigners upon better terms than the United States, "because none can perhaps afford so good security."² He made his calculations, as we have seen, on an early fall in the rate of interest to be paid by the government. And he wished to hasten the rise of the national securities which he foresaw, in order that, if they should pass into the hands of foreigners, it might be for full value.³ His optimism was, after all, the truest wisdom; and it explains and justifies the boldness with which he fixed the scale of his funding system. In his view, the debt which was to be funded, so far from being a perpetual burden, would fall easily within the resources of the rising nation; and, as it turned out, a still more confident policy might have succeeded.

The legislation which he advised or procured was strictly consistent with this expectation of future growth. Threatening as his propositions appeared to his opponents, few men would now dispute the statement that he undertook to cast the debt in such form as to keep its redemption fairly within the control of the

tion of state debts, he says, rest chiefly on the increase of the general debt and the difficulty of commanding all the resources of the country. "Give the Union that command, prove that its ability of paying the principal of the debt is not impaired by having assumed the state debts, and the measure will stand almost justified." "Writings of Gallatin," iii. 165.

¹ "Works" (Lodge's edition), iii. 124.

² "State Papers, Finance," i. 20.

³ *Ibid.*, p. 25.

government, making the securities redeemable either at pleasure or at such a rate as might be supposed to correspond to the ability of a prosperous country. A quarter of a century ago the promise of a sinking fund of one per cent per annum appeared to Congress and to the public to be sufficient.¹ Less than twenty years ago a large part of the national debt was made irredeemable for thirty years; and a period even longer was favored by men who were under no suspicion of favoring perpetual debt. With a scheme far removed then from perpetuity, as judged by recent standards, Hamilton undertook also to provide the machinery for carrying on systematic redemption even before the resources needed for the purpose could be counted on with certainty. So far, then, as the terms of his legislation are concerned, or those of the measures proposed by him, but not accepted by Congress, the charges made by his opponents appear to be without real foundation.

It must be admitted, however, that Hamilton, when urging the funding of the debt, sometimes used language which might well expose him to the charge of desiring its permanence and the suspicion of aiming at its establishment on something like the English model. He saw plainly that the revival of industry could only be accomplished by the aid of a sound mercantile credit, and that for the growth of this the establishment and regular operation of public credit were necessary. He saw the advantage which must accrue to the community when the resources of individuals locked up in claims upon the government should become mobile, by being converted into negotiable securities having a recognized standing in the market. And he held the opinion, often expressed since his time, that under some conditions a diffused domestic debt may be a bond of union. In urging his plans, then, he set forth in strong terms these advantages to be gained from the funding system. He sometimes fell little short of declaring a funded debt to be a real increase of capital, although he did in fact make the distinction between an absolute increase of capital — which, he says, a funded debt is not — and a tendency to increase real wealth by increasing activity.² In his letter to Morris

¹ The operation of the sinking-fund provision of 1862 is of course much slackened by the construction which calls for one per cent., not of the original debt, but of the balance remaining unpaid at the beginning of the fiscal year.

² On this subject, see his "Report on Manufactures," in "State Papers, Finance," i. 132.

in 1781 he had declared that a "national debt, if it is not excessive, will be to us a national blessing. It will be a powerful cement of the Union."¹ And in his "Report on Public Credit" he uses the same expression.² On this occasion, however, an explanation follows, which shows us his real thought. "Persuaded as the Secretary is that the proper funding of the present debt will render it a national blessing, yet he is so far from acceding to the position, in the latitude in which it is sometimes laid down, that public debts are public benefits, a position inviting to prodigality and liable to dangerous abuse, that he ardently wishes to see it incorporated, as a fundamental maxim, in the system of public credit of the United States, that the creation of debt should always be accompanied with the means of extinguishment." This declaration, not standing alone, but repeated on other occasions,³ places his opinion as to national debts on consistent and easily defensible grounds. How far it fell in with the English practice of the day can best be seen when we consider the measures which Hamilton took to secure the regular payment of the debt the United States funded by the act of 1790.

Coming, then, to the second of Hamilton's leading measures, the establishment of a sinking fund for the national debt, we find an expedient unmistakably adopted from English legislation,—so clearly derived from that source, in fact, that it would not call for discussion here if the meaning of the English precedent had not sometimes been lost sight of, and the key to Hamilton's action therefore lost. Without doubt, Hamilton in this matter followed Mr. Pitt.⁴ What, then, was the scheme of Pitt? This question

¹ "Works" (Lodge's edition), iii. 124.

² "State Papers, Finance," i. 24. Jefferson fastened upon this famous phrase, and in his letter to Eppes, November 6, 1813, remarks that at "the time we were funding our national debts we heard much about 'a public debt being a public blessing'; that the stock representing it was a creation of active capital for the aliment of commerce, manufactures, and agriculture. This paradox was well adapted to the minds of believers in dreams, and the gulls of that sort entered *bona fide* into it." Jefferson's "Works," vi. 239.

³ See especially his "Report on Public Credit" of January, 1795, "State Papers, Finance," i. 331, 332.

⁴ A committee consisting of Hamilton, Madison, and Fitzsimons reported to Congress a resolution, December 16, 1782, declaring that any excess of funds granted by the states for the support of the debt should be inviolably appropriated as a sinking fund for the payment of the principal. *Journal of Congress*, viii. 38. Whether Hamilton was the author of the resolution or not, it does not conflict with the above statement of his indebtedness to Pitt.

is not to be answered by referring to the English sinking fund, such as it became under later legislation in the years from which most of the current impressions about it date. We must go back to Mr. Pitt's sinking fund act of 1786, that being the legislation actually before Hamilton when he adopted his policy, and not yet modified even by Pitt's act of 1792, when the act of Congress of that year gave to our system its more formal organization.

Having a sufficient surplus of revenue in 1786, and, as was then believed, the prospect of a long peace, Mr. Pitt carried through Parliament an act¹ appropriating £250,000 quarterly to be expended in the purchase of government securities, and providing that the interest on securities purchased should also be so expended, all under the direction of a board of commissioners of high rank, the accumulation to continue until such time as the commissioners should hold securities yielding a clear income of four millions, beyond which point, distant by calculation about twenty-eight years, the interest on further purchases should be stopped, and its amount made available for the relief of taxpayers. This sinking fund of one million per annum, it is to be observed, was by the terms of the act applicable to "the present public debt," of which the estimated capital was a little over £238,000,000. After all, however, Mr. Pitt looked to excess of income over expenditure as the means of payment; and the dazzling results of compound interest, often drawn from Dr. Price's popular calculations,² were only significant of the rate at which a given surplus might be made to act, and not indicative of any new power of extinguishment. Forced in 1792 to meet the possibility of extraordinary expenditures which might require fresh loans, Mr. Pitt carried through an additional act,³ providing that every future loan should

¹ 26 George III., c. 31.

² Dr. Price's "Appeal to the Public on the Subject of the National Debt" was published in 1772, and had been followed by other pamphlets on the same subject before 1786, when Mr. Pitt accepted his authority. Dr. Price was favorably known in the United States; for in 1778 Congress invited him to come to this country and take charge of the finances. "Diplomatic Correspondence of the Revolution," iii. 64. And as by the edition of his "Observations on Reversionary Payments" in 1783 he had thrown new light on the subject of life annuities, it is a little singular that Hamilton passes him by in silence, using the old tables of Halley for his calculations on annuities. "American State Papers, Finance," i. 32.

³ 32 George III., c. 55. For a review of Mr. Pitt's legislation on this subject, see Mr. Huskisson's speech of March 25, 1813, Hansard's "Parliamentary Debates," xxv. 287.

be accompanied by fresh taxation sufficient to meet its interest and to provide a sinking fund of one per cent per annum for its capital, so that it might be extinguished in thirty or forty years,¹ according to the rate at which purchases could be made for that purpose. The act of 1792, however, merely carried out the plain intent of the act of 1786, that every funded debt should have the means provided for the steady extinguishment of its principal. The machinery of the acts, the establishment of a board of commissioners to apply the income of the fund for this purpose and to invest the interest earned upon its accumulations, was a device for holding Parliament to the policy which it had undertaken; and the high rank of the commissioners was relied upon as a protection against legislative tampering. Under all the legislation down to 1802² Mr. Pitt's sinking-fund system, stripped of its formalities, was as nearly as possible that which states and corporations not infrequently adopt in our own day. It was not illusory in its financial provisions, nor even in its dependence on the chances of war or peace. It did rest, however, upon a complete illusion as to the possibility of holding Parliament permanently to the system — as to the possibility, that is, of binding the debtor by a compact made with himself.³

This political defect of Mr. Pitt's measure was not disclosed, however, during Hamilton's administration. Especially in the years 1789-1792, the English exchequer was working on a peace

¹ Ricardo says "under the most unfavorable circumstances in forty-five years." "Works," p. 524.

² 42 George III., c. 71.

³ In Ricardo's hard-headed "Essay on the Funding System" he declares that "it will not . . . admit of a doubt that, if Mr. Pitt's sinking fund, as established in 1792, had been always fairly acted upon, — if, for every loan, in addition to the war taxes, the interest and a one per cent sinking fund had been invariably supplied by annual taxes, — we should have made rapid progress in the extinction of debt." "Works," p. 531. But "Mr. Pitt flattered himself most strangely. . . . With the knowledge of Parliament which he had, it is surprising that he should have relied so firmly on the resistance which the House of Commons would offer to any plan of ministers for violating the sinking fund." *Ibid.*, p. 543. In its actual operation under later legislation, Ricardo thought the sinking fund had increased debt rather than diminished it, and so concludes "that no securities can be given by ministers that the sinking fund shall be faithfully devoted to the payment of debt, and without such securities we should be much better without such a fund." *Ibid.*, p. 545.

For Lord Stanhope's attempt to make the sinking fund a part of a fresh contract with the fund-holders, see the debate in the House of Lords, May 22, 1786. "Hansard," xxvi. 17.

footing, and the sinking fund was therefore the last new thing in finance and full of promise, when Hamilton organized his financial system, and adopted, as a fundamental maxim, "that the creation of debt should always be accompanied with the means of extinguishment." The application of this maxim made it essential that with the funding of the debt should be joined some plan for finally sinking the principal. In his "Report on Public Credit," then, Hamilton proposed the establishment of a Board of Commissioners, composed, like Pitt's, of high officers of state,¹ in whom should be vested the control of a fund, to be applied to the purchase or payment of debt, and to continue so vested until the whole of the debt should be discharged; and he also proposed the contraction of a new loan by the commissioners, its proceeds to be applicable chiefly to the payment of matured foreign debt and to the purchase of public securities below par, it being, in his opinion, an important object both to raise the value of the public stock in the market and to secure for the government the profits of such a reinvestment. Waiving the proposition for a new loan and its application, it is clear that Hamilton had in mind the establishment of an organized sinking fund. The embarrassment was in finding the means for feeding it, in the untried resources of the new government. He proposed to devote for this purpose the net produce of the post-office, to an amount not exceeding one million dollars, to be used in purchases, and so to serve as a nucleus for a growing fund. Congress, however, besides a general appropriation of the proceeds of Western lands for sinking the existing debts of the United States,² preferred to use for this purpose the surplus of revenue which might remain at the end of the year 1790, owing its existence to the funding of interest on the domestic debt of the United States to that date.³ This appropriation was not perfected by any

¹ Pitt's commissioners, under the act of 1786, were the Speaker of the House of Commons, the Chancellor of the Exchequer, the Master of the Rolls, the Accountant-General of the Court of Chancery, the Governor and the Deputy Governor of the Bank of England. Hamilton proposed as commissioners the President of the Senate, the Speaker of the House of Representatives, the Chief Justice, the Secretary of the Treasury, and the Attorney-General. Congress, by the act of August 12, 1790, § 2, added the Secretary of State, and struck out the Speaker of the House. "Statutes at Large," i. 186.

² Act of August 4, 1790, § 22, "Statutes at Large," i. 144.

³ This surplus is reported, February 1, 1793, to have amounted to \$1,374,656. "State Papers, Finance," i. 219.

provision for the investment of the interest accruing on stock purchased by the commissioners, so that the act of 1790 for the reduction of the public debt went no farther than the mere establishment of a commission, not provided with any permanent resource whatever.¹ Hence the necessity for the recommendations made by Hamilton in his report of January 23, 1792, when, evidently in pursuance of his original conception, he advised that the interest on so much debt as might at any time have been purchased or paid by the commissioners should itself be appropriated for further payments or purchases. "It will deserve the consideration of the legislature," he added, "whether this fund ought not to be so vested as to acquire the nature and quality of a *proprietary* trust, incapable of being diverted without a violation of the principles and sanctions of property."² The act which carried out this recommendation as to the investment of interest accruing on previous purchases,³ although it does not use the term "sinking fund," in fact created such a fund for the then existing debt of the United States, on precisely the model of Pitt's sinking fund of 1786;⁴ and it must be added that, although the act of 1795 and Gallatin's act of 1802 differed from this model in form, they both in fact depended for their efficacy upon the same essential principle,—the compounding of interest by the investment of interest accruing on purchases already made.

We have seen that Pitt in 1786 relied imprudently on the good resolutions of future Parliaments. Hamilton, by the peculiar form which had been given to a large part of the debt of the United States, was enabled to secure a much more solid safeguard for the uninterrupted working of his sinking fund. The six per cent debt of the United States had been made reimbursable by payments not exceeding eight dollars upon a hundred in any one year for both principal and interest. The act of 1792 had contemplated the redemption of this stock when the whole annual income of the sinking fund should have reached two per cent of the whole amount of the stock outstanding, and had declared the interest

¹ See act of August 12, 1790, "Statutes at Large," i. 186.

² "State Papers, Finance," i. 148.

³ Act of May 8, 1792, §§ 6, 7, "Statutes at Large," i. 282.

⁴ The term "sinking fund" does not appear in the legislation until the act of March 3, 1795. The commissioners, however, in their journal, appear to have called themselves "Commissioners of the Sinking Fund of the United States" as early as August, 1791. "State Papers, Finance," i. 235.

accruing on stock held in the sinking fund to be "appropriated and pledged firmly and inviolably" for this purpose. But, in his elaborate report of January, 1795,¹ Hamilton, dealing with larger revenues and brighter prospects, recommended an addition to the income of the sinking fund of so much of the proceeds of duties on imports and tonnage and of excise as would suffice to begin at once the redemption of the six per cents bearing a present interest; and so much of the same revenues as, with the dividends accruing to the government from the United States Bank, would complete the payment for the bank stock and enable the redemption of the deferred six per cents to begin in 1802. These recommendations, with others strengthening the organization of the sinking fund, were adopted by Congress. The appropriation of the revenues and resources in question was made permanent "until the whole of the present debt of the United States" should be reimbursed; "and the faith of the United States is hereby pledged that the income or funds aforesaid shall inviolably remain, and be appropriated and vested as aforesaid, to be applied to the said reimbursement and redemption in manner aforesaid until the same shall be fully and completely effected."² Under these provisions, the redemption of the six per cent stock began from January 1, 1795, by a series of payments fixed at eight per cent per annum for principal and interest; and the stock was thus converted from an ordinary six per cent of indefinite duration "into an annuity of eight per cent per annum for a period of somewhat less than twenty-four years." Hamilton, in proposing this devotion of revenue to the redemption of debt, had intended to make the arrangement a contract with creditors, not to be violated. "The intent is to secure, by all the sanctions of which the subject is susceptible, an inviolable application of the fund, according to its destination. No expedients more powerful can be devised for this purpose than to clothe it with the character of *private property* and to engage absolutely the faith of the government by making the application of it to the object a *part of the contract with the creditors.*"³ Wolcott, Hamilton's successor, in his communication

¹ "State Papers, Finance," i. 320.

² Act of March 3, 1795, § 9, "Statutes at Large," i. 435.

³ "State Papers, Finance," i. 332. A little farther on is a plain allusion to the diversion of the English sinking fund from its purpose prior to the act of 1786.

to the House, January 26, 1796,¹ observed that, "as the injunctions of the law upon the commissioners of the sinking fund are unconditional, and as permanent funds have been vested and appropriated, it is conceived that a successive reimbursement annually of the debt before mentioned has become an irrevocable stipulation with the creditors." Gallatin also recognized a pledge of the public faith in this action; and the change made in the sinking fund legislation by his advice in 1802² carefully saved all rights of creditors under previous acts, and he and his successors therefore continued, in war as well as in peace, the reimbursement undertaken in 1795.³

The idea, then, which Hamilton had in common with Pitt, and of which Pitt's action was the practical illustration, was to couple with every debt the means for its extinguishment,⁴ to be applied to that purpose, whatever the condition of the Treasury otherwise. This could not prevent debt from accumulating, if expenditure was excessive; but it insured the good credit of the loans to which the plan was applied, and the system, if adhered to, tended to keep constantly before the legislature the necessity of having a stated revenue above ordinary expenses. The application of this idea to an existing debt Hamilton was able to provide for more effectively than Pitt, owing to the peculiar form given to the obligations of the United States; but in neither case did it prove to be possible to guarantee sufficient provision for such fresh expenditure or debt as the legislative will might insist upon. Less than justice has usually been done to the common sense of both of these great statesmen. There is nothing to show that either of them in adopting his system had any delusion as to the impossibility of paying debt without money, or any notion that compound interest could

¹ "State Papers, Finance," i. p. 381.

² Act of April 29, 1802, "Statutes at Large," ii. 167. See especially §§ 3, 7.

³ For the rate at which stated payments of eight per cent per annum extinguished the capital as well as defrayed the interest, see the table given by Wolcott, "State Papers, Finance," i. 405; compare also the act of April 28, 1796, § 1. Inspection of the table shows the application of the compound interest. Obviously, Gallatin's system of devoting a fixed sum for interest and redemption of principal together, thus increasing the payment of principal as the sum required for interest diminished, was an application of the same method to the whole debt instead of to a particular part thereof.

⁴ Hamilton's "Report on Public Credit" of 1795 gives in a foot-note a significant reference to this provision of the English act of 1792. See "State Papers, Finance," i. 331.

be made to supply the place of an adequate revenue or even to conceal its absence. Pitt, at the time when Hamilton took him as his example, had a surplus; and Hamilton hoped for one, and upon good grounds. Apply this surplus effectively to present debt, and then contract no more without at the same time making provision from new sources for its interest and ultimate payment, — this was the system on which both proceeded. In the one case the system was swamped by the gigantic wars of the French Revolution; in the other it was made useless by the astonishing growth of national revenue; but in neither case, under the conditions and for the purposes of the time, was it the pure folly which it is often represented to have been.

The third point in Hamilton's financial system which we have to consider here is the establishment of a Bank of the United States. This measure was referred to by Hamilton in his "Report on Public Credit" as a part of his scheme not then fully matured, and was presented in form in December, 1790, under a resolution of the House adopted in the previous August, calling upon the Secretary to report "such further provisions as may, in his opinion, be necessary for establishing the public credit." In stating the advantages to be gained from a bank he dwelt especially on the influence of a bank in quickening and virtually increasing the productive capital of the country and its utility as a financial agency of the government. It was then not far from eleven years since the probable date of his draft of a letter to Morris¹ urging the establishment of a Bank of the United States by the Confederation, and not far from ten years since his letters to Duane, Sears, and again to Morris, discussing and enforcing a similar proposition. The claim of priority in the conception of a national bank, which has been rested on these letters, is hardly a valuable one. The letters were written at the moment when the continental paper had

¹ The draft of a letter to Morris, Hamilton's "Works" (Lodge's edition), iii. 61, is inserted in the earlier edition of the "Works," i. 116, as if written between December, 1779, and March 17, 1780. A few important blanks are left in it to be filled later, and the manuscript is said to be otherwise defective. It seems not to have been referred to in subsequent correspondence between Hamilton and Morris, and may then perhaps be the draft of an intended letter, never sent, but interesting as showing the state of Hamilton's opinions on the subject when he was twenty-three years old. If sent, the letter was intended to be anonymous, as appears from its last paragraph.

become practically worthless, and Congress was at its wits' end. The schemes proposed by Hamilton were perhaps no wilder than were offered by others, but he would have been slow in 1790 to recognize their affinity with the maturely deliberated proposition of that year. It is enough to say that the second and more carefully elaborated of the letters to Morris¹ proposes a bank, the stock of which, to the extent of at least one-third, might be paid for in landed security, the notes of 20s. and upward to bear interest, and the places of redemption to be in the interior, making "applications for payment of bank-notes less convenient."² Among the advantages of the scheme, besides the loans to be made to Congress, was the familiar attraction of all land-bank schemes, that proprietors could have the use of their land and also the use of a cash representative of its value.³

The earlier schemes, however, mark the length of time for which Hamilton's mind had been busied with the idea of securing financial relief from a great banking institution of some sort;⁴ and his letters show his interest in the working of the great European banks. Of these there was but one which could be an available model. The French Caisse d'Escompte was embarrassed by its close connection with the government, hardly tried to conceal the real inconvertibility of its paper, and was fast approaching ruin. The Bank of Amsterdam, still in good credit, was organized upon a plan adapted only for an opulent community, rich in specie, and indifferent to the use of bank credit in its usual forms. There remained the Bank of England, a successful institution, strengthening private enterprise, aiding the government,⁵ and regulating currency upon a sound basis. Without presenting this formally as

¹ April 30, 1781, Hamilton's "Works" (Lodge's edition), iii. 82.

² *Ibid.*, p. 118.

³ *Ibid.*, p. 107.

⁴ The constitution of the Bank of New York, adopted March 15, 1784, given by Domett, "History of the Bank of New York," p. 11, was written by Hamilton, but contains little except the formal provisions necessary for determining the duties and responsibilities of officers, rights of stockholders, and other details incident to the organization of a moneyed institution. The act of incorporation (*Ibid.*, p. 122), passed March 21, 1791, contains, however, a series of provisions relating to the banking powers of the corporation, which follow closely even the phraseology of the act passed by Congress a month before, establishing the Bank of the United States.

⁵ In 1781, Hamilton, writing to Morris, and referring to the Bank of England, says, "Tis by this alone she [England] now menaces our independence." "Works" (Lodge's edition), iii. 101.

an example,¹ he shaped his own proposition according to the lines of the Bank of England, with the changes which the circumstances of the United States required.

The primary question as to the connection of the government with the proposed bank is argued and settled by Hamilton in his report in accordance with the English precedent and directly against the other European cases. He concludes in favor of an institution in private hands and under private direction, and to be influenced as little as possible by public necessity. "The keen, steady, and, as it were, magnetic sense of their own interest as proprietors, in the direction of a bank, pointing invariably to its true pole, the prosperity of the institution, is the only security that can always be relied upon for a careful and prudent administration." No profit to be gained by the state from banking could in his mind be set against this advantage. The state might be an owner of stock, though not of a principal part of it, and ought to exercise a supervision for the good of the community; but he admitted no real departure from the theory of the Bank of England as an essentially private establishment employed as a public agent. This independence of the executive he secured by forbidding loans of serious amount for the use of the government, unless specially authorized by law, as was done by the Bank of England charter until the passage of Mr. Pitt's act in 1793.² As for the holding of public securities as an investment of the capital of the bank, Hamilton was establishing his bank in the presence of a debt already contracted, instead of using it as a means of borrowing, as the Bank of England had been used. It was enough for his purpose, then, to allow three-fourths of the stock to be paid for by transfer of public securities, these to be held until the needs of the bank might require their sale.

It has been remarked already that for Hamilton's purposes a bank was needed of a different kind from the Bank of Amsterdam. A bank of discount, deposit, and issue was required for the transaction of general business, public and private. In the summary

¹ The Bank of England is not mentioned in the "Report on a National Bank," except in a passage near the beginning, where Hamilton says that public banks have successively obtained in Italy, Germany, Holland, England, and France, as well as in the United States. The omission appears to be studied.

² 33 George III., c. 32. See McLeod, "Theory and Practice of Banking," i. 445.

of his plan given in his report, Hamilton makes a brief statement as to the powers of the proposed bank as follows:—

VII. The company may sell or demise its lands and tenements, or may sell the whole or any part of the public debt, whereof its stock shall consist, but shall *trade* in nothing except bills of exchange, gold and silver bullion, or in the sale of goods pledged for money lent, nor shall take more than at the rate of six per centum per annum upon its loans or discounts.

The bill offered in the Senate was drawn by Hamilton and, with few changes, became a law, and we there find this important provision amplified in terms which may fairly be set side by side with a similar provision in the Bank of England Act of 1694.

[*Act of February 25, 1791.*]

The said corporation may sell any part of the public debt whereof its stock shall be composed, but shall not be at liberty to purchase any public debt whatsoever; nor shall directly or indirectly deal or trade in anything, except bills of exchange, gold or silver bullion, or in the sale of goods really and truly pledged for money lent and not redeemed in due time; or of goods which shall be the produce of its lands. Neither shall the said corporation take more than at the rate of six per centum per annum, for or upon its loans or discounts.

[*Act of 5 Will. and Mary, c. 20.*]

§ xxvii. [That the corporation shall not deal in Goods, Wares, or Merchandise.] § xxviii. Provided, That nothing herein contained shall in any ways be construed to hinder the said Corporation from dealing in Bills of Exchange, or in buying or selling Bullion, Gold or Silver, or in selling any Goods, Wares, or Merchandise whatsoever, which shall really and *bona fide* be left or deposited with the said Corporation for Money lent and advanced thereon, and which shall not be redeemed at the Time agreed on, or within three Months after, or from selling such Goods as shall or may be the Produce of Lands purchased by the said Corporation.

Other passages also might be cited to show that the framer of the act incorporating the Bank of the United States had the English acts open before him; but, after all, the important fact is that in both there was the same purpose of establishing a private company with general banking powers, to coöperate with the Treasury. The limits and safeguards thrown around the use of these powers were few in both cases, with differences mainly to be accounted for by differing conditions. In each, the redemption of notes in specie was required; and the amount of the issue was limited in the charter of the Bank of England by forbidding debts in excess of the capital, and in the charter of the Bank of the

United States by forbidding the debts exclusive of deposits to exceed the capital. The prohibition of investment in real estate was inserted by Hamilton,¹ and with good reason, considering the condition of the United States at that date.

Closing here the present examination of Hamilton's system, it must be added, in order to avoid misconception, that it is in the grouping of these measures so as to make a consistent scheme for the accomplishment of a definite purpose that we find Hamilton's best title to rank as a great financial statesman. He had the insight and cheerful resolution which enabled him to see and draw out the still latent strength of the new country, the knowledge of the world necessary for bringing together the best of tried expedients, and the breadth of conception required for shaping a system which should make growth rapid and burdens lighter, by the creation of public and private credit. No statesman could have a greater task set for him, and political science can hardly have in store any greater triumph than this application of the experience of other men and other nations. Details may be criticised, and yet as a whole his measures meet the real test of financial soundness, representing in their great features the best that could be done under the conditions then existing. And in this as in other parts of our political system his impress was lasting. "The results, legislative and administrative," says the biographer of his greatest successor, "were stupendous and can never be repeated. A government is organized once for all, and until that of the United States fairly goes to pieces no man can do more than alter or improve the work accomplished by Hamilton and his party."

¹ Hamilton's letter to Church, March 10, 1784, condemns Chancellor Livingston's scheme of a land bank, and shows that Hamilton had then outgrown the ideas expressed in his letter to Morris in 1781. See Hamilton's "Works" (J. C. Hamilton's edition), i. 414.

THE DIRECT TAX OF 1861¹

THE direct tax laid by the act of Congress of August 5, 1861, was the fifth levy which has been made under the provisions of the Constitution, requiring that "representation and direct taxes shall be apportioned among the several states . . . according to their respective numbers." There would be little risk in predicting that this will also be the last resort to a method of taxation which the framers of the Constitution thought important enough to hold a place in one of the difficult compromises embodied in that instrument. The insufficiency of the method for revenue purposes, the confusion which has arisen as to the meaning and incidence of a direct tax under the Constitution, the extraordinary inequalities which grew out of the circumstances under which the last levy was made, and the really insoluble questions raised as to the effect which refunding the tax would have in mitigating or aggravating those inequalities, make it altogether probable that, in any future stress of fortune, relief for the Treasury will be sought anywhere else rather than in a resort to this discredited source.

The phrase "direct taxation" appears to have been introduced in the Convention of 1787 by Gouverneur Morris, on July 12,² when he made the motion, which was carried, "that direct taxation ought to be proportioned to representation." The Convention, perhaps, had no clear opinion as to the precise meaning of the words here used;³ but it is plain that Morris had in mind some well-marked distinction between direct and indirect taxes. He had proposed at first simply that "taxation shall be in proportion to

¹ *Quarterly Journal of Economics*, July, 1889.

² The use of the same expression in what purports to be the draft of a Constitution offered by Mr. Pinckney, May 29, need not be considered, in view of the plainly garbled text of that document. Elliot, "Debates," v. 130, 578.

³ Thus, on August 20, when the report of the Committee of Detail was under discussion, "Mr. King asked what was the precise meaning of direct taxation. No one answered." "Madison's Debates," in Elliot, v. 451.

representation." To this it was objected that, although just, this plan might be embarrassing and "might drive the legislature to the plan of requisitions"; and Morris thereupon, admitting that objections were possible, "supposed they would be removed by restraining the rule to direct taxation. With regard to indirect taxes on exports and imports and on consumption, the rule would be inapplicable." Wilson also saw no way of carrying Morris's plan into execution, "unless restrained to direct taxation"; and Morris then modified his motion, with the result that the phrase "direct taxes" passed into the Constitution.¹ It is clear that in Morris's understanding, and in Wilson's as well, none but direct taxes could be levied by an apportionment among the states, the others named requiring to be laid by a general rate.

From what source, then, did Morris and Wilson derive this classification, which set down as direct certain taxes having this convenient characteristic of being readily apportioned among the states? The answer to this question is, no doubt, to be found in Hamilton's suggestion that the writings of the French economists of the eighteenth century were the source.² The doctrine that agriculture is the only productive employment, and that the net product from land, to be found in the hands of the landowner, is the only fund from which taxation can draw without impoverishing society, led them habitually to class taxes as direct, when laid immediately upon the landowner, and as indirect, when laid upon somebody else, but in their opinion destined to be borne ultimately by the landowner. This distinction between direct and indirect taxation, resting upon the supposed method of incidence upon a single class of persons, is fully developed and used by Quesnay, Mercier de la Rivière, Dupont de Nemours, and Turgot. It was a necessary result of their reasoning, became familiar in all the discussions of the school in France, and, we can hardly doubt, was carried to the knowledge of readers in political science in other countries, during the short-lived preëminence of the Physiocrats.³

¹ Elliot, v. 302.

² See his brief as counsel for the United States in the Carriage Tax case, *Hylton v. United States*, Hamilton's "Works," vii. 845.

³ Adam Smith did not adopt their use of direct and indirect, because he rejected the reasoning on which it rested; and he does not appear to have formally classified taxes under these heads upon any other principle, although he occasionally uses the terms "direct," "directly," and their opposites, with a near approach to their modern use.

As for the kind of taxes to be classed as direct, there was not complete agreement. Necessarily, taxes upon land or its returns were set down as direct taxes, and so, too, taxes upon commodities, or consumption, were called indirect. Taxes upon persons, however, do not appear to be regarded by Quesnay, Dupont de Nemours, or Mercier de la Rivière as direct. The writer last named, after saying that the fund for taxation is in the hands of the landowner, and that to draw from it otherwise than directly is a subversion of the natural order of society, lays down the principle that "la forme de l'impôt est indirecte lorsqu'il est établi ou sur les personnes-mêmes ou sur les choses commerciables."¹ In Turgot's writings, however, we find taxes upon persons occasionally classed as direct. Thus, in his "Plan d'un Mémoire sur les Impositions,"² he says of the forms of taxation:—

Il n'y en a que trois possibles:—

La directe sur les fonds.

La directe sur les personnes, qui devient un impôt sur l'exploitation.

L'imposition indirecte, ou sur les consommations.

And in the fragment which we have of his "Comparaison de l'Impôt sur le Revenu des Propriétaires et de l'Impôt sur les Consommations,"³ a memoir prepared for the use of Franklin, a careful analysis of the same purport is made, although the point of formal classification is not reached. Of all writers upon economics in 1787,⁴ Turgot was perhaps the one most likely to have the ear of American readers; and, of Americans, Gouverneur Morris and James Wilson were as likely as any to give him their attention. The former had already formed that familiar acquaintance with French literature and politics which made possible his singular career in Paris a few years later, and Wilson had been from 1779 to 1783 accredited as advocate-general of the French nation in the United States. There was, then, an easy and a probable French

¹ "L'Ordre Naturel des Sociétés Politiques," in Daire's "Physiocrates," p. 474. For Quesnay's use of the terms in question, see Daire, i. 83, 127; and for Dupont de Nemours', *ibid.*, ii. 354-358.

² Daire, i. 394; and see also 396.

³ Daire, i. 409.

⁴ Dupont de Nemours published his "Mémoires sur la Vie et les Ouvrages de M. Turgot" (16mo, 2 parts, pp. 156 and 216) in Philadelphia and Paris, in 1782, the year after Turgot's death. See Hildeburn, "Issues of the Press in Pennsylvania."

source for the meaning which they both attached to the phrase introduced by Morris.

It is to be observed, also, that there were some well-known precedents for levying by apportionment such taxes as those which Morris and Wilson probably had in mind. The French *taille réelle*, a tax on the income of real property, was laid by apportioning a fixed sum among the provinces and requiring from each its quota, as has been the practice in levying its substitute, the *impôt foncier*, ever since 1790. The *capitation* was also levied in France, before the Revolution, in the same manner. The English land tax, established under William III., had for ninety years presented an example of apportionment among counties and other subdivisions, leaving the rate for each locality to be settled at the point necessary to give the due quota. Other contemporary examples could easily be cited; but these are enough for the present purpose, being necessarily familiar in this country in 1787, and likely to have a strong influence.¹

The meaning of the phrase "direct taxation," as to which Rufus King vainly sought for light, was judicially considered in the well-known Carriage Tax case, *Hylton v. United States*, in 1796. The case had been heard in the circuit court by Wilson, who was then one of the associate justices of the Supreme Court; and, when his judgment in the lower court was affirmed by the full bench, he contented himself with a bare statement of assent, so that we lose what would have been the most interesting and perhaps the most important opinion of all. The judgment of the court, declaring that a tax upon carriages is not a direct tax within the meaning of the Constitution, was supported by considerations which showed a strong disposition to limit the definition of direct taxes so as to include only capitation and land taxes. Mr. Justice Paterson, indeed, suggested personal property by general valuation as a possible additional subject of direct taxation, the practicability of apportionment having already been accepted as a test of the proper meaning of the term; but he thought the question difficult, and

¹ For the *taille* and *capitation*, see Pizard, "La France en 1789," p. 257; De Parieu, "Traité de l'Impôt," i. 224, 153. The act of 1763, apportioning the English land tax, is given in full in Ruffhead's "Statutes at Large," ix. 78. The text of the acts of William III. is found in the Rolls edition of the statutes. See also Dowell, "History of Taxation and Taxes in England," iii. 94-97.

added that he never entertained a doubt that the principal — he would not say the only — objects contemplated by the framers of the Constitution were a capitation tax and a tax on land. Wolcott in his report upon “Direct Taxes,” in December,¹ 1796, took no notice of the decision by the Supreme Court a few months before, but, for reasons of expediency, concluded that the objects of direct taxation should be limited to lands, houses, and slaves; and they accordingly were thus limited by Congress in the acts of 1798, under which the first direct tax was levied. When the question came before the Supreme Court again in the case of *Veazie Bank v. Fenno*,² Chief Justice Chase referred, with some doubt, to Paterson’s suggestion as to a tax on personal property by general valuation, but remarked that, in the practical construction of the Constitution by Congress, direct taxes had been limited to land and capitation taxes, and that this construction was entitled to great consideration in the absence of anything adverse to it in the discussions of the federal convention or of the state conventions which ratified the Constitution. Finally, when the whole subject was reviewed in the case of *Springer v. United States*,³ Mr. Justice Swayne, giving the opinion of the court, declared it to be their conclusion “that direct taxes, within the meaning of the Constitution, are only capitation taxes, as expressed in that instrument, and taxes on real estate.” The judicial interpretation of the phrase, “direct taxes,” is well settled therefore,⁴ and in close accordance with the usage found in the writings of the French economists of the last century.

The acts of 1798⁵ established the general plan on which all succeeding direct taxes have been levied. These acts apportioned the total sum of two millions of dollars among the states, divided them all into convenient divisions, placed every division under a commissioner, and provided the requisite array of principal and

¹ “State Papers on Finance,” i. 414.

² 8 Wallace, 533.

³ 102 United States, 586. This was a case arising under the act of 1864 laying an income tax, the plaintiff in error maintaining that this, as a direct tax, should have been apportioned among the states, under the provisions of the Constitution.

⁴ The unexpected extension of the meaning of “direct taxes” by the Supreme Court in the “income tax” decisions of 1895 is touched upon, p. 133, below.

⁵ The act of July 9, 1798, 1 “Statutes at Large,” p. 580, provided for valuation of taxable objects; and that of July 14, *ibid.*, p. 597, provided for the apportionment and collection.

assistant assessors, collectors, supervisors, and inspectors. The quota of every state was to be assessed upon houses, lands, dwelling-houses, and slaves. Houses were to be assessed according to a classified valuation at rates fixed for the whole Union, and slaves were to be assessed fifty cents per head, if between twelve and fifty years of age; and so much of the quota of any state as was not covered by the levy upon houses and slaves was to be assessed upon lands and improvements at such rates as might be required to make up the deficiency.¹ The tax was to be a lien upon the real estate and slaves of the person assessed for two years from the date when it became payable, and collection could be enforced by distraint and sale of personal effects. Wolcott had suggested, but had also disapproved, a plan for fixing a time at which a state might pay its quota into the Treasury and for prescribing collection by the authority of the United States "in cases of delinquency."² But no trace of any such plan is to be found in the acts of 1798. Beyond the bare apportionment the states are not recognized except as mere geographical divisions. The acts provide solely for levy by the federal government upon its citizens, the individual taxpayer is the only party responsible, and no authority stands or can interpose between him and his government.

The framers of the direct tax acts of 1813³ followed in general the lines laid down in 1798. Comparison of the acts will show revision and rearrangement, and perhaps simplification of the system, but no serious change of theory. The tax of three millions is apportioned to the counties in every state, and it is provided that the state legislature may by act vary the county quotas, provided such alterations are duly certified to the Secretary of the Treasury;

¹ This residual assessment upon lands closely resembles the method adopted in assessing the group of taxes of which the English land tax is the survival. See 10 William III., c. 9 (Rolls ed.); and Act of 1763, 4 George III., c. 2, §§ 3, 4 (Ruffhead).

² This plan, he says, "partakes of the system of requisitions upon the states, which utterly failed under the late confederation, and to remedy which was one great object of establishing the present government." "State Papers on Finance," i. 436.

³ The act of July 22, 1813, 3 "Statutes at Large," p. 22, provides for the assessment and collection, and that of August 2, *ibid.*, p. 53, for the apportionment. Gallatin sailed for Europe in May, 1813, but it seems probable that the direct tax bills of that year were among the bills spoken of in his letter of June 10, 1812, as already prepared in answer to a request from the Committee of Ways and Means. "State Papers on Finance," ii. 614. It is interesting to observe that, in January, 1812, Gallatin appears to have lost his hold on the strict definition of direct taxes under the Constitution. *Ibid.*, p. 525.

but the levy according to such alterations is made by virtue of the act of Congress, and not under the act of the state legislature.¹ The tax is to be levied on the value of lands, houses, and slaves, "at the rate each of them is worth in money," abandoning the peculiar method of a residual assessment upon land, adopted in 1798; and the provisions as to enforcement by lien and distress remain as before. In short, the theory of the acts of 1813 continues to be that of a levy by the general government upon the individual citizen, in no way different in principle from any case of national internal taxation. With a wise regard to convenience, however, the apportioning act provided that any state "may pay its quota into the Treasury of the United States," and thus secure a deduction of fifteen per cent, by paying before February 10, 1814, or of ten per cent, by paying before May 1; "and no further proceedings shall thereafter be had under this act in such state." The option thus allowed to the states did not, however, change the character of the tax as a tax upon individuals, or make it a tax upon states. Seven states assumed the payment of their quotas;² but the other eleven, in which the collection by federal officers was made as originally provided, were not for that reason in any sense delinquent as states, nor did they thereby fail in any obligation to be found in the acts of Congress or elsewhere.

The act of 1815, which provided for an annual tax of six millions of dollars, is to a considerable extent a literal transcript from the two acts of 1813, with such amendments in detail as experience or the proposed permanency of the tax required, but with no change in theory or in general procedure. And no change was made by the act of 1816,³ which simply repealed the provision for an annual tax, and laid instead a tax of three millions for the current year. In 1815, and also in 1816, four states assumed the payment of their quotas; and the collection was made by the United States in the other fourteen.

When the levy of direct taxation by apportionment was resorted to for the fifth time, in 1861, Congress found most of the work of

¹ § 6 of the act of August 2, 1813, 3 "Statutes at Large," p. 71. For the painful effort of the Committee of Ways and Means to arrive at a county apportionment, see their report, "State Papers on Finance," ii. 628.

² "State Papers on Finance," ii. 860.

³ The act of January 9, 1815, 3 "Statutes at Large," p. 164; the act of March 5, 1816, *ibid.*, p. 255.

legislation done for it in advance. The first revenue measure of the war provided for an annual direct tax of twenty millions,¹ to be laid on the value of lands with their improvements and dwelling-houses, "at the rate each of them is worth in money." In its general scheme and in its details, the act of 1861 was a revised transcript of the acts of 1813 and 1815. The theory enunciated in *Hylton v. United States* was unfamiliar to many members; and the Committee of Ways and Means had to labor in debate with representatives who wished to include personal estate, or incomes, among the objects of taxation. The Committee itself at first treated slaves as taxable property, as was done in the earlier acts. In its careful provision for dealing directly with the individual citizen of the United States and for enforcing a direct lien upon his property, the law of 1861 follows the earlier legislation, section by section. It makes the same provision for an assumption of quotas by the respective states at their pleasure, providing that any state may give notice of its intention "to assume and pay, or to assess, collect, and pay," the direct tax, and upon payment be entitled to a deduction of fifteen per cent in lieu of the costs of assessment and collection. The date for giving this notice was the second Tuesday of February, 1862, and the expectation that the states would use this option was so strong that the act postponed the appointment of assessors and collectors until that day. But the greater completeness of the optional arrangement does not appear to import any change in the real bearing of the act as laying a tax upon individual citizens.

The recommendation of this tax to the attention of Congress by Secretary Chase, in his report of July 4, 1861, did not imply any strong reliance upon it. Mr. Chase advised the raising of "twenty millions, for the current year at least, by direct taxes or from internal duties or excises, or from both." It is probable that both the Secretary in giving this advice and Congress in improving upon it were influenced by the fact that the earlier legislation on direct taxation could be made available quickly,² and

¹ The act of August 5, 1861, 12 "Statutes at Large," p. 294.

² The Chairman of the Committee of Ways and Means, Mr. Thaddeus Stevens, felt no mortification when Mr. Roscoe Conkling stigmatized the bill as "undigested." "It may be so, for it was a direct copy of one drawn by a man who was less wise than our critics are now. It was drawn by Albert Gallatin; and this undigested, ill-considered bill is an exact copy of his." *Cong. Globe*, 1861, p. 307. Mr. Collamer, of Vermont,

that time was needed for the study of any broader system of internal taxes. The direct tax had, in fact, far less to recommend it in 1861 than at the beginning of the century. The inequality of apportionment according to population, serious enough at first, had been increased by the concentration of wealth in the commercial and manufacturing states. Only the smallness of the sum to be raised made a special assessment upon one species of property tolerable, in a country where personal property had multiplied so greatly. And, finally, the slowness of the method, amply shown by four trials, unfitted it for an occasion when promptness of supply was of the last consequence. But all of the action at the special session of 1861 was essentially provisional, and both for the Secretary and for Congress it was a welcome reflection that twelve or fifteen millions could be added to the regular revenue by a tried expedient and by forms already settled.

The organization of the internal revenue system in 1862 appeared to the Senate a fit occasion for repealing the direct tax, but not so to the House. In the committee of conference on the internal revenue bill, the House members insisted that the repeal would release real estate from its due share of burdens, and would leave the whole weight of taxation to be borne by commerce and manufactures; and the difference between the representatives of the two Houses was so great that the bill was nearly shipwrecked in conference.¹ But the House receded in substance, and the Senate in form; and thus the act of July 1, 1862, provided (in § 119) that the direct tax act of 1861 should be held to authorize the levy and collection of only one year's tax, and that no other should be levied under the said act until April 1, 1865. This suspension of levies under the system was made final by the great internal revenue act of June 30, 1864, which (in § 173) provided that no further direct tax should be assessed until Congress should "enact another law requiring such assessment or collection to be made." By this action, proposed by the Senate and accepted without demur by the House, proceedings under the direct tax of 1861 were finally limited to the levy and collection of a tax for that year only.

remarked in the Senate that "the bill is essentially the same, in all its essential features, with the bill by which a direct tax has been laid four times in this government." *Ibid.*, p. 398.

¹ See Mr. Stevens's statements to the House, June 23, *Globe*, 2890, 2891.

The results of the levy for 1861 can be considered more conveniently if we separate the loyal states and territories from those in insurrection. Of the former, all except Delaware and Colorado territory assumed the payment of their quotas. The act of 1861, following the precedents of 1813 and 1815, allowed any state or territory, upon giving due notice, to assume or assess "in its own way or manner" its quota, with a deduction of fifteen per cent, if payment should be made to the Treasury before July 1, 1862, or of ten per cent, if made before October 1, with the provision that such quotas might be satisfied by the release of liquidated and determined claims of equal amount due to any state or territory by the United States. The settlement of the quotas by this process of offset, at a time when every loyal state had its account against the general government for military services, equipments, or advances of some sort, and the slow passage of such accounts through the forms of the Treasury, no doubt makes the collection from the direct tax, as given in the published tables, appear much slower than it was in point of fact.¹ Still, it can probably be said with truth that the government received nothing from the direct tax during the war which it would not have received otherwise. The loyal states which paid their quotas in services and equipments would have raised as many men and have equipped them as promptly if the direct tax had never been laid. Their quotas ultimately gave the government some facility for the adjustment of their accounts, but the military aid on which the quotas were virtually expended was not called out by taxation. In Delaware and Colorado the tax was collected, after some delay, by the internal revenue officers of the United States; and, except some trifling amounts from the territories, the accounts of all the other loyal states and territories for the direct tax were cleared. The amount assessed upon all the states and territories, except the eleven states in insurrection and the territory of Utah, was \$15,027,534. Deducting the allowances made to states which

¹ The annual *Finance Report* states the receipts from direct taxes down to 1870 as follows:—

1862	\$1,795,332	1867	\$4,200,234
1863	1,485,104	1868	1,788,146
1864	475,649	1869	765,686
1865	1,200,573	1870	229,103
1866	1,974,754		

advanced their quotas, the amount collected from the loyal states and territories appears to have been \$12,937,805.¹

There remain the eleven states which were in insurrection when the tax was laid, and the territory of Utah. More than one of the speakers in Congress urged as a recommendation of an apportioned tax that the amount allotted to any state in arms against the government could stand over for ultimate collection, and that communities which refused to contribute to the revenue in any other form might thus be made to yield finally a share of direct taxation. The act of 1861 accordingly provided (§ 52) that, if the execution of the law should be prevented in any state by rebellion, it should be the duty of the President, "so soon as the authority of the United States therein is reëstablished, to collect the sums due from the persons residing or holding property or stocks therein," with interest for delay. Detailed provision was made and special machinery was established for the same purpose in 1862 by the act of June 7, "for the collection of direct taxes in insurrectionary districts within the United States and for other purposes." This act made full provision for the levy of the tax in case of partial occupation of the territory of any state by the forces of the United States. It authorized the levy upon lands in insurrectionary states according to the last state valuation, and charged every parcel accordingly with its proportion of the quota of the state, and with a penalty of fifty per cent in addition, the tax and penalty becoming a lien upon the lands in all states or parts of states declared by the President, by due proclamation, to be in insurrection.² A board of three tax commissioners was to be appointed for every insurrectionary state, to enter upon their duties whenever the commanding general entering any such state "shall have established the military authority of the United States throughout any parish or district or county of the same." Sixty days were allowed for payment by the owner of any parcel of land after the amount of tax due upon it should have been fixed; and

¹ This is the statement for February 18, 1888, given in *Cong. Doc.*, 1887-1888, *House Reports*, No. 552, p. 44, deducting \$8,409 overpaid by Wisconsin. It is to be observed that the figures given cannot be reconciled with precision, the methods of accounting in the Treasury having been inconsistent; *e.g. ibid.*, pp. 9, 15.

² The proclamation of July 1, 1862, declared in insurrection the eleven states, with the exception of thirty-nine counties of Virginia, comprised in the inchoate State of West Virginia.

thereupon all lands upon which the tax was unpaid became forfeited, and the commissioners were required to advertise them for sale to the highest bidder and to strike them off to the United States, unless some person should bid as much as the tax, penalty, costs, and interest for delay of payment. Provision was made for the redemption of property thus sold, if the owner or any person in interest should appear within sixty days and make payment, taking an oath to support the Constitution of the United States. Redemption within one year was allowed to any owner who should be unable to make payment by reason of the insurrection, and should have taken no part therein after the passage of the collection act; and two years for redemption were allowed to absentees, aliens, or persons under legal disability.

Under the act of June 7, 1862, commissioners from time to time made assessments for the direct tax in about one-half of the counties in the eleven states, and made collections in all those states except Alabama.¹ Assessments were enforced by sales of lands for taxes in districts occupied by the federal forces until the order of the Secretary of the Treasury, on May 17, 1865, suspending all such proceedings. The sales were necessarily within narrow areas,² and the amount received from the sale of valuable properties under such circumstances was trifling.³ After the suspension of sales, the collection still went on, but under great difficulties, caused by the unsettled and impoverished condition of the South. Moderate as were the sums called for, the distress of Southern taxpayers made a profound impression. The Joint Committee on Reconstruction, which reported the fourteenth amendment of the Constitution, recommended a measure whereby any Southern state, upon ratifying the amendment, should be empowered to assume the payment of such part of the direct tax

¹ "Report of the Commissioner of Internal Revenue" for 1883, in *Finance Report*, p. 165.

² The sales in Virginia were in the counties of Alexandria, Accomack, and Northampton, — that is, near Washington and on the Eastern Shore; in South Carolina, they were confined to the parishes of St. Helena and St. Luke, in the Sea Islands; in Florida, to St. Augustine and Fernandina; in Tennessee, to Memphis; and in Arkansas, to Little Rock.

³ For an account of the property sold in Virginia, Florida, Arkansas, and Tennessee, with the valuation of each parcel, the tax due thereon, proceeds of sale, and other particulars, see the letter from the acting Secretary of the Treasury, February 26, 1883, in *Senate Exec. Doc.*, No. 85, of 1882-1883.

assessed upon its citizens as should still remain unpaid, with permission for postponing the payment in that case for ten years.¹ The House, on the 9th of July, 1866, on motion of Mr. Boutwell, who remarked that "the operation of collecting what remains uncollected of the direct tax in the rebel states operates more harshly upon our friends than upon our enemies," inserted a section in a tariff bill of that session suspending that operation until January 1, 1868. The tariff bill did not reach final action; but the Senate, on the 24th of July, inserted the same provision at the end of a bill to protect the revenue and in this form it became a law.² The Southern states, it was explained in the Senate, were proposing to assume their respective quotas, with some indulgence to be given by Congress in the way of credit; and it was deemed unwise to distress individuals by the regular process of collection, when the whole matter could be arranged on easier terms. At the next session, by the act of March 26, 1867, the Secretary of the Treasury was authorized to discontinue the employment of officers for the collection of direct taxes in the insurrectionary states, and to turn over the business to the local officers of internal revenue. A joint resolution of July 23, 1868, continued the suspension of proceedings until January 1, 1869; but when that day came, no further measures were taken by Congress or by the Executive, and thus the further collection of the tax was practically abandoned. Attention to the subject was asked for by the Commissioner of Internal Revenue in 1868,³ but the subject had clearly become too much embarrassed to be inviting. It is clear, however, that down to this time the government, in collecting the tax, had dealt with the individual taxpayer precisely as in all other cases of taxation. The privilege of assumption, allowed to the states by the original act, not having been used, had expired by its own terms; and, as no renewal of the offer was made by the United States, the direct tax continued to be an obligation resting upon the individual when assessed, secured perhaps by a lien upon his land, but binding upon no other person or body of persons whatever.

It was, perhaps, owing to the expectation of an arrangement

¹ See *House Reports*, 1865-1866, No. 30, p. v.

² See *Cong. Globe* for 1865-1866, 3692, 4068. The provision is § 14 of the act of July 28, 1866.

³ See *Finance Report* for 1868, p. 482.

for the assumption of unpaid quotas by the Southern states that the First Comptroller of the Treasury, in a statement of accounts between the general government and the several insurrectionary States on May 20, 1868, charged them with their respective quotas as if some legal liability therefor rested upon them. This view of the case, although not uniformly followed by subsequent comptrollers,¹ appears for many years to have fixed the construction of the law for the accounting officers in the Treasury.² The states being charged each with its unpaid balance of direct tax, moneys becoming due to them from the general government upon other accounts, as from the sale of public lands in which they were interested jointly with the government, were not paid over, but were credited to them by way of offset. The extreme point in this official confusion was reached when, in 1883, the First Comptroller decided that the sum of \$35,555, appropriated by act of Congress to refund to the state of Georgia money expended by her for the common defence in 1777, should be paid to the Treasurer of the United States, "to the credit of the state of Georgia on account of direct taxes charged against the state."³ As far as a government can be said to remember or forget, the government of the United States must be said at this juncture to have forgotten what it meant by the direct tax of 1861. The true meaning of the tax was settled, however, by the highest authority, and the whole subject placed in its true light, when the Supreme Court of the United States, in the case of the *United States v. Louisiana*, at the October term, 1887,⁴ decided that the direct tax law in 1861 did not create any liability on the part of a state to pay the tax, and that the apportionment merely designated the amount to be levied upon the property of individuals in the several states without any liabil-

¹ See the important adverse decision by A. G. Porter, First Comptroller, giving the legislation from 1798 and much documentary matter. *Senate Exec. Doc.*, 1879, No. 24.

² See *House Exec. Doc.*, 1885-1886, No. 158, p. 15.

"It must be acknowledged that this construction of the law appears not to conform to the intention of the acts upon this subject; but the decision fixing it as a state debt has such force in the Treasury Department as to preclude any other view of the direct tax than that of a debt due by the state. . . . If the state owes the debt, the landowner does not owe it." *Ibid.*, p. 17.

³ 4 "Decisions of the First Comptroller," *House Miscell. Doc.*, 1883-1884, No. 56, p. 354.

⁴ 123 United States, 37. The opinion of the court was given by Field, J., no one dissenting.

ity attaching to the state in its political and corporate character. This decision finally leaves the unpaid quotas of the direct tax in precisely the same position as any other tax assessed upon individuals, which the United States government has been unable, or has neglected, to collect in full. It is difficult, for example, to distinguish it in any essential particular from the case of unpaid income taxes laid during the war and collected by severe process throughout the loyal states, but neither then nor at any other time collected in the insurrectionary states.

This decision plainly makes it necessary, in determining the amount still unpaid on the quotas of the Southern states, to disregard all the accounts with tax commissioners and with states, and to set down simply the amount of taxes reported as uncollected. These are the amounts due from individuals; and, as no individual owes any more than the due assessment upon his property, by reason of any other person's default, so no individual owes any less than that assessment, because of money stopped on its way to the state Treasury, or otherwise coming to the United States from any of his fellow-citizens. The amounts reported as remaining uncollected,¹ in the eleven insurrectionary states and in Utah, are given in the following table:—

	QUOTAS	UNCOLLECTED		QUOTAS	UNCOLLECTED
Alabama . . .	\$529,313	\$529,313	N. Carolina, . .	\$576,195	\$198,742
Arkansas . . .	261,886	107,185	S. Carolina, . .	363,571	141,174
Florida . . .	77,523	72,762	Tennessee, . .	669,498	277,506
Georgia . . .	586,367	501,940	Texas, . . .	355,107	174,265
Louisiana . . .	385,887	71,386	Virginia, . . .	729,071	286,663
Mississippi . .	413,085	343,500	Utah, . . .	26,982	26,982
				<u>\$4,972,485</u>	<u>\$2,731,418</u>

The process of collection in the insurrectionary states during the war by assessment and sale of property in limited districts, under the act of June 7, 1862, caused great hardship to dispos-

¹ These sums are taken from the accounts stated by a commission, appointed by Secretary Manning in 1885, to investigate and adjust all the direct tax accounts. *House Exec. Doc.*, 1885-1886, No. 158. See particularly pp. 24-31 and 7-12. The sums found by this commission to be still due differ from the amounts stated by Secretary Folger in 1884 and from the statement made by the Commissioner of Internal Revenue in 1885, and the Secretary and the Commissioner also differed from each other. *Ibid.*, pp. 14, 15. The report of the commission appears to have been adopted in the Register's office. See *House Reports*, 1887-1888, No. 552, p. 44.

sessed owners; but this was buried and lost sight of in the vast destruction of property and the widespread ruin which marked the track of contending armies. In South Carolina, especially, this process led to complications which must be noticed briefly as an important element in the general confusion caused by the tax. The act of 1862, as has been said, authorized the tax commissioners, where property was sold in the insurrectionary districts for the tax, to strike it off for the United States, if no other bidder offered more than the tax and penalty with interest. Under an act of February 6, 1863, the commissioners were authorized to bid on behalf of the United States as high as two-thirds of the assessed value of the property. Lands struck off to the United States the commissioners were empowered to lease until the reestablishment of civil government, or, under the direction of the President, to sell in limited parcels to loyal citizens or to persons who had served in the army or navy, only one-fourth of the purchase money being required in cash from army or navy purchasers; and the proceeds of leases and sales were to be paid into the Treasury of the United States, one-half thereof to be paid over ultimately to the reestablished state governments for specified purposes.

The special application of these provisions to the case of South Carolina was affected by the peculiar circumstances under which the forces of the United States held the abandoned Sea Islands with their valuable cotton lands, and by the great numbers of colored people collected there. The lands sold for taxes were there held and managed from the first with necessary reference to the employment and well-being of the black population. To this end, instructions were issued by President Lincoln, September 16, 1863, which, besides regulating the sale of land to persons of the army and navy, required certain plantations to be sold in five-acre lots, set apart others to be leased and the rents to be used for school purposes, and a further large number to be divided into twenty-acre lots, to be sold "to the heads of families of the African race."¹ Under these arrangements, some lands, bought in at the tax sales for the United States, remained for several years in the possession of the government; others were resold at a large

¹ These instructions, with a variety of other documents, are annexed to the report of A. G. Porter, First Comptroller, in *Senate Exec. Doc.* of 1879, No. 24, p. 223.

advance; others still, having been sold and partly paid for, reverted to the government, and were resold or remained in its possession. The transactions became involved, litigation sprung up, and it became plainly impossible for the government to manage its complicated interests in the Sea Islands with advantage. Congress, therefore, by a general act, dated June 8, 1872, with judicious liberality provided that any lands owned or held by the United States, under the collection act of June 7, 1862, and the subsequent proceedings, and not used for public purposes, might be redeemed by the original parties in interest or their representatives at any time within two years, upon payment of the tax and costs, with interest at the rate of ten per cent, saving the rights of all persons who might in the meantime have made valuable improvements. Lands not redeemed at the end of the two years were to be sold by public auction, but by subsequent acts the period for redemption was extended to February, 1877. The school farms spoken of above were not covered by this act, but were similarly provided for by the act of March 3, 1887, which closed a troublesome and exceptional piece of administration.

The result of these operations is that, the quota of South Carolina being \$363,571, of which \$141,174 remains unpaid, the Treasury of the United States appears to have received in cash \$468,864, besides sums amounting to \$134,592 paid to the Freedmen's Bureau and otherwise disbursed on various accounts, of which a part should no doubt be added to the sums accumulated in the Treasury as the result of the tax sales. That the former owners of the lands have no claim to this fund as against the government goes almost without saying. At the same time, it is clear that, whatever else the government may do as to the direct tax, this is not money to be retained by a great and generous nation.¹

It has been seen that the decision of the Supreme Court in the Louisiana case finally brought the direct tax of 1861 back to its proper position as a tax laid by the United States upon its individual citizens and imperfectly collected by reason of the Civil War. The default in its collection being a default of less than one-seventh of the total amount called for, it is probable that this tax has been more completely collected than most of those laid during the war.

¹ See the remarks of Mr. Sherman, p. 114, below, note.

For example, it has probably been collected more thoroughly than the income tax, the foundation of which was laid by the same act which established the direct tax; and it is not likely that anything but an overflowing treasury would have enabled Congress to see in the one case more than in the other an occasion for remedial legislation. Under any other conditions it is likely that the uncollected \$2,730,000 of direct tax would by common consent have been treated as an insignificant detail in a great mass of incurable irregularities left behind by four years of civil war. The question as to the possibility and expediency of clearing up this special case of fiscal confusion having been raised, however, it must be admitted that the solution of it is not simple, and that the division of opinion created is not unnatural.

Three modes of dealing with the subject have been suggested. First is that proposed by the Commissioner of Internal Revenue in 1883,¹ "that measures be taken, as soon as possible, to collect the balance of the tax," on the ground that "exacting a direct tax from one landowner and permitting the tax upon the land adjoining to remain unpaid is not equitable." The reason is undeniable; but, after all, could equity be secured now by resuming the collection of a tax, all proceedings under which have been suspended for twenty years? The condition of landed property has altered, in one place for the better and in another for the worse, throughout the states concerned; the rights in such property have changed hands, and all the relations once existing between the individual members of any body of taxpayers and forming the basis of possible equity in 1861 have vanished. A large part of the individuals themselves have disappeared. To levy upon the lands on which the tax is unpaid would be, in a great proportion of cases, to collect a tax from subsequent purchasers under a claim which they were justified in believing that the government had abandoned long ago. It has been declared with great positiveness that the government has lost its hold upon the land, but this point need not be considered. If the government still retains the right of assessment on the lands of delinquents, the exercise of that right upon the lands as now owned and used would be universally recognized as too difficult and too certainly unjust, as between members of the same community, to be an admissible

¹ *Finance Report*, 1883, p. 167.

expedient. The cure of the difficulty by the first method appears, then, to be out of the question.

The second mode of dealing with the case, the opposite of that just considered, is to return such taxes as have been paid under the legislation of 1861, and to remit all that are unpaid. In other words, equity being unattainable by completing the levy, secure it by undoing what has been done. It is not within the proposed scope of this paper to discuss the constitutional question as to the right of Congress to lay taxes, let us say in 1890, in order to refund taxes which were properly levied and collected according to law in 1862-1866. We are here concerned solely with the proposition to remedy the inequality resulting from the failure to collect from all of the taxpayers in 1862 and the years following. Undeniably, if there were no question except one of bookkeeping between the states of the Union, as the Treasury has sometimes seemed to suppose, the process of crediting every state with an amount equal to its quota would finally close the accounts and produce equality in that sense. But the only question really open, under the circumstances, is that of producing equality among the taxpayers; and this object it appears to be impossible to secure by any process of refunding. If, of two men, one paid his tax twenty-five years ago and the other has never paid it, it is impossible to restore equality by simply returning to the former that which has been detained from him for a quarter of a century. And if a third, when assessed, suffered the collection of the tax by a forced sale of his land for a fraction of its value, he is not placed on the same footing with either of the others, by returning to him or his heirs the amount of the tax or even the proceeds of the tax sale. In short, when the tax-collector has done a part of his work by compulsory process and time has elapsed, an equitable adjustment between individuals becomes impossible. Refunding the tax may satisfy the mere formal accountant, but it does not undo the past or its consequences; and, so far as the object sought is the equalizing of burdens, such a measure is nearly nugatory.

It is, at any rate, so nearly nugatory that there may be a grave question whether, in the attempt to cure one set of inequalities by a distribution of money, a greater set does not spring out of the process of raising the money. It was contended in debate in Congress that the taxes collected in 1890, after the growth of the

states has changed their relative places in population and wealth, would not rest upon them in the proportion in which the contributions of 1862-1866 must be returned. Kansas, it was said by one gentleman, will pay toward the refunding operation not less than \$340,000, but will receive less than \$72,000; New Hampshire, it was said in the Senate, will receive but \$185,000, and will contribute at least \$300,000. The incidence of our taxation is too uncertain to make these calculations important; and, in most cases of expenditure for public objects, such considerations as to the exact balance of benefits and burdens are properly disregarded. But the present is a case in which the attempt to restore such a balance with respect to a particular transaction is the main proposition; and it therefore becomes not only justifiable, but necessary, to inquire whether the proposed equality would be real or only apparent. The answer to this question is found in the census tables, where the redistribution of taxpaying power in the last quarter of a century is too manifest to require recital.

The third method of dealing with the subject would be, if we can neither complete the collection nor return the tax without producing fresh mischief, to leave the matter where it is. No doubt this course, as well as the others, is open to objection. It is a peculiarity of the case that the United States can neither act nor refrain from acting in it without running counter to some instinct of justice. But there would be less disturbance of existing interests, and time would heal all difficulties more quickly, it is probable, if it were frankly recognized that, in such matters, the errors or misfortunes of the past are finally beyond all remedy. The funds which have been collected from the proceeds of lands leased or resold, or from the surplus of tax sales, might be returned to the parties representing the original ownership, and the account of the direct tax could then be wound up, as that of the other taxes of the war has been, without further inquiry as to the degree in which different bodies of citizens contributed to them.

It is the second of these methods, however, which has secured the approval of Congress. The bill which was passed last winter, vetoed by the President and passed over the veto by the Senate in the closing hours of the session, was the fruit of an agitation which has been in progress in different forms for ten years, and has developed a strong appetite among the state governments for

the refunding of their quotas. The bill required the Secretary of the Treasury to credit every state and territory and the District of Columbia with a sum equal to all collections made from it or its citizens, by set-off or otherwise, and to remit all sums remaining unpaid; and appropriated the money necessary to pay all sums thus becoming due from the Treasury; it being provided, however, that sums which have been collected in any state from citizens, directly or by sale of property, should be held in trust by the state government for the benefit of the persons from whom collection was made, or their representatives. It was also provided that the owners of lands sold in the parishes of Saint Helena and Saint Luke's in South Carolina should be paid the value of their lands, — to the owners of lots in the town of Beaufort one-half of the value assessed by the direct tax commissioners, to the owners of cultivated lands five dollars per acre, and to the owners of other lands one dollar per acre, with the proper exceptions as to lands heretofore redeemed. The purchase money received on account of uncompleted sales to persons in the army and navy was to be returned to the persons paying it. For all these purposes \$500,000 was to be appropriated, including in this sum moneys in the Treasury derived in any way from the enforcement of the tax.¹ And, finally, moneys received from the sale of lands bid in for the United States at tax sales in any state, in excess of the taxes assessed, were to be paid to the owners of the land bid in and resold, or to their representatives.

This bill was not reached by the House of Representatives after the veto, and therefore failed to become a law. There can be little doubt that it will be passed by the present Congress.² It is sufficiently clear from its terms that the combination of local interests in its support is powerful, and it has every political

¹ As passed by the House, the bill proposed to pay the dispossessed owners according to the valuation of 1860, and appropriated \$850,000 for the purpose. The rate and amount were cut down in conference to meet the views of the Senate. On the adoption of the report of the conference committee, Mr. Sherman made this explanation: "Upon the first sale for direct taxes, the land was bid in, I think, at some \$13,000, which we credited to the state of South Carolina; and it was subsequently resold by the United States for \$455,000. So, after all, the money we are to pay back to the owners of this land in South Carolina is only about the sum that we received on the resale of the land." *Cong. Record*, 1888-1889, p. 2139.

² [This expectation was exactly realized by the act of March 2, 1891. — EDITOR'S NOTE.]

chance in its favor. The passage of the measure, whenever it comes, will close a singular chapter in the history of taxation,— a chapter the repetition of which, we may be sure, our people will not be easily tempted to risk hereafter. The direct tax provided for by the Constitution has at last been effectually discredited as a source of revenue, and it has also been too prolific of misconception and confusion to have any interest henceforth as a practical measure of finance.

THE NEW INCOME TAX¹

By the tariff act of 1894 the United States government, for the second time in its existence, undertakes the levy of an income tax. The future student of our history will probably have a moment of mental embarrassment when he finds the provision for laying this novel burden upon the taxpayer in "an act to reduce taxation, to furnish revenue for the government, and for other purposes." His difficulty in comprehending the real significance of the measure will not be lessened when he attempts to trace the legislative history of the act. He will not find the explanation in any exigency of the Treasury, where the first-fruits of the tax cannot be received before July, 1895. He will not find it in the avowed policy or the unavowed political needs of either of the great parties, both of which found themselves deeply divided by the proposition for the tax. He will be likely to ascribe the easy acquiescence of a considerable section on each side in Congress to the presence of an ill-defined notion that the people are about to demand some drastic action for depleting the well-to-do classes, and to the habitual dread with which most politicians for a time listen to the demands of any new political movement, like that of the Populists. At any rate, it will be clear that the considerations which weighed with Congress in taking this important step were not fiscal, and that the provisions of the new act were not studied and perfected by its framers from this point of view. The very fact that the limit of exemption is set so high as \$4000 will be a standing demonstration that the measure was shaped to meet some supposed social or reformatory end, possibly with some sectional bearing, but, at any rate, not as the best result of either modern theory or modern practice.

It is a great misfortune that the question of a fresh resort to the income tax should have come up under such untoward circum-

¹ *Quarterly Journal of Economics*, October, 1894.

stances, and that it should have received such a solution as this. The question is of too great importance to be disposed of with so little real study as it received from Congress, and the income tax is too important a resource to be discredited in the public mind by the working of an imperfect and crude system. The subject was one for the best and most careful thought of the legislator, in the light of the important body of practice to be found in other countries as well as our own. So far from the careful examination which it required, the matter has had only a snap judgment, and the probability of any thorough treatment of it by our government is indefinitely removed. In the minds of a large part of our people the income tax will be more thoroughly identified than ever with the system in vogue during the Civil War; and five years hence they will seem to have had a fresh trial and bitter experience of *the* income tax, when, after all, it is only *an* income tax — and that a badly devised one — which they have seen applied for the second time.

The language used above, no doubt, implies a certain acceptance of the general theory of taxing income. There is good reason for the agreement between the theoretical views of so many economists on this subject and the instinctive popular belief, which is so often met. It is, after all, the aggregate income of society which supplies the fund, and determines an upper limit, for public expenditure; and it is the income of each individual member of the society which supplies the fund, and determines the limits, for his contribution to that expenditure. Every tax, says Adam Smith, must be paid from one or other of the sorts of revenue which make up the private revenues of individuals; and his maxim which follows, to the effect that the subjects of a state ought to contribute to its support as nearly as possible in proportion to the revenue which they respectively enjoy, although sometimes treated as a sounding truism, is, at any rate, unavoidable. So far the economist and the simple poll-tax payer may very well agree. The former makes his reservation as to the difficulties, or even impossibility, of just administration, as Mill did when he “feared that the fairness which belongs to the principle of an income tax cannot be made to attach to it in practice, and that this tax, while apparently the most just of all modes of raising a revenue, is, in effect, more unjust than many others which are *prima facie* more objectionable.” To the payer of the

poll-tax, however, it appears that the power of government is equal to every task, and that strict laws and severe penalties will readily accomplish the work of complete and just assessment. Without accepting this Utopian view of the omnipotence of human law, which is certainly no more true in the case of taxation than in any other of the operations of government, we may at least urge that it is sometimes worth while to inquire how close an approximation to administrative perfection can be made. It is the judgment of some important and enlightened countries, as, for example, of England and Prussia, that, without attaining absolute success, they make an approximation near enough to justice to make it worth their while, under every change of administration, to maintain a tax upon incomes as a branch of their regular revenue. The question whether the United States cannot do the same thing appears to be of some interest. If this government can make such an approximation, the direct resort to the actual source of all taxation has much to recommend it in this country.

The most striking defect in the financial system of the United States is the want of some easy adjustment of the receipts of the government. As a result of those circumstances which have made the customs duties our chief reliance, the Treasury may sometimes have a plethora when a prosperous business swells our imports, and sometimes a dearth when the course of trade changes; but in neither case have we any important elastic branch of taxation, which can be relied upon to lower a surplus or fill up a deficit at short notice. Neither customs nor excise duties can be used for this purpose without serious disturbance and friction. England, as is well known, meets the analogous difficulty — caused by fluctuations, not in her receipts, but in her expenditures — by the adjustment of the income tax. Continental writers and statesmen have long pointed with envy to this unfailing resource of the Chancellor of the Exchequer. With a tax for which the administrative machinery is permanent, but the rate is fixed for only one year at a time, it is easy and usual, even after the fiscal year has begun, to meet unexpected changes in affairs by a change in this variable element of revenue, — a change which takes instant effect. This use of the income tax, together with the power given to the government to borrow on short time in anticipation of receipts, is, in large part, the explanation of the singularly close calculation

and the small balances of cash with which the English Exchequer is habitually managed. The circumstances of the United States, and the unavoidable difference in our leading sources of taxation, make it unlikely that this generation or the next will see any similar administrative success here; but a much closer adjustment of revenue to actual needs than we have at present could be attained by the use of a well-arranged and quickly movable tax on incomes, as a part of our ordinary revenue. Thus a proper income tax appears to have uses which make it desirable to have its practicability more carefully studied.

When we pass from the case of ordinary revenue, and consider the sources of supply for emergencies, a well-constituted income tax has a still greater importance. Even writers who would rule it out from the everyday practice of a government, by reason of the manifest difficulty of justly administering it, will accept it as a proper provision for sudden and severe stress. In the presence of a great public exigency the inequalities of any tax cease to weigh with their full weight in comparison with a quick and copious yield of revenue. This was the case in the Civil War, when it was not so much the ignorance and inexperience of Congress as the imperative necessity of obtaining money by the quickest process, that was the real cause of many harsh and unjust provisions in our financial legislation; and the same thing will happen again whenever some heavy strain is felt by the federal Treasury. Unless our system is improved by the addition of some important tax which is capable of sudden expansion, without the inconvenience which attends any change in a tax on commodities, we shall again see the government driven, may indeed see it driven in any year, to lay some bad tax or to borrow, in order to bridge over the gap caused by the slow increase of ordinary taxation. As a provision for such cases of extremity, the tax on incomes, if shaped for the purpose, has no superior and no rival; but it can best be shaped in a time of quiet. Maintained at a low rate in ordinary times, and its methods and machinery thus perfected and made familiar, it might put in the hands of Congress a resource in case of need, such as has been sorely missed in many turns of our affairs.

How the income tax of 1894 fails to meet the necessities either of ordinary or of extraordinary occasions may best be shown after

a brief recapitulation of its leading provisions.¹ For five years, beginning with 1895, a tax of two per cent becomes due on the first day of July in each year on gains, profits, and incomes, in excess of \$4000,² enjoyed in the preceding calendar year by any citizen of the United States or any person resident therein, whether derived from property, rents, interest, dividends, or salaries, or from any profession, trade, or employment. The taxable income is to be subject to the usual deductions for taxes paid and losses incurred, but is to include all personal property acquired by gift or inheritance. As a basis for the assessment, every person of lawful age, having a taxable income of more than \$3500 in his own right or in any fiduciary capacity, is to make "a list or return" "of the amount of his income, gains, and profits," under oath, with heavy penalties in case of refusal, neglect, or false return. All corporations or associations doing business for profit in the United States, not including partnerships, are required to pay a tax of two per cent annually on their net profits for the preceding year; and, upon such payment being made, dividends upon their stocks are not to be included in computing the income of their stockholders. On all salaries and payments for services due from the United States, and in excess of \$4000, the tax of two per cent is to be withheld by the disbursing officer.

The first point which invites attention in the general scheme of the new law is the singular provision for including in the annual gains, profits, and income to be taxed the value of personal property received by gift or inheritance. The difficulty of making a sound distinction between income and growth of capital has always been recognized. Financial writers have dwelt on the importance of maintaining a line somewhere, and of so limiting taxation as not to impede additions to the capital which is to be the source of future income. The income tax of 1864 dealt with the subject with a rough hand, and probably treated as taxable income much that should have been spared; but not even the war tax went to

¹ The sections of the Tariff Act of 1894 providing for the income tax are §§ 27-36.

² The English law, as modified by the legislation of 1894, exempts £160 from all incomes under £400, and £100 from all between £400 and £500. The Prussian law now exempts all income under 900 marks, and, starting from that point with a tax of 6 marks, advances by degrees until for incomes of 100,000 marks and upward the tax is approximately four per cent.

the extent of classifying inherited property as income. It is obvious that, in this capital point of the definition of income, the present tax gives up the idea of preserving any tenable line. The treatment of this precise point by the Prussian income-tax law of 1891 is instructive. After defining taxable income as the annual receipts from invested capital, from real estate, from trade and industry, and from other sources of periodical gain, it goes on, apparently from abundant caution, to draw a line between the income and that which yields the income:¹ —

SECT. 8. Extraordinary receipts from inheritances, gifts, life insurance, from the sale of real property not undertaken as a business or for speculative purposes, and similar gains, are not to be held as taxable income but as an increase of the main capital [*Stammvermögen*], and, like diminutions of the main capital, come into consideration only so far as the yield of this is thereby increased or diminished.

The English income tax, from its peculiar structure, also avoids the confusion which exists in our law. It will be recollected that the English law does not undertake to tax the aggregate or total income of the taxpayer, but only taxes certain specified descriptions of income, — rents, farmers' profits, annuities, interest, and dividends, gains from professions and trades, and salaries of public officers, — and that the taxation of legacies and distributive shares is left, as it should be, to stand as a part of the general system of death duties, and to be dealt with according to the policy governing the whole subject, and is not made an incident in the application of an entirely different branch of taxation. It may be urged that the United States government no longer levies duties upon inheritances and successions, and that both Prussia and England do levy such duties, and that this provision in the new income tax may thus fill a hiatus in our legislation, the presence of which is now sometimes noted with regret. But it is to be remembered that not a few of the states now levy such duties, that more of them are likely to do so, and that in a comprehensive view of the whole field of taxation, therefore, the transmission of property at death did not require this attention from the federal legislator. If it did require such attention, it may be added, then plainly the succession to real property should have been taxed, as well as personal inheritances.

¹ *Das preussische Einkommensteuergesetz vom 24 Juni, 1891* (Krause's 8vo ed.), p. 47.

The purpose of the provision for taxing personal inheritances, however, is probably not so much to fill a gap in our legislation as to strike a blow at large accumulations. The blow is not a heavy one, although the income tax of two per cent is double the rate which was levied during the war upon the transmission in the direct line of property, real or personal. Except as a first step, to be followed in the future by some more serious legislation, this tax will probably have no appreciable effect upon the great fortunes. On the successors to small properties the moral effect, however, may be considerable. The man of relatively small means, who finds his "income" carried above the limit of \$4000 by his inheritance of a small property, and a tax exacted from him for the excess, is certain to feel his grievance keenly; and the number of such men on the list of possible taxpayers is vastly greater than the number of inheritors of large properties. To such men, and to the public generally, the word "income" has a certain definite meaning, not to be confused with capital by any eccentricity of a statute; and the violence done to this understanding, when a so-called "income tax" takes away a share of the source of income, is tolerably sure to leave behind a sense of personal wrong, like that which can still be remembered as among the fruits of the income tax of the Civil War.

Leaving this special case of inheritances, it may be remarked, in passing, that it may be doubted whether the same danger of doing violence to an instinctive sense of the difference between income and capital is not met in any attempt to make an income tax widely inclusive by sweeping phrases. "Gains, profits, or income . . . derived from any kind of property, rents, interest, dividends, or salaries, or from any profession, trade, employment, or vocation, . . . or from any other sources whatever" — is it possible, under such a description of the object of taxation as this, to keep to any such line as that which the Prussian law, cited above, so clearly points out? In this case the legislator of 1894, like his predecessor of 1864, in his overweening anxiety lest some taxable persons should escape, runs to the opposite extreme of throwing his net over a greater number whom the law should properly let alone. But this excess of zeal is not peculiar to income-tax laws or to our national legislation.

Coming now to the method by which the amount of taxable income, however described, is to be ascertained and brought to the knowledge of the assessing officer, we find that the act of 1894 follows the line laid down by the acts passed during the Civil War, by making the personal declaration of the taxpayer the basis on which the collector is to proceed, with the aid of the best information he can obtain. Nothing could be simpler, on paper, than this method. The taxpayer is himself the one person who knows best the amount of his income for the tax year, and knows best the elements from which it may be computed if its amount is doubtful. The law imposes upon him the duty of making the necessary disclosure for confidential use by the public officer; and under a free government it is presumed that the great mass of citizens can be trusted to perform what is, after all, in a sense a self-imposed duty. But what has been the experience of the several states in assessing by the same method the general property taxes, which have been so familiar a part of our local taxation throughout this century, and in some states for a still longer period? We have had painful evidence of the truth of Leroy-Beaulieu's extremely cautious observation that "*nulle société humaine n'est composée en totalité d'hommes d'une inflexible probité.*" In an earlier generation and in a simpler community, where every man's affairs were tolerably well known to his neighbors, and probably differed little in kind from those of his neighbors, and when the opportunities for investment were comparatively few, and chiefly of such kinds as to be well open to observation, the process of self-assessment by declaration in some form to assessing officers may have answered its purpose; although, even in this case, the chief safeguard was probably the notoriety of essential facts rather than the individual sense of duty among our predecessors, strong as that may have been. But with the growth of wealth and the change in social conditions there has been substituted for this primitive state of things, over a large part of our country, an organization of astonishing complexity, in which the affairs of the individual are known to others little beyond the point which he may choose; and his opportunities for the unobserved investment of capital may almost be said to be infinite. State legislation has often attempted to support the flagging conscience of taxpayers by increased stringency, until in some cases the laws prescribing the form of declaration, and seeking to probe

to its depths the knowledge of the declarant, are miracles of ingenuity. And yet there is probably no state in which the attempt to tax personal property, upon a list made out by the taxpayer under the requirements of the law, any longer succeeds. In the emphatic words of a board of commissioners in a state which has been said to bear the palm for the minuteness and scope of its inquisition, so far as the statute is concerned, "fully one-half of the property of a modern state exists in intangible forms: of this all but a mere bagatelle escapes taxation entirely, when the attempt is made to reach it in the form of property."¹ The inability of the law to reach that which is known to the taxpayer alone is everywhere notorious, and shows itself in such absurd results as the apparent decline of personal property in highly prosperous communities. After long and obstinate efforts to enforce it, the taxation of intangible property has failed even in states like Massachusetts, where the machinery for its enforcement has been as carefully perfected as anywhere, and has found constant support in the robust faith of legislators and administrative officers.

The difficulties in the way of assessing an income tax upon declarations made by the taxpayers appear to the writer to be completely analogous to those which defeat the taxation of personal property. The sources of a large part of the current income of individuals are the very classes of intangible property which constantly elude assessment. The dependence for the disclosure of income in general is on the same average degree of honest compliance with law, which has hitherto proved insufficient for the success of state taxation *in pari materia*. What reason is there for expecting any better result under the act of 1894 than has been secured under a multitude of state laws?

It is probable that reliance is placed on the power of the United States government to enforce its will where a single state fails; and, in dealing with some classes of evils, the superiority of the central power and its freedom from the influences which sometimes hamper local authority is undeniable. It is sometimes of unspeakable importance that a power not affected by the passion or ruling interests of a narrow community should come in, with its irresistible strength, to enforce the laws made for the benefit of

¹ *Report of the Tax Commission of Ohio, 1893, p. 42.*

the whole, and to protect the general interests of the nation. But the present case is not analogous to the suppression of a riot which has become too strong for a state government to deal with, or to a case of threatened interruption of the mails or of interstate commerce. This is a case of widely prevailing inability to meet a certain strain upon the conscience, and is not to be met by marching in troops, and is not at all affected by the circumstance that certain public officers receive their orders from Washington, and not from a state capital. The federal power, after all, can act in this matter only by making its rules stringent and its penalties severe. It must proceed, that is to say, in the same direction in which the state governments have been moving; and, if it is expected to advance farther than they, this can be only because it is supposed that its measures will be more severe or more strictly enforced. But what power, federal or other, can by sheer severity carry through successfully a system which demands from the individual conscience more than is required by the general moral sense of the community? Increased severity in such a case must inevitably be met by increased ingenuity, and this all the more certainly if the severity is practised under an authority which is felt to be in any degree external and remote. Not much can be argued in the present case from the measure of success attained in the enforcement of the income tax of the Civil War and for a few years after. The United States government was then supported by a vast current of popular feeling, which for a time was ready to treat any attempt to evade public dues in the hour of calamity as a species of treason; and yet it would still be easy to collect the evidence of the increasing difficulty which was experienced in finding the incomes to be taxed, after the danger had passed and the enthusiasm of the time had begun to cool. With no great tide of sentiment now existing in support of unusual federal taxation,¹ there appears to be no ground for believing that the act of 1894 will be able to secure the full disclosure at which it aims. Doubtless large sums will be collected under it, for the field to be reaped is wide and rich. But it is altogether improbable that the assessment will approach completeness or uniformity, or that the administration of the tax by the United States will escape the

¹ See Dr. J. A. Hill's estimates, *Quarterly Journal of Economics*, July, 1894, pp. 445-448.

progressive demoralization which takes place when conscientious taxpayers find that others are shirking the burden which was intended for all.

No doubt the acknowledgment that the taxpayer's declaration is an unsafe basis for the assessment, even when corrected by the best information at the command of the assessor, would make the framing of an income tax for this country far more difficult. It would be necessary, in all probability, to abandon the fiction on which our law proceeds, — that every person having taxable income pays to the government a fixed proportion of it, to be mathematically ascertained by a uniform rule. In place of this theoretical perfection of system, we should have to substitute provisions for collecting the tax in all possible cases from the source of the income instead of its recipient, and this with a frank recognition of the fact that such a method could only give us an approximation to equality. It would, however, give us in all probability as close an approximation as the present condition of our part of the world will allow, which is, in fact, all that can be secured in practice under any system, however rigid and precise we may make the letter of the law.

The obvious advantage to be gained by taxing income at its source, beyond the mere convenience of collecting the tax in relatively large amounts, is that the assessment is made in the quarter where there is the least temptation to concealment. The companies or persons paying the rent, interest, or dividends which are to be taxed, independently of their openness to inspection, are not actuated by the same motives as the individual who is called upon to return the amount of his income. It is with a wise perception of the motives at work that the English income-tax law provides for the taxation, not of total income, but of five distinct classes of income, described under the schedules A, B, C, D, and E. The schedules are broad, and cover the ground fairly well, no doubt; but, if they do not, the law does not concern itself with a failure on a small scale. The great object is to narrow the field within which individual declarations must be relied on; and this is accomplished by providing that under schedule A (rent), C (public funds), and E (public offices), the tax shall be collected at the source of the income, and not from the person who enjoys it; that, under schedule B (farmers' profits), the tax shall be assessed on an estimated

profit equal to one-half of the rent paid; and that a declaration shall be required only under schedule D for income from trades and professions. In short, the source of the income is aimed at by the English law, wherever the nature of the case permits; and the resort to declarations, recognized as hazardous, is restricted to less than one-half of the total actual assessment. This system is entirely at variance with the current notion of an income tax; for under it the income, as a whole, is not brought into view, and the tax is laid, not on the income as such, but on several probable chief constituents of the income. But, after all, the practical question must be whether the tax is more thoroughly collected under one system or the other. On this point the remarkable regularity of receipts from the English tax¹ and the close correspondence between estimated and actual receipts is strong evidence of successful administration, and raises a presumption in favor of the adoption of a similar method even under the different conditions presented in this country.

It is true that, by the Prussian law of 1891, the declaration is now made the basis of assessment of the income tax in that country. The people of Prussia have had a long course of education under the various forms assumed by the class and income tax since 1820.² At long intervals the law has been strengthened until, from a rough classification of the taxpayers by merely external signs, it has advanced to its present demand that the taxpayer shall show that his income falls between certain rather close limits. But the Prussian declaration, made under affirmation, and "to the best of his knowledge and belief," is a simple document compared with that

¹ For the last ten years the receipts from income tax, as estimated by the Chancellor of the Exchequer at the beginning of each fiscal year and as reported at the close, have been as follows, stated in millions and hundredths of millions:—

	ESTIMATED	ACTUAL		ESTIMATED	ACTUAL
1884-1885 . .	11.25	12.	1889-1890 . .	12.55	12.77
1885-1886 . .	15.40	15.16	1890-1891 . .	13.20	13.25
1886-1887 . .	15.75	15.90	1891-1892 . .	13.75	13.81
1887-1888 . .	14.34	14.44	1892-1893 . .	13.40	13.47
1888-1889 . .	12.25	12.70	1893-1894 . .	15.15	15.20

Even in the exceptional year 1884-1885 the actual receipts varied less than 7 per cent from the estimates.

² See *Quarterly Journal of Economics*, January, 1892, p. 207, for an article on this subject by Dr. J. A. Hill.

which formerly confronted the American taxpayer, or that which is contemplated by the recent act; and it is likely to have a much less important place in the business of assessment. It calls only for general statements of the distribution of the taxpayer's income under the four heads referred to on page 121, and leaves to the chairman of every board of assessment a wide discretion as to the extent to which he shall carry further inquiry.¹ The Prussian declaration, in short, appears to be a rather cautious tentative advance from a system of extreme laxity, — an experiment of which the success has not yet been tested by sufficient practice to make it significant for the United States.

It may appear at first sight that the act of 1894 makes some concession to the method of taxation at the source, by the provision that all corporations doing business for a profit, including banks, insurance, railway, and telegraph companies, shall pay a tax of two per cent on their annual net profits; and that dividends thus taxed at the source shall not be included in the taxable income of the stockholder. Whether this provision was adopted for any other reason than the increased facility of collection, especially from non-residents, and the occasion which it supplies for requiring from all corporations a statement of accounts, may well be doubted. At all events, the provision acts, for the most part, not as a substitute for the declaration, but as an auxiliary; for the taxpayer, except in cases where his income from other sources than dividends is not more than \$3500, must still make his declaration in due form. It is clear, then, that the act does not tax this species of income at its source as the means of exempting any considerable number of persons from the duty of making the usual declaration. Apparently, in the mind of the legislator, the collection of a tax at its source and the declaration by the taxpayer are things altogether dissociated.

In some other particulars, also, the treatment of the question of payment by corporations in the new act is hard of explanation. It would seem, for example, that there would be the same reasons

¹ The administrative instructions, published by the Minister of Finance, require, in article 55, that the chairman shall see that the assessment is not negligently made upon incorrect declaration, and then add the caution, — “Andrerseits sind kleinliche Erörterungen über geringfügige Punkte und jede nicht zur Erreichung des Zweckes gebotene Belästigung der Steuerpflichtigen zu vermeiden.” See *Das preussische Einkommensteuergesetz*, p. 204 of Krause's 8vo edition.

of convenience and security for collecting from corporations the tax on their payments of interest, as for collecting from them the tax on dividends. The former income-tax law, which cared little about the question of method, but cared much for speedy, certain, and large collections, provided that the income tax upon interest or coupons should be detained by all corporations, as well as the tax on dividends or other profits, and should be paid over in like manner to the United States.¹ This was a most judicious and useful provision, and would seem to be strongly suggestive under present circumstances. It is obvious that an enormous mass of incomes from investments would now be covered by a similar provision, and also that the income from coupon bonds, as to the ownership of which no record exists, is the most slippery income of all, and the most easily concealed by the reluctant taxpayer. Still, the income from bonds and other interest on debts—so easily taxed at its source—is left by the new act to stand upon the taxpayer's declaration alone. Another point somewhat difficult of explanation is the fact that, while the act of 1894 professes to establish an exemption of \$4000, nevertheless persons whose incomes are within that line are to be subject to an income tax on so much income as they may derive from dividends. The corporation paying the tax levied on its net income evidently pays, and is intended by the act to pay, an income tax for every stockholder whose dividend is thereby diminished, whether he is a millionaire or a poor man. It is clear that the stockholder in such a case remains subject to the tax, unless some provision is made for refunding to him the amount paid on his account. Under the English law, where dividends or interest have thus been taxed at the source, any stockholder or creditor entitled to exemption from income tax can obtain repayment of the tax thus unduly exacted from him, by making application in the proper place and form. But no provision of this sort is made in the new act of Congress; and a person supposed to be exempt from taxation under the law may, in fact, be subject to taxation on his whole income if, as sometimes happens, he receives it all from dividends. No doubt the machinery for making a rebate to small incomes in such cases would have to be elaborate, and would be difficult to manage—more difficult, perhaps, in this country than in one so compact and

¹ Internal Revenue Act of 1864, § 122.

homogeneous as England. This, however, is a part of the problem of taxation of income at the source that has to be faced squarely in even a partial treatment of the subject; and it is not creditable to our legislation that it should have been satisfied with the absurd result just pointed out.

It is hardly possible that the renewed resort to taxation upon declaration, under a law of the United States, should not have some effect on the current of opinion which has been so long gathering in opposition to the analogous practice of state taxation of personal property. The wide recognition of the failure of the local practice has already been referred to. There has been for some years past an increasing disposition in many States to find some substitute for this ineffective and obsolete system. What will be the effect of the adoption by the United States of the same practice of grasping at the intangible? Will it encourage or dishearten the movement for local reform, or will the movement pause until the issue of the new experiment is seen? We shall be fortunate if it proves that the United States have not interposed some serious delay in the progress of a change, not likely to be too rapid at the best.

The only remaining feature of the act of 1894 which we have to consider is the provision by which the tax is, for the most part, to be levied annually on the income, not of the current year, but of the year preceding. This is a natural, although not a necessary, application of the system of levying upon declared income. In theory the accounts of the taxpayer for a year are made up and closed. He knows to a penny what his income was; and it is the simplest of financial operations to calculate two per cent of the amount, and in due time to pay down this tax. So long, indeed, as the law proceeds on the theory of an exact determination of the income to be taxed, it is hard to see how anything but the income of a finished year can be dealt with. And yet it is probably more convenient for the taxpayer that his tax should come as a deduction made at the time, from the income on which it is actually assessed, and not as a payment to be made from the income of another year, which is perhaps less prosperous.

The English income tax, being levied at the source whenever possible, is almost necessarily a tax on current income. The rate

fixed by the important Finance Act of July 31, 1894, for example, is to be levied on incomes of the year beginning April 6, 1894, except in the cases where, for convenience of approximation, the average income of two or three years is taken as the basis. Even the Prussian law of 1891, which follows in moderation the plan of levying upon declaration, calls upon the taxpayer to declare what his income is for the current tax year in which the payment is to be made.¹ The provisions made, however, by the law of the United States on this point are whimsical in the extreme. The tax on income derived from dividends and other profits, as well as the neglected case of coupons, naturally suggests the collection of income tax at the moment when the income accrues and passes to the stockholder or creditor; but the law throws away this opportunity by postponing the levy upon the corporation until the first half of the next year, when the accounts of the calendar year for which the tax is laid shall have been completely made up. But for all persons in the service of the United States the income tax on the excess of salaries above \$4000 is to be withheld from the salary when paid, so that for this class of persons and to this extent the tax is laid upon the income of the current year, and not of that preceding.²

The method of taxing income in the year in which it accrues, especially if accompanied by the practice of stopping the tax at the source of the income wherever possible, brings into view some possible conveniences in administration which are lost by the method so familiar in this country. Taxes on accruing dividends and interest, paid by the debtor, must of necessity be pretty well distributed over the fiscal year, offering some advantages to the Treasury not to be secured from a tax of which the greatest part

¹ This is easily done of course with all fixed incomes from investments. Variable and business incomes are to be returned at the average of the last three years. See § 10 of the law of 1891.

² It was the intention at one stage of the bill to extend the provision for the deduction of the tax from salaries, so as to require some employers besides the United States to withhold the tax on any excess of salaries over \$4000, and to pay it to the proper collecting officer; and § 28 contains two references to "that portion of any salary upon which the employer is required by law to withhold, and does withhold, the tax." In the final draft of the act, however, as printed at Washington for public use, the provision for the payment of the tax by other employers than the United States does not appear, so that these two references are without meaning, except as evidence of the haste and confusion in which this important measure was carried through.

falls due at a single epoch. Collected at the natural dividend periods such taxes come in by instalments, to the considerable relief of the company or person making the payment. It is then a natural and easy step to provisions, found both in the English and the Prussian systems, for the payment by instalments in some other cases, when circumstances make this method convenient. Probably for a large part of the community the option of paying such a tax by quarterly payments, which is the general rule under the Prussian law, instead of the lump sum to which we are accustomed here, would make the collection a far less formidable proceeding than it must now appear as the day of reckoning draws on.

But beyond this there is another point at which the whole relation of the taxpayer to the tax is altered, when the income is taxed by instalments in the year in which it accrues. The law of the United States allows the deduction from income of "losses actually sustained during the year"; but there can be no deduction for misfortune incurred in the year when the tax falls due. There is a complete separation between the conditions under which the liability for the tax accrues and those under which the payment must be made. But, where the tax is levied upon current income, it is brought into close correspondence with the actual ability of the taxpayer. It then becomes possible to provide, in some cases, for an increase of the tax where new sources of income are opened to the taxpayer within the year, and in some to lighten the tax where misfortune has diminished his income since the assessment for the year was made.¹ The tax then loses some of its harshness, and something of its present aspect of an arbitrary levy, and takes its place as a natural and speedy result of the good or bad fortune of the year in which it is due.

It is not worth while, however, to go farther in urging this or that point in which the method of levying an income tax in this country is defective. The law of 1894 marks no advance in this difficult branch of taxation. The whole subject is one in regard to which our legislators, national and local, are bound in a singular degree by habit and precedent. A practice once adopted becomes fixed, an old method is good and a new one is visionary, and the appeal to the experience of other countries is pronounced un-

¹ See the cases provided for in §§ 57, 58, of the Prussian law.

American. The framers of the new law have made no exceptional mistake in resolutely shutting their eyes to what may be learned elsewhere on this subject. They have taken the course which might easily have been predicted, in going to the legislation of the Civil War¹ for the model to be followed at the present time; but they have followed that model without thought or discrimination, and without the defence of overwhelming necessity which could be made for their predecessors thirty years ago.

POSTSCRIPT²

The collapse of the income tax of 1894, under the decision³ of the Supreme Court of the United States, has probably caused more surprise than grief. Nothing could disguise the fact that, considered as a financial measure, the tax was hastily and clumsily arranged, and that its provisions defied the teachings both of equity and of experience. It offended, as a piece of class legislation on the one hand, and by its weakness failed to satisfy those who demanded such legislation on the other hand. Such strength as it had with the public was in a considerable degree sectional, and deepened the distrust of many who might have been willing to see incomes taxed under more favorable conditions.

But that the tax should disappear by reason of a construction of the Constitution, which practically forbids the levy of a national income tax, is an event likely to cause regret, which will strengthen with time and reflection. A most valuable financial resource is thus lost, for which there is no available substitute — a resource specially adapted for use in emergencies and at times when, as in the Civil War, indirect taxation is strained as far as it will bear. The decision of the court that “direct taxes,” in the language of the Constitution, is a phrase of wider meaning than had been held in previous adjudications, must be accepted. But it follows that, in one important respect, the government established by the Constitution is not so strong as it had been supposed to be, and probably not so strong as the majority of our people would desire to have it.

¹ For a careful study of the income-tax legislation of the Civil War and the operations under it, see Dr. J. A. Hill's article, “The Civil War Income Tax,” *Quarterly Journal of Economics*, 1894, p. 416.

² *Quarterly Journal of Economics*, July, 1895.

³ *Pollock v. Farmers Loan and Trust Company*, 137 United States, 429, and 158 *idem*, 601.

It must be added that the fact that the decision of the court in this case was the decision of a bare majority is not the least disagreeable circumstance of the case. The possibility that the adjudication which thus reversed a previous line of decisions may itself be reversed hereafter upon some slight change in the composition of the court is the subject of general comment, and must certainly cause much uneasy reflection in the minds of those who value the stability and dignity of our judicial institutions.

From every point of view, then, the attempt to revive the income tax by the act of 1894 promises to stand hereafter as a conspicuous example of the danger of playing with edge-tools.

EARLY BANKING SCHEMES IN ENGLAND¹

THE establishment of the Bank of England in 1694, and the abortive Land Bank of 1696, were the results of a discussion which had left its traces in projects and pamphlets scattered over a century. The following notes of a series of banking schemes will show how the English mind was long attracted on the one hand by the successful operation of deposit banking in Venice and Amsterdam, and on the other by the hope of devising some means for using landed security as the basis of banking credit.

In Price's "Handbook of London Bankers" (p. 142) is given in full the petition of Christopher Hagenbuck and his partners in November, 1581,² representing that he has found a way to institute an office into which much money shall enter every year without expense, so that her Majesty can have the use of any needful sum, the country be kept in abundance, and usury stopped. The petitioner proposes to explain his plan on condition that he shall have for twenty years six per cent on the gross sum received by the office. The queen agreed to allow four per cent by a grant under the Great Seal, but nothing further appears to have been done.

Hagenbuck's petition is in Italian, and he is himself spoken of as "an Italian" (p. 147). The petition is dated just three years prior to the decree of the Venetian Senate establishing the "Banco della Piazza de Rialto," at a time when private banking had shown its advantages and its dangers, and when the debate as to the substitution of a public bank had probably begun in Venice. It is not unlikely, then, that Hagenbuck proposed to import into England an idea which had become familiar to him from Venetian experience.

¹ *Quarterly Journal of Economics*, July, 1888.

² This is entered by title in *Calendar of State Papers, Domestic, 1581-1590*, p. 311.

Price also gives ("Handbook," p. 145) a series of papers under date of May, 1622,¹ in which it is proposed that a bank should be established, under the charge of a commission of merchants, where the king should receive and make his payments, and merchants be invited to leave their money, and where "all payments of 20*l.* and above shall be made, and only an entry made ther of the payment."

They which receive ther mony at the Bank shal be at ther owne libertye, eath^r to carry it away, or to leave it ther for the owne use at ther need: If they leave it ther they shall by way of assignation pay it over, only by entering it in the Bank, which shall goe as an actuall payment, & soe a 100*l.* may be assigned from man to man to serve for payment of tenn severall 100*l.* or more. . . .

The examples of oth^r states might teach us the use of this Bank, especially of the Venetians & other places in Italye.

Other references are made in these papers to the example of Venice. No action appears to have been taken on the scheme of 1622.

Under the commonwealth, W. Potter published:—

"The Key to Wealth." Folio, 84 pp.

"The Tradesman's Jewell." Small 4to, 16 pp.

"Essay upon a Bank of Lands to be erected throughout the commonwealth." Small 4to, 6 pp.

"Humble Proposals." Small 4to, 16 pp. 1651.²

The "Key to Wealth" is a prolix discussion, of which the effect is seen in the proposition (p. 14) "that an encrease of money cannot possibly occasion an encrease in the price of commodities (or any other Inconveniencies) but by increasing the sale of Commodities." Anything else, the author argues (p. 38), which would give as good security for obtaining commodities at pleasure, would be as good as money; and so (p. 45) bills might be issued by a company of tradesmen by consent, who should bind themselves each to the other to receive and make the bills good. The "Tradesman's Jewell" suggests that the bills should be paid within

¹ These papers, numbered 29, 30, 31, and 32, are described in *Calendar of State Papers, Domestic, 1619-1623*, p. 386, where Nos. 29, 30, and 32 are said to be by Sir Robert Heath, then Solicitor-General.

² My note of the full titles of Potter's pamphlets is mislaid. For the "Tradesman's Jewell," see McCulloch's "Literature of Political Economy," p. 159. The "Key to Wealth" and "Tradesman's Jewell" are both referred to in the "Humble Proposals," and are therefore as early as 1651.

six months after demand, and points out that estates would rise from quick trading with bills, and become greater security, —

Whereby to borrow more Bills to the doubling of such increase, and so *ad infinitum*.

Now this perpetual doubling the Increase of their stock is of so great concernment, as though men's Trading should be but ordinary ; yet it will make an Estate of 1000*l.* to amount in 40 years to 500 millions . . . and, by consequence, it would make the people of this Nation to be worth in 40 years (the World affording but Commodity enough for Money) five hundred thousand times more than now they are ; that is, he who is now worth but twenty shillings to be worth five hundred thousand pounds and so of others proportionally.

In his "Humble Proposals" the author makes the pregnant suggestion that obstructions in law to transferring bills be removed, "to which purpose there is a Petition it seems already presented ;" and in the "Essay" he makes a distinct proposition for a land bank, of which this is a summary : —

1. That 100 places be appointed for payments to be made, etc.
2. That all payments above 10*l.* or 20*l.* be required to be made in Bank credit.
3. That there be no way to raise this credit in Bank but by the mortgaging of land at 6 per cent.

Besides giving landed men credit at two per cent (?) and a large revenue to the public, this would avoid "all danger of surprise (as lately in *Holland*), there being (by the law of the Bank) no money to rest there."

Of very different character is the following : —

"Seasonable Observations Humbly offered to his Highness the Lord Protector. By *Samuel Lambe*, of *London*, Merchant. Printed at the Author's charge for the Use and Benefit of the English Nation, and to be considered of and put in execution as the High Court of Parliament, in their great Wisdoms shall think meet. Jan. 27, 1659."¹

Having in mind the rivalry of the Dutch, Lambe finds a bank the best means of coping with them : —

A bank is a certain Number of sufficient Men of Estates and Credit joined together in a joint Stock, being, as it were, the general Cash-keepers or Treasurers of that Place where they are settled, letting out imaginary Money at Interest at 2 and $\frac{1}{2}$ or 3*l. per Cent* to Tradesmen, or others, that agree with them for the

¹ Reprinted in the *Somers Tracts*, ii. 164, or in Scott's edition, ii. 446.

same, and making Payment thereof by Assignation, and passing each Man's Account from one to another with much Facility and Ease, and saving much Trouble in receiving and paying of Money, besides many Suits in Law and other Losses and Inconveniences which do much hinder Trade.

He proposes that the management of the bank should be given to merchants chosen by the great trading companies of London, like the East India, the Turkey, and the Muscovy companies.

That all be at Liberty to bring in any Money into Bank or not, and if any that have Money there, desire to have it again in Kind, should have it at Demand. . . .

That they let out imaginary Money on Credit, upon Ticket, at $2\frac{1}{2}$ and $3l.$ *per cent* at the most.

That all Bills of Exchange be received and paid in Bank.

That all the Profits of the Bank go to the good Men that manage the same, in lieu of their great Care and Pains, and defraying Bank Charges, and Officers' Salaries, or so much as shall be thought fitting to be reserved towards the Increase of the Stock; and as the Bank increaseth in Credit, so the Reservation to increase to augment the Stock, but the Stock always to remain whole and intire.

Lambe was satisfied that such a bank would so encourage trade and be so convenient that others would soon be called for at Edinburgh, Dublin, York, Bristol, and Exeter, "for the Furtherance of Trade, by holding Correspondence with each other, than which I do not apprehend or know any way better to equal the *Dutch* in Trade, both at home and abroad."

Next, we have, —

"An Expedient for taking away all Impositions and for raising a Revenue without Taxes, by Francis Cradocke. London, 1660." 12 pp. 4to.

Also, —

"Wealth Discovered: Or, an essay upon a late expedient &c., by F. C. London, 1661." pp. viii. 44. 4to.

In the former of these pamphlets, which is addressed to Charles II., the author gives, with little change, the definition of a bank already cited from Lambe, and then states his own plan, which is somewhat elaborated in "Wealth Discovered." He proposes to divide the kingdom into one hundred registry districts, and to make the registration of titles and conveyances of real estate compulsory; then to establish a bank, which shall lend its credit upon deposit of goods or pledge of lands; this credit to be by law "as undeniably

current in payment " of debts or for goods as gold or silver, and to be given out at three per cent ; but money not to be drawn from the bank.

Now that such credit is as good as Money will appear, if it be observed, that Money itself is nothing else but a kind of security which men receive upon parting with their Commodities, on a ground of hope or assurance that they shall be repayed in some other Commodity : since no man would either sell or part with any for the best Money, but in hopes thereby to procure some other Commodity or Necessity. (p. 14.)

The bank credit, he thinks, will not raise the prices of commodities, for they can be imported, but will raise land and lower interest. Cradocke says that the books which he has seen on banks are Malynes, " *Les Mercatoria*," Lewis Roberts, " *Mappe of Commerce*,"¹ Henry Robertson [*sic*], " *Trade's Increase*,"² and Lambe, " *Seasonable Observations*." But all these he finds merely encourage imitation of other countries without proposing increase of revenue, whereas by his bank he computes that the public would gain a revenue upon loans of £1,730,000 with little expense. He notices Potter, and thinks him an ingenious person, and refers to "the shops of *Lombard Street* (which are banks in effect)." That his bank should be erected without the use of money he finds to be an advantage ; for gold and silver have their dangers, and so have banks which are based on them, whereas land can be made to answer much better.

In " *Wealth Discovered* " it is stated that April 12, 1661, Cradocke's plan was referred to the Council for consideration ; and added to the Council are Francis Cradocke, William Godolphin, George Monk, Samuel Hartlib, Henry Ford, Sir Peter Leare, Sir William Petty ; but the matter appears to have gone no farther.³

¹ Lewis Roberts, " *The Merchant's Mappe of Commerce*, wherein the Universal Manner and Matter of Trade is compendiously handled. London, 1638." Fol.

² Henry Robinson, " *England's Safety in Trade's Increase*. London, 1641." 4to.

³ In the *Calendar of State Papers, Domestic, 1661-1662*, p. 78, under date of August, 1661, note is made of a brief description by Sir B. Gerbier d'Ouvilly, of " a Bank of Exchange as very beneficial. . . . To make the credit of English merchants equal to that of foreign, there should be a bank, with a large stock, under fitting governors, such as to remove all jealousy of its falling into the hands of those who hold the militia, with a coinage of its own, called bank money, and ability to lend on real estate." Sir Balthasar Gerbier probably made this proposition as the result of his sojourn in the Netherlands during the Commonwealth.

In a postscript, Cradocke explains to his readers that he is the son, not of Cradocke the preacher to Cromwell, but of another of that name who lived "about seventeen years since" in Somersetshire, near Glastonbury, had an estate of £500 per year, and lost his life in the service of the king. He also makes a reference to his present "short stay in England."

The impression produced by the success of the Bank of Venice appears strongly in the pamphlets of Matthew Lewis, published in 1677 and 1678:—

"Proposals to increase Trade And to Advance his Majestie's Revenue without any hazard or charge to anybody, and with apparent profit to everybody. By M. Lewis. London, printed for Henry Million at the Sign of the Bible in Fleet Street. MDCLXXVII." 16 pp.

This pamphlet proposes the establishment of an office with warehouses, where advances in bills of credit may be made upon goods for not exceeding twelve months, the bills to be exchanged [discounted?] by the office, if desired, "into Money at four per cent." The example of Venice is more than once referred to; as, *e.g.* (p. 12), "Men desire Credit at *Venice* (though never answered out of the Bank in specie) rather than Money; because it is more safe and more transferrable than Money." Of the moderate charge to borrowers, the author says that "this is nothing like the borrowing Money to the Scrivener, where the Security is usually sealed at a Tavern, and the Borrower pays the Reckoning."

"Proposals to the King and Parliament how this Tax of one hundred and sixty thousand pounds *per* Moneth, may be raised, by a Monethly Tax, for one Year. without any Charge to any particular person, and with great advantage to the whole Nation. This may be done, by setting up Banks here, like the Bank at *Venice*. By M. Lewis, D.D. London. Printed in the Year 1677." 7 pp. 8vo.

Of this pamphlet, nearly half is taken up with an account of the Bank of Venice, apparently resting on the authority of "my Intelligencer," but sustainable by "several *Venetian* Merchants, that have lived many years upon the place, and made it their business to understand the nature and constitution of this Bank, called, *Banco de al gero*; A Bank of transferring Credit."

The writer's plan is that a tax of £160,000 per month should be laid for one year; that banks in every country town should

receive the money, and that the taxpayers should receive bills of credit in exchange, these bills to be made current money, and Parliament to pledge its faith that money should be raised in specie to answer the bills, "if ever it be desired." The case of Venice is relied upon to show that, while the government could thus have the use of the money obtained by this levy, its credit would be a practical and advantageous substitute, saving the taxpayers from any inconvenience.

In the next year, the indefatigable author produced two more pamphlets, of which the first is the best known of the series:—

"Proposals to the King and Parliament, or a large Model of a Bank, Shewing how a Fund of a Bank may be made without much charge or any hazard, that may give out Bills of Credit to a vast extent, that all *Europe* will accept of, rather than Money. Together with some general proposals in order to an Act of Parliament for the establishing this Bank. Also many of the great advantages that will accrue to the Nation, to the Crown, and to the People, are mentioned, with an answer to the Objections, that may be made against it. By M. L. D.D. London. Printed for *Henry Million* at the sign of the *Bible* in *Fleet Street* 1678." pp. 48. 4to.

The author here proposes that no payment of £100 or upward should be good in law, unless made in bank; that the bank should lend upon either personal or real security, but should be wary at first in giving out credit except for money; that it should be empowered to buy lands and ships, to set up "a lumber," and to engross the stock of tin and make it into money or ingots to be money at the market price. That good security may be had for loans, he proposes that the registration of ships, houses, and lands should be authorized, all adverse claims to be barred, if not brought in within six months after notice given of registration. The advantages of registration are discussed incidentally; and it is complained that estates are settled privately and titles made uncertain, so that land formerly worth twenty years' purchase or more is little above sixteen, though interest is at six per cent.

Lewis enlarges on the case of the Bank of Venice, which, he says, sprung from the dishonesty of bankers. "The Bankers at *Venice* did just as our Bankers have done here, they got Men's money into their hands at Interest" and lent it to insolvents or "laid it out in desperate cases as our Bankers did"; they broke and fled from the territories "as ours do into the *King's Bench*." The

State therefore set up the bank, which he believes to be "a perfect Credit Bank and its Fund a meer imaginary thing," and yet "credit in Bank is more safe, more portable, and more transferable than money *in specie*, and so of greater value, as Gold is better than Silver." On the difference in rate between bank credit and currency, both at Venice and Amsterdam, he dwells at some length, returning, however, to the above explanation.

"A Short Model of a Bank Shewing how a Bank may be erected without much trouble, and without any charge or hazard to any body, and with apparent profit to every body, except Theeves, Brokers, and griping Usurers, which Bank will be able to give out Bills of Credit to a vast extent that all persons will accept of rather than Money. By M. Lewis, D.D." [No place or date.] 8 pp.

This pamphlet refers the reader to "a larger discourse of this Model at Mr. Million's," and then gives a summary as follows:—

The Epitome of this Compendium is, when the Nation is divided into Precincts, erect an Office in each Precinct to return Money.

Order all greater Payments to be made at these Offices, where any person may leave his Money without interest, and take a Bill of Credit for it of the Office, which shall be made transferrable.

That the Bill of Credit may be current; let the whole Precinct be obliged to make good the acts of their Office, as in case of Robbing.

That the Precinct may not be damnified, let them choose their own Officers, who shall give security to them.

They shall also choose four and twenty substantial persons to meet once a Month to supervise their stated Officers.

These four and twenty shall dispense Money lying dead in the Office, as oft as they please.

Much of the running cash of the Nation will in a little time pass through these offices, and all that can will leave it there, and take a Bill of Credit of the Office: because this Bill of Credit will be more safe, more portable, more transferable, and so of greater value than Money, as Gold is (for these reasons) better than Silver.

Hence these Officers will have a vast Credit, which is equivalent to so much Money in specie, and may do whatever any can do, that have an inexhaustible treasure.

To these notes the better known schemes of Briscoe and Chamberlayne are the proper sequel; but it is unnecessary to pursue the subject. Before the close of the seventeenth century, the rise of private banking had done much to clear the public mind, the land bank scheme was sanctioned only in modified form, and the establishment of the Bank of England had come about as the natural result of experience and the final prevalence of sound ideas.

THE BANK OF VENICE¹

AN often repeated and long accepted legend respecting the origin of the Bank of Venice carries back the history of that remarkable institution to the latter part of the twelfth century. A public debt, contracted not far from 1171, is said to have been made transferable like a modern registered debt, then to have been found useful as a medium of payment, to have become the nucleus of a system of deposits and transfers of money, and so to have developed into a bank of deposit of the primitive type, holding a place of great though variable importance in European commerce for more than six centuries. With this legend have been joined confused and often contradictory statements as to a "money of account" of mysterious nature created by the bank, and the superiority of this "imaginary money" to actual cash in hand. Owing, perhaps, to the aversion of the Venetian government to anything like publicity in the management of its business, even the Venetian historians were sometimes misled by the tradition; and it is, therefore, not surprising that writers in other countries followed it with little question.

The researches of Lattes and Ferrara in the archives of the Frari destroyed the familiar legend twenty years ago; and the date and manner of the establishment of the Bank of Venice were then settled as definitely as the chartering of the Bank of England. The traditional fable has perhaps been more persistent in English than in any other language, still holding its place in the most recent encyclopædias, English and American;² but elsewhere it is effectually discredited, and ceases to adorn the history of mediæval banking. It would hardly be worth while, then, to revive the subject here, were it not for the light which the documentary evidence

¹ *Quarterly Journal of Economics*, April, 1892.

² McLeod, "Dictionary of Political Economy," p. 69, rejects the fabled connection of the Venetian *monti* of the twelfth and succeeding centuries with the beginning of public banking in 1587; but his erudition has often failed to command proper attention.

throws upon the early practice of private banking in Venice and upon the place which the public bank and its credit really held in the commercial organization of the city for the last two centuries of Venetian independence.

The leading documents relating to this subject, which are now within reach of the public, may be classified as follows:—

1. A series of acts of the Venetian Senate, nearly forty in number, ranging from the year 1270 to 1530 and regulating the business of private bankers, brought to light by Professor Elia Lattes, and reprinted by him, apparently with great fidelity to the text of the original records, in his work, “*La Libertà delle Banche a Venezia dal secolo XIII al XVII,*” published at Milan in 1869.

2. A mass of original papers relating to Venetian private banks from the fourteenth century to the end of the sixteenth, collected from public and private sources by Professor F. Ferrara, and published by him in part in the *Archivio Veneto* for 1871, and also used by him as material for a paper on the ancient banks in Venice, published in the *Nuova Antologia* for January and February, 1871.¹

3. The acts of the Venetian Senate of 1584 and 1587, under which the first public bank in that city, the Banco di Rialto, was established; several other acts regulating the affairs of that bank; a speech made in the Senate, in 1584, by Tommaso Contarini, in favor of establishing a public bank; and a speech, by an unknown senator, opposing such an establishment. These are collected and printed with great care by Lattes.

4. The act of the Senate of May 3, 1619, establishing by the side of the Banco di Rialto a second public bank, known as the Bancogiro, or Banco del Giro, which ultimately became the only public bank of the city and was famous throughout Europe for generations as the Bank of Venice. This act is also given by Lattes.²

5. The rules and regulations of the Bancogiro, put in force by the Senate and published by its authority in 1663, and also given by Marperger, in his “*Beschreibung der Banquen.*”

¹ Ferrara explains with great frankness that, in his introduction of Volume VI., 2d Series, of the *Biblioteca degli Economisti*, he had himself helped to propagate the *favole* which Lattes destroyed by irrefragable proofs. See especially Ferrara’s “*Avvertenza Preliminare,*” in the *Archivio Veneto*, vol. i.

² A translation may be found in the *Quarterly Journal of Economics*, April, 1892.

6. A discourse upon the Bancogiro communicated by the French ambassador in Venice to his own government in 1786, and referred to by Daru in his "Histoire de Venise," but printed for the first time in the Appendix of the *Quarterly Journal of Economics* for April, 1892, and containing the fullest contemporary account yet published of the bank and its methods in the last years of its existence.

These documents present a distinct picture of banking in its true sense, as an entirely spontaneous growth during the flourishing period of Venetian commerce, carried on by private individuals, and exhibiting the mixture of advantages and abuses which have been its familiar results in every country and age; and they also show the Bank of Venice to have been established, not by gradual development or chance, but by deliberate purpose, in order to take under the guarantee of public authority some of the functions which for two hundred and seventy years or more had been performed by private bankers.

It is tolerably clear that private banking in Venice began as an adjunct of the business of the *campsores*, or dealers in foreign moneys. In a city having a great and varied trade with many countries, these dealers necessarily held an important place, close to the stream of payments which was constantly in motion. As early as 1270 it was deemed necessary to require them to give security to the government as the condition of carrying on their business, but it is not shown that they were then receiving deposits. In an act of September 24, 1318, however, entitled "Bancherii scriptae dent plegiaras consulibus," the receipt of deposits by the *campsores* is recognized as an existing practice, and provision is made for better security for the benefit of depositors.¹ Whether the title of this act is contemporary or not, its text shows that somewhere between 1270 and 1318 the money-changers of Venice were becoming bankers, by a method similar to that by which the same class of men in Amsterdam a couple of centuries later, and

¹ The acts of March 8, 1270, and September 24, 1318, are given by Lattes, pp. 26, 28. Lattes thinks that the "natural scope" of the former covers security for depositors. The opinion of Ferrara is to the contrary (*Nuova Antologia*, January, 1871, p. 183); and it does not appear that any direct evidence has been found to show that in 1270 the *campsores* were receiving deposits, although the occasional possession and use of money belonging to others must have become an incident of their business very early.

later still the London goldsmiths, became bankers. More than once in the next half-century provision was made for some public oversight of the *campsores*, and in the acts the terms *bancherius* and *bancus* became frequent in what seems to be a technical use. The number of bankers appears finally to have become considerable; ¹ and the terms *bancus scriptae* and *bancherius scriptae* came into use in the sense which, in their Italian equivalents (as *banco di scritta* or *banco di scrittura*), they held for centuries, denoting the banker who keeps written accounts of transferable deposits.

The documents brought to light by Lattes and by Ferrara give us the names and tell something of the checkered fortunes of a considerable number of these private banks which flourished between 1348 and 1584. Some of them belonged to families or men of high standing, as the banks of Soranzo, Priuli, Pisani, Lippomano, Vendramin, Sanudo, and of Pisani and Tiepolo; some of them stood in close relations and high favor with the government of the day; several of them went through the phases of failure, reorganization, and resumption more than once; and, in fine, of the banks now known by name Ferrara was only able to find one, the house of Soranzo, which after an existence of over a century closed its affairs by payment in full, — *a trombe e piffèri*. The list as we now have it comprises rather more than twenty names, including probably the most important. But the speech of Tommaso Contarini in 1584 ² sets the number of banks known to have existed at one hundred and three, "of which ninety-six have come to a bad end and only seven have succeeded." And yet, notwithstanding a train of disasters nearly two centuries and a half long, the service rendered by the banks to commerce had been such, on the whole, as to lead Contarini to argue that to preserve the trade of the city without banking was not only difficult, but impossible.

A series of acts beginning in the fourteenth century and running through the fifteenth and sixteenth show plainly that this

¹ This is to be inferred from the language, explicit, if not classical, of the act of August, 1374, giving the bad condition of the banks as a reason for placing them under the charge *quinque sapientum*: "Quia est providendum de necessitate pro bono terrae nostrae et mercatorum et mercationum etiam nostri communis super facto bancorum Rivoalti, quae non possent stare in peiori termino eo quod sunt ad praesens Consideratis damnis et incommodis, quae fiunt toti terrae," etc. See Lattes, p. 33.

² *Ibid.*, p. 124.

service was rendered by means of deposit accounts. How early the convenience of making payments by transfers on the books of a banker was understood there is nothing to show. An act of 1403¹ recites that great sums are placed in the hands of the *bancherii scriptae*; and an act of 1421² deals with some evils which had arisen, in terms which imply not only the receipt and payment of deposits, but their use in payment of bills of exchange. In 1445³ it was thought necessary to require the bankers to be present daily for a certain number of hours, and a penalty was imposed *se non sentaranno et scriveranno* as required, in consequence of the loss to merchants occasioned by their irregularity. Passing by numerous acts for regulating or reforming the banks, we come to an act of 1526, entitled "Ordinationes circa bancos a scripta," and evidently designed to restore regularity and honesty in a long-established business. In this act we find the following provisions,⁴ showing distinctly the form which banking transactions had then taken:—

7. It shall be free for every one to accept or not accept a credit in bank (*partida de banco*) for contracts made heretofore; but this shall not be refused for those made hereafter, unless by express agreement it shall have been declared that payment shall be made outside of bank.

8. Credit in bank shall not be written off to any one for any amount in his absence; but credits shall be written with both parties present.

9. Bankers, as aforesaid, must pay, to those who wish, in cash at once and in hand their money in good and heavy gold, or good moneys at the market rates, or rates current at our offices; and, if any should refuse, they shall be subject to the penalty of twenty-five ducats, and the proveditor then present shall none the less make them pay.

But the language in which Contarini discusses the usage of Venetian merchants is enough to show that in 1584 the transfer of credit had long been an important means of payment. A comparison made by him with the practice at Antwerp and at the Lyons fair makes it certain also that, in his mind, the convenience to be obtained by the use of credit did not arise from any such substitution of credit for money as should enable the community to dispense with any part of its stock of cash, but from the simple fact that the transfer in bank saved the necessity of counting coin and of its manual delivery in every transaction. The coin itself

¹ See Lattes, p. 44.

² *Ibid.*, p. 47.

³ *Ibid.*, p. 56.

⁴ *Ibid.*, p. 91.

had been deposited as the foundation of the credit, and was to be paid on delivery: the creation of a credit without such deposit was in his view an abuse; but payments could be made by the transfer of the right of the depositor to demand, with such facility as to enable merchants to carry on dealings to an extent otherwise impossible. "Buyer and seller are satisfied in a moment, while the pen moves over the page: whereas a day would not be enough to complete the contract for a great mass of merchandise by counting a great number of coins." To this simple but important use of bank credit the Venetian Senate was unable to restrict the private bankers; and it was to secure the advantage of payment in this convenient form, without the risks of private mismanagement, that, as we shall see, the public bank was afterwards established.

The nature of the case, however, gave a much wider scope to the business of the private bankers than the primitive function of deposit-keeping. "Those who open banks," says Contarini, "do not undertake this labor, and subject themselves to the burden of being cashiers for all the money in the market merely for the sake of holding it, but in order to trade with it, and by trading to make gains." In 1374 an act forbids any one *qui teneat bancum de scripta* to be concerned in any way in dealings in copper, tin, iron, lead, saffron, or honey, or in the purchase of silver at public sale.¹ This prohibition was somewhat relaxed by the Senate in 1386, 1387, and 1390;² but in 1403 an act was passed forbidding any banker to ship or send away by land either merchandise or money beyond the amount of one and a half times the loans which he might have made to the republic.³ This singular restriction, which is treated by Lattes as a remarkable anticipation of the legislation of the United States requiring from national banks a deposit of

¹ Lattes, p. 34. Lattes supposes the fluctuating price of these articles and the difficulty of converting them into cash at all times to have made them unfit, in the opinion of the Senate, to be held by bankers. Ferrara has the well-grounded opinion that, besides hindering bankers from placing deposited money in trade, the Senate also wished to prevent any monopoly of certain articles of great importance. *Nuova Antologia*, January, 1871, p. 187.

² See Lattes, pp. 39-41. The act of 1386 recites that the house of Soranzi have petitioned for some relief for the bankers because "ipsi sunt onusti mercationibus olei, et aliis mercationibus, de quibus male possunt exire, si ipsas ad ferrum, et alia barrattare non possunt, sicut alii cives nostri," and because of the small gains of banking. In 1430 the law was again relaxed at the instance of the Soranzi. Lattes, p. 55.

³ *Ibid.*, p. 44.

public securities, is at any rate important as showing a wide range of investment opened to the bankers in 1403, provided the public securities bore a certain proportion to the whole. The laws show other traces of loans made by the banks to the republic; and Ferrara's researches enabled him to compile a list of such loans for the years 1457 to 1507, amounting to rather more than five million lire of the present day.¹ But the language of Contarini is enough to show the variety of methods in which the bankers used the funds confided to them by depositors. Trade with the Levant, the western trade, corn, exchange, the accommodation of friends, the purchase of lands and houses,—these were typical classes of a banker's investments in that age. That loans to individuals had some place among the bankers' use of capital is shown by an act of 1467, limiting to ten ducats the amount which could be lent to any person upon a single obligation.² But the restrictions imposed by the canon law upon the reservation of interest impeded loans of this kind, and probably hindered the definition and even the growth of legitimate banking investments. Mercantile adventure long continued to be the banker's natural employment of his funds; and the dangers of such employment, pointed out with great distinctness by Contarini, were keenly felt by the Venetian public century after century.

Nothing shows when the Venetian bankers first learned that, besides the money actually received from depositors, they could also make use of credits opened on their books, but not representing any deposit, and when they began in this manner the modern system of issue. The idea must have come soon after the transfer of deposits became common. The act of 1374, forbidding bankers to deal in certain commodities, declares that the banker shall *nec mutuare nec facere scriptam argenti alicui qui emeret argentum ad campanellam*,—shall neither lend nor open a written credit for the prohibited purchase. Another act, of 1450, forbids

¹ *Nuova Antologia*, January, 1871, p. 205. The loans noted by Ferrara are those mentioned in scattered documents, and it is certain that their amount is far below the real total.

² Lattes, p. 72. “. . . Accomodare non possint alicui personae maiorem summam ducatorum decem sub uno quoque signo.” On the somewhat doubtful meaning of this limitation, see a remark by the late Professor Nasse in his review of early Venetian banking in *Jahrbücher für Nationalökonomie*, 1880, p. 338; and Ferrara's remark, *Nuova Antologia*, 1871, p. 452.

the giving of credit, either to any foreigner or any citizen, for the purpose of purchasing silver, except for such money as he shall really have in the bank.¹ These limitations upon the extension of credit for some purposes imply strongly that its extension was a recognized practice for other purposes; and we learn from Con-tarini that, in the sixteenth century at any rate, such was the case. The banker, he says, can accommodate his friends without the payment of money, merely by writing a brief entry of credit. The banker can satisfy his own desires for fine furniture and jewels by merely writing two lines in his books, and can buy estates or endow a child without any actual disbursement.² In short, the Venetian private banks had become banks of issue, and the bankers found many temptations in the way of a prudent use of this power.

The immediate effect of the over-issue, to which the bankers were thus tempted, would of course be a difficulty in meeting the demands of depositors and the resort to expedients for avoiding payment. Embarrassment of this sort, as well as actual fraud, is probably the explanation of a long series of practices legislated against by the Venetian Senate. When, in 1445,³ the bankers were required to be present for business daily, at least two hours in the morning and two after dinner, instead of presenting themselves merely *quando et quanto voleno*, we may be sure that the Senate intended, among other things, to provide for depositors who might wish to draw out their money. The requirement in 1467 that bankers should show to any person the books containing his accounts and balances, *rationes et resta sua*;⁴ the strict provision in 1523 that the bankers should have ready on the counter, *sopra li banchi tenir conveniente*, the money for making their payments in full and publicly,⁵ and must count it out *sopra il banco* or be responsible for any deficiency sworn to by the payee,—these provisions may have been directed against debtors avoiding payment either from embarrassment or fraud. But when the law of 1526 declares that bankers shall not, upon a demand for cash,

¹ Lattes, p. 34, *note*, and p. 70.

² So, too, in the speech against the establishment of a public bank published by Lattes, "i mercadanti si servivano della commodità dei banchi particolari, scrivendo partide, seben non havevano alcun credito in banco, ò seben il credito era inferior assai a i danari, che scrivevano ad altri." Lattes, p. 152.

³ *Ibid.*, p. 56.

⁴ *Ibid.*, p. 72.

⁵ *Ibid.*, p. 82.

send the creditor to another bank with an order upon it, and so wear him out by sending him from one to another, nor say that there is an error and that accounts must be compared, nor delay or refuse to transfer to a person likely to demand actual payment,¹ we are instantly reminded of the shifts of insolvency. The repeated increase of the security to be given by bankers, which in 1523 had risen to 25,000 ducats; the summary jurisdiction over questions between bankers and depositors, given, by various acts from 1421 to 1523, to designated public officers; and other precautions into the detail of which it is impossible to enter, — all show that the republic was painfully aware that prompt payment was not always the first object of the Venetian banker. How much the republic accomplished by its efforts to regulate the banks is doubtful. In one or two cases the preambles of acts naively admit the non-observance of previous legislation.² It is enough for the present purpose, however, that the laws disclose the presence, in the Venetian private banking, of precisely the same evils and mistakes as those with which later centuries have had to struggle.

With a system of banking obligations on which payment is avoided or suspended, depreciation is a natural result. There is reason to infer from the law of 1421³ that this evil had then shown itself; for the law explains that, as money cannot be drawn from the banks, there is a practice of selling credits held against them, with great injury to the state. The evil appears more clearly in 1523, when the law declares⁴ that the banks shall make their payments without deduction for cash, *far li pagamenti integri et senza alcuna diminuzione*, and also forbids the purchase or sale of cash with bank credits, — a prohibition which implies a difference in value, and hence a depreciation of the credit. But the "Ordinationes circa bancos" of 1526⁵ declare in so many words that the extortion practised by the bankers upon those who wished for money had then reduced the bank credit twenty per cent below the level of cash. The remedy applied was vigorous. The number of the *sopra banchi* already in office as

¹ Lattes, p. 92.

² See especially Lattes, p. 69, where, in 1447, it is said of an act of 1421, "Sicut notum est talis ordo nunquam fuit observatus, nec presenti tempore observatur."

³ Lattes, p. 47.

⁴ *Ibid.*, p. 82.

⁵ *Ibid.*, p. 89.

inspectors of the banks was increased, so as to give one for each bank, their presence day by day during banking hours was required, and large powers were given to them. Dealings in bank credit with an agio for cash, *con alcun laza*, were then forbidden. It was ordered that exchange should be sold at one price, whether for cash in hand or in bank, and that payments for goods or for other cause should be made in the same way, the bank credit to be taken, if at all, on the footing of cash, ducat for ducat, the bankers being at the same time required under penalty to maintain their payments in cash. In the preamble of a law respecting money-changing passed in 1528¹ it is recited that these provisions had brought the bank ducat and cash to equality of value. Two years later a law respecting bills of exchange makes the same recital, but adds that at the Lyons fair bills had been drawn payable in bank with a difference of two and a half per cent, and therefore requires that bills drawn payable in bank shall be settled at the rates current for bills made payable in cash.

Contarini's statement as to the large proportion of the Venetian banks which ended in failure has already been noticed. Details of the failure of several have been collected by Ferrara, the cases of the Soranzi, Garzoni, and Lippomani being the most remarkable. The winter of 1498-1499, when the two latter failed and the Pisani had in consequence to meet a run by depositors,² appears to have been a season of panic upon the Rialto. There are also indications of serious trouble not far from 1523. In 1584 came the failure of the house of Pisani and Tiepolo for 500,000 ducats, and this event apparently brought private banking in Venice to its end. Its history, if we may judge from the fragments which have survived, was a tale of repeated disaster; and yet it must be remembered that the events which appear to us now as parts of a single picture were, in fact, spread over the greater part of three centuries, during which the Venetian public continued to intrust its interests to the private banks. It may be, therefore, that, if we could restore the proper perspective of time and could see these disasters in their true relations to other events, the Venetian experience might not

¹ Lattes, pp. 95-97: "Essendo per l' iddio gratia riddotti li banchi nostri de scritta in buon esser, che tanto è al presente il ducato del banco, quanto è il contado."

² A lively account of this run, given by Malpiero and cited by Ferrara, may be found in the *Archivio Storico*, Ser. I., vol. vii., p. 715.

appear more unfortunate or even more checkered than that of other countries, which have had to learn by actual trial how to use the dangerous forces of credit.

But, however this may be, the Venetian Senate became satisfied of the necessity of a radical change of system. The speeches of Contarini and his unknown opponent were part of a debate which, in a few months after the failure of Pisani and Tiepolo, ended in the act of December, 1584, for the establishment of a public bank, to be called the Banco della Piazza di Rialto. This act was repealed in the following April, in consequence of strong opposition; and it would appear that the city was left for the next three years without any bank, either public or private, to the great confusion and injury of its business. The act of April 11, 1587, at last established a bank of deposit, sometimes called the Banco di Rialto, and sometimes the Banco della Piazza.¹ The acts of 1584 and 1587 differed in some important particulars, but they agreed in their main purpose of giving to a public institution the deposit business so long retained by the private bankers; and we can therefore conveniently confine our attention now to the act of 1587, as expressing the meaning of the revolution in Venetian banking which took place in 1584.²

The act of 1587, after reciting the mischiefs resulting from the ruin of the private banks, the great need of a bank of some kind, and the conclusion that private banks could not supply the want, establishes a *banco de scritta* for three years, to be placed under the charge of a governor elected by the Senate for the same term, and under the inspection of the *Proveditori soprabanchi*. The bank was required to receive all cash deposits offered in good and current money; the money was to remain always subject to call,

¹ The acts of 1584 and 1587 are given in full by Lattes, pp. 101 and 109.

² Morosini, in his "Historia Veneta," under the year 1587, says: "Negotiatorum quoque incommodo subvenire decretum, qui, apud privatos mensarios pecunia deposita, eorum fraude, avaritia, crebrisque decoctionibus ingentes jacturas damnaque patiebantur; ex quo publicis etiam redditibus haud parva detrimenta accedebant. Itaque lex lata in Senatu, ut publica mensa erigeretur, in qua tuto singuli argentum aurumque adservarent; ei Gubernator praeficeretur, qui rite atque ex ordine cuncta administranda curaret; id munus Francisco Gradenico primum tributum." But Morosini takes no note of the establishment of the Banco del Giro in 1619, and perhaps supposed that bank to be the same as the "*mensa*" of 1587.

sempre pronto a requisition di creditori; transfer in bank could be made, but only in the presence of the depositor or by his written consent lodged in the office of the *soprabanchi*; no transfer could be made in blank, but credit must be given in account to the transferee at the same time that the transfer was debited; and, finally, the expenses of the establishment were to be met by means of the duties on imported goods. In December, 1593, a further act provided that all bills of exchange should thenceforward be paid by transfers in bank only. It is evident from these provisions that the Bank of the Rialto was not a bank in the modern sense, as the private banks superseded by it had been. The republic wisely declined to undertake the investment of the funds intrusted to it, sought no profit from the use of its credit, and, in short, merely undertook to keep the money of depositors in safety, and to pay it out or transfer it to others at the will of the owner. At a given moment the depositors might even draw out the whole of the cash, in full satisfaction of their claims, if they chose, and nobody would be any the worse.¹ Certain of the functions of the private banks were thus selected and made the work of the new establishment, and the rest were disregarded. It is clear, then, that this development of the Venetian public bank from the business carried on in private hands had no possible relation to any public debt or to any use which the state might be able to make of the moneys deposited with it.

The provision made in 1593 as to bills of exchange, already referred to, was for two centuries an important regulation of Venetian commerce; but it had its origin from a special cause. It is manifest that, so long as the Bank of the Rialto should be conducted in accordance with its fundamental law, payments in bank must be the exact equivalent of cash payments, since the payee in bank received a credit convertible into cash at pleasure. Debtors who found it inconvenient to meet their debts with cash would therefore find it equally inconvenient to meet them with a transfer in bank. This led to a practice of settling bills of exchange by

¹ It is worth noting that the governor of the bank was forbidden under heavy penalties to traffic in, use, or lend any of its moneys. Lattes, p. 110. Contarini's discussion as to what might happen in case of war, and his assertion of the ability of the bank to pay everything on demand, *tanto sarà il dar, quanto l' haver*, is important as showing that commercial and not fiscal convenience was the purpose of the undertaking. See Lattes, p. 137.

novation, or the substitution of one debtor for another, like that described by Contarini as existing in Antwerp.¹ An act of November, 1593, says, "There has been introduced within a short time a notable abuse in the Piazza di Rialto: that payments for exchange and merchandise, which ought to be made by accounts in bank or in cash, are made by a kind of transfer in which debtors assign to their creditors each one his debtor, and this debtor assigns another, and so on," to the great embarrassment and injury of creditors who really wish for their money, *se il creditor vuol valersi del suo per qualche bisogno*. This transfer (*giro*) of debts, when cash was really due, was therefore forbidden; and a few days later the act of December 14, 1593,² after a similar recital of the evil, made the well-known requirement for payment in bank of all bills of exchange, under severe penalty. The increase of transactions thus thrown upon the bank compelled the Senate, in April, 1594, to authorize an increase of clerical force in the bank; and they then took occasion to require that not only all letters of exchange drawn upon Venice, but all bills of a similar kind drawn at Venice and sold, should be settled for in bank, thus making payment in bank a legal tender for all commercial paper of this class.

The question whether the public bank with its restricted functions should have the sole occupation of the field of banking was finally decided by convenience rather than by deep policy. The act of 1584 had forbidden the establishment of private banks, *restando nell' avvenire proibito del tutto a' particolari il levar più banchi*;³ but this act being repealed, and the act of 1587 containing no such prohibition, the establishment of private banks may be said to have become possible, although for several years bankers were not forthcoming. But in February, 1596-1597,⁴ the Senate, after reciting the impossibility of meeting all the needs of commerce by means of a single bank, gave to Dionisio Contarini, who had served as governor of the public bank, leave to establish a private bank for six years. The banker bound himself to give

¹ See Lattes, p. 121.

² For the two acts of 1593, see Lattes, pp. 170, 171. In Colwell's "Ways and Means of Payment," in a chapter on the Bank of Venice, the date of this act is given on the authority of Savary as 1423. Mr. Colwell, adopting the traditional account as to the great age of the bank, easily accepted a date which carries the act back to a time when there was no public bank in Venice, and long before the establishment of any such provision as to exchange.

³ Lattes, p. 102.

⁴ *Ibid.*, p. 177.

security to an extent declared to be unexampled, and to supply the mint annually with an agreed quantity of gold and silver. All his receipts and payments were to be in good money of lawful weight, he was to undertake no public contract for merchandise, and payments offered by transfer upon his accounts were to be receivable only at the pleasure of the payee. Nothing more has yet been brought to notice respecting Contarini's bank; but in 1619 the Senate again gave a companion to the Bank of the Rialto by the act of May 3, creating the famous Banco del Giro,—the great public bank whose origin is so often said to date from the twelfth century.¹ The two banks, organized separately, but with similar powers, continued to work side by side until 1637, when the Bank of the Rialto was discontinued in consequence of the absorption of its business by the Bancogiro;² and the latter was then left as the sole occupant of the field.³

The circumstances under which the Banco del Giro was established are stated in general terms in the preamble of the act. Giovanni Vendramin had contracted to supply to the Venetian mint a large amount of silver, in bulk or in Spanish reals, and to receive payment, one-half in coin or in bank credit, and the other half in gold, either coined or in bars; and, as the rate at which he supplied the silver was low, the republic agreed to make him a large loan in bank credit. At the same time there were merchants, to whom the republic was indebted for goods and for bills of exchange, who had received assignments upon the mint and other public offices, the collections upon which were slow and embarrassed by official forms. To make a prompt settlement with Vendramin and with the other creditors, the new bank was created, and placed in charge of an officer called the *Depositario del Banco del Giro*; and the creditors were paid by being credited with deposits on its

¹ The act is given in full by Lattes, p. 183. As for repetitions of the legend referred to in the text, it is enough to cite among the latest, "Encyclopædia Britannica" (9th ed.), iii. 316; Appleton's "American Cyclopædia," ii. 273; "Dictionnaire des Finances" (1889), i. 291.

² Rezasco, who made a diligent search in the Venetian archives for matter relating to the two public banks, cites the order abolishing the Bank of the Rialto as dated January 2, 1637. "Dizionario di Linguaggio Italiano Storico ed Amministrativo," p. 85.

³ The Banco del Giro was so named, as has often been explained, because of the continual movement of credit by transfer from one depositor to another. The name distinguished the bank from the Banco della Piazza, but the practice referred to by it was in no way peculiar to the new bank, as has been shown already.

books. To enable the bank to meet the demand for payment to which it was thus exposed, a large sum in reals received from Vendramin was exchanged at the Banco di Rialto for current money; and this, with coin struck from silver in bulk supplied under Vendramin's contract, was placed in the Banco del Giro, to the extent of 150,000 ducats, as a reserve. It was also provided that payments of 10,000 ducats per month (increased soon afterwards to 30,000 ducats) should be transferred from the mint to the bank, until the sum of 500,000 ducats, the amount of the payments to be made to public creditors, should be covered.¹

The greater part of the act of 1619 relates to the organization of the bank and the duties of the officers to be appointed; and there is little pains taken to explain the functions of the institution so carefully officered and guarded. There is enough on the face of the act to make it clear, however, that the Banco del Giro was to be a deposit bank of the familiar type, holding, transferring, and paying deposits at the call of the depositor, like the existing Banco di Rialto, but performing no other of the functions of banking:—

That in this new Bank it shall not be allowable to exact any charge (*non si possi scuoder*) from merchants, but only to pay in cash, except to those who have overdrawn.

That no one shall refuse payment, in said Bank, of his credits, from one hundred ducats upwards.

That transfers of any amount may be made, although of one hundred ducats or less, at the convenience of merchants, provided the parties are agreed.

And, as the reason for establishing the large reserve described above, the law premises, —

Since one of the chief and most necessary considerations as to this Bank for the public and for the private interest is, that such a sum be assigned to it that not only private individuals may receive promptly whatever sum of money they may need to draw for the day, but that always, in case it should seem good to this

¹ These transactions can be made out with reasonable clearness from the preamble and the last four sections of the act of 1619 establishing the bank. An account is given of them by Rezasco, p. 82, with some details as to Vendramin's contract obtained by examination of the original. There is also a brief account given in a short memoir on the public banks, written near the end of the seventeenth century by the senator Bernardo Trevisan, and published under the title of "Informazione per il Banco del Giro" in Viganò's translation from Sonnleithner, "La Scienza del Commercio," p. 293.

Council to proceed to close the said Bank, the Capital may be ready in sufficiency to pay to every one his just due,

Therefore, be it ordered, etc.¹

These provisions undoubtedly contemplated the establishment of a cash-paying deposit bank, of which the reserve was supposed to be sufficient at the start for all probable demands, and was to be increased to the point of equality with the total liability. The credit of the bank was to be sustained, therefore, not only by the good faith and policy of the republic, but ultimately by the actual presence of all the money which the credit might represent. This system contained the least possible mystery, either as regards theory or practical operation; and the Bancogiro would have been simply a second Bank of the Rialto but for the fact that the debts of the republic to Vendramin and the other public creditors were the occasion for its creation. As it was, instead of opening for business with neither liabilities nor cash on hand, as a simple bank of deposit might have opened, the Bancogiro began with a large liability upon its books to certain creditors of the state, and with a considerable resource in cash, which the state agreed to fill up to the full amount of the liability. If we imagine the case of a government taking advantage of a demand for paper circulation by paying its creditors in notes convertible on demand, with the purpose of gradually accumulating in its treasury cash equal to the amount of notes in use, we should have a case strongly resembling the operation undertaken by the Venetian Senate in establishing the Bancogiro as one of its public offices.

These circumstances afford some explanation for the tradition that the Bank of Venice was originally a public debt;² and, taking into account further the fact that the Banco del Giro superseded the Banco di Rialto so effectually that the date of its own creation was, as it were, submerged, and that the transfer of deposits, the

¹ This statement is so important as showing the object of the reserve that it is worth while to present its text: —

“Et perchè una delle principali et più necessarie considerationi di questo Banco per il publico, e per il privato interesse, è che li sia fatto assignamento tale, che non solo possano li particolari haver prontamente qualche summa de denaro, che è loro bisognasse cavare alla giornata, ma che sempre, paresse à questo Consiglio il venir alla estinzione di detto Banco, vi siano pronti li Capitali sufficienti per dar ad ogn’ uno il suo giusto credito.

“Però s’ intendi fermamente preso, ecc.” Lattes, p. 189.

² This explanation is suggested by Rota, “Storia delle Banche,” p. 114.

giro practised by both, was their best known characteristic, and had also been the practice of private bankers for an unknown period, we can see the possible growth of the legend which finally assigned to the Bank of Venice a life of about six centuries.

The history of the Banco del Giro from its establishment in 1619 has never been written.¹ Materials for it exist in abundance in the Venetian archives; but, although they have been drawn from by Ferrara and Rezasco, nobody has thought it worth while to follow the bank carefully through its vicissitudes, and it is not certain that the gain from doing so would be great. For the present purpose, at any rate, it is enough to say that the republic did not find it easy to carry on the business of the bank in the regular course contemplated by the law. The engagement to fill up the reserve of the bank by monthly payments was, in effect, an engagement to pay off a public debt at that rate from revenue; and, this being found difficult, fresh creations of liability put off the time for completing the payments. In 1630 the closing of the bank was determined upon,² and the raising of the money needed for this purpose was provided for; but some changes in affairs—the effect probably of the breaking out of the war in Candia in 1631—caused this plan to be abandoned. The bank kept on with varying success and credit; and in 1650 money was again raised to cover in part the public debt and thus to place the establishment on a firmer basis. During all this earlier part of its history, however, the bank probably suffered as much from disorderly management as from the inability of the government to clear off its debt. Notwithstanding the elaborate regulations prescribed by law to insure against official malfeasance, frequent irregularities and frauds appear to have occurred; and several revisions of the regulations had to be made to check the negligence of responsible officers. In 1662 a great fraud committed by a bookkeeper was discovered;³ and it is to this culmination of evil in the management of the bank that the revision of its regulations in 1663 was due.⁴ The new code then published is filled with such minute

¹ See p. 166, below.

² See Trevisan's "Informazione," as cited above, p. 297.

³ Trevisan says "un enorme intacco." "Informazione," cited above, p. 298.

⁴ The *Ordini e Regole* of 1663 begin with this recital: "Vedendosi da gl' Infedeli Ministri neglette, e contravenuto a tante sapientissime Regole dalla prudenza dell'

provisions against neglect and misconduct, and contains such frequent references to abuses and fraud, as to give the impression of a constant struggle with unfaithful or dishonest servants.

The eighteenth century saw the cash office of the bank closed and specie payments suspended, from 1717 to 1739, as a consequence of the wars in which the declining republic was engaged for many years. The credit of the bank fell during this period, but recovered when the cash office was reopened by order of the Senate in 1739;¹ and thenceforward the commercial writers treat the bank as a solid and important establishment until the breaking out of the wars of the French Revolution. The embarrassment of the republic by the year 1797 had led to such drafts on the cash of the bank that, with a deposit of nearly 1,500,000 ducats, the reserve was reduced to a trifle over 522,000 ducats.² The bank, however, survived the occupation of Venice by the French; and when, under the treaty of Campo Formio in October, 1797, the Venetian republic was extinguished and the city was given to Austria, an effort was made to restore the credit of the establishment by creating a redemption fund, *fondo di Amortizzazione*, supported by a stamp duty on bills of exchange, bills of lading, and policies of marine insurance,³ and later by other revenues. The deficit was for a time reduced; but the Austrian administration found its own wants pressing and the coffers of the bank tempting, and in 1804 the deficit had again risen, according to Rezasco, to nearly 1,280,000 ducats. The *Fiscal deputato al Bancogiro* reported at some length in January, 1805, upon some reforms for the benefit of the redemption fund. But the defeat of the Austrians at Austerlitz and the treaty of Presburg in December, 1805, brought Venice under the French domination; and in July, 1806, Napoleon issued his decree for the liquidation of the debts of the Bancogiro, allowing for one-fourth of the amount of scrip receivable for purchases of public property, and registering the other three-fourths in the public debt called the Monte Napo-

Eccellentiss. Senato fondate per la buona direzione del Banco del Giro, anzi con fraude dannabile dilapidati i Capitali del Banco stesso con tanto universale gravissimo pregiudicio." In Marperger, "Beschreibung der Banquen," p. 190.

¹ For the decree, see Rota, "Storia delle Banche," p. 116.

² Rezasco, p. 83.

³ Proclamation by Count de Walis, imperial commandant, October, 1798, in the archives of the Frari: *MS. copy*, received from Mr. F. R. Grist, late United States vice-consul at Venice.

leone.¹ This stroke, by a heavy hand, closed a remarkable chapter in economic history.

Without seeking to trace more minutely the changes in the varying credit of the bank and their causes, it is important to observe the effect produced by the suspensions of payment, which, as has been seen, occurred several times, beginning with perhaps more than one such period during the war of Candia² between 1631 and 1669. In order to do this, however, we must briefly consider the nature of the currency used by the bank. The uniform statement of the writers who at any period had occasion to notice its currency is, that the ducat in which the bank kept its accounts was twenty per cent higher in value than the actual ducats in circulation, or, in other words, that the bank used a money of account which bore this premium when rated in current money. This, for example, is the statement made by Turbolo so early as 1629;³ by Malynes in 1656; by the author of the "Discorso," who wrote near 1760; and by Ricard and other commercial writers near the close of the last century. The ducat *banco* represented no coin, and as little did it represent, as some have supposed, a superior value caused by the high credit of the bank. Whatever the reason for the particular ratio selected, the establishment of a nominal bank ducat superior to the real ducat was an administrative provision probably made when the bank was opened or shortly after.⁴ It was, in fact, simply the establishment of an imaginary denomination, for use in accounting. The language of the "Discorso" as to what really took place when the bank was still in

¹ For copies of the report of the Fiscal Deputy in 1805 and of Napoleon's decree of liquidation in 1806, the writer is also indebted to Mr. F. R. Grist.

² It is probably a suspension during this war that Matthew Lewis refers, in his pamphlet "A Large Model of a Bank" (London, 1678), when he says that in the late Turkish wars the Senate was forced to expend all the specie: "now there is no money at all, neither is any money *in specie* ever paid out; but . . . the Fund is a meer imaginary thing."

³ Turbolo, "Discorsi e Relazione sulle Monete del Regno di Napoli," in Custodi's Collection, vol. i., p. 200.

⁴ Turbolo's statement, made in 1629, is that the difference of twenty per cent existed *da molto tempo*. Trevisan, writing near the close of the same century and after examination of the documents, says expressly, after describing the foundation of the bank, "In questo momento si stabilì anche una moneta propria per il medesimo banco," etc. "Informazione," p. 296. Malynes, "Lex Mercatoria" (edition of 1656), describes (p. 257) many cases of what he calls imaginary money. Among them is the Venetian ducat *banco*, but he does not remark upon it as in any way unusual.

full operation leaves no doubt on the point. If, says the writer, a person carries 1200 real ducats, *ducati effettivi*, to the bank, he receives credit for 1000 ducats *banco*; and if, having credit for 1000 ducats *banco*, he draws it out, 1200 real ducats are paid to him.¹ The so-called constant agio of twenty per cent was then simply the result of using two denominations to express the same real value, — as if the Bank of England were to keep its accounts in guineas, which are worth five per cent more than sovereigns, but are represented by no actual coin, sovereigns being used the while as current money. The agio presupposed freedom of deposit and freedom of withdrawal; and, such freedom being maintained, the agio would hardly rise and could not fall. It would not rise so long as credit in bank could be obtained by depositing coin, and it could not fall so long as 1200 real ducats could be drawn for every 1000 ducats *banco*. If there were a scarcity of bankable coin, the ducat *banco*, being required for certain payments, might conceivably be “cornered”; but this could not affect its relation to coin, and it could not depreciate except in the case of suspension.

The 1200 real ducats with which the depositor procured his credit for 1000 ducats *banco* were, however, ducats of lawful weight: whereas the coin in actual use in Venice, as in the other commercial cities of that age, consisted, to a great extent, of pieces below the standard, either from wear or from illegal practices, constituting a currency often much depreciated. The coin of full weight then bore a variable premium when exchanged for that in ordinary circulation; and thus we have what was called the *sur-agio*, which had to be taken into account in reducing bank money to everyday cash.² The agio represented the difference between the denominations used by the bank and by the public in dealing with standard money, and the *sur-agio* measured the depreciation of circulating coin below the legal standard.

These were the conditions under which the Bancogiro carried on its operations when receiving, transferring, and paying out, according to the scheme of its charter. The execution of this scheme

¹ *Quarterly Journal of Economics*, April, 1892, Appendix, p. xviii.

² Thus Kruse, “Allgemeiner Contorist” (Hamburg, 1753), p. 174, says, “Die Valute at entweder Banco, oder Corrente, oder Piccoli,” and then goes on to explain that *Banco* bears an agio of twenty per cent in *Corrente*, and *Corrente* an agio of twenty-nine per cent in *Piccoli*, defining the three *valute* substantially as above.

was several times interrupted, however, as we have seen, by suspension of payment. Besides one or two earlier suspensions of uncertain date,¹ the bank stopped its payments in 1691 and again in 1717, both times under the stress of war. In these cases, the Senate, closing the cashier's office, appears to have used for the public service the cash on deposit, and on the second occasion, if not on the first, according to the writer of the "Discorso," the supplies for the fleet were paid for by credits in bank, which, he adds, "is the same thing in substance as giving out notes instead of money." The statements made as to the effect of these suspensions on the credit of the bank are contradictory; but they may be reconciled upon a little reflection as to the connection between depreciation and over-issue.

It is plain that a currency which for important purposes is a legal tender would not lose its ease of circulation by becoming inconvertible, and might even be kept at par with specie, if its supply were strictly limited to the demand for the special purposes referred to, as, for example, in this case, the settlements for exchange. In short, the good credit sometimes enjoyed by the bank after suspending payment, which excited the wonder of foreign observers, like the English pamphleteer, Dr. Matthew Lewis, is the same phenomenon which has been observed in other cases, where inconvertibility has not been made the excuse for over-issue. The notes of the Bank of England did not seriously depreciate for ten years after the suspension of 1797; the notes of the suspended banks of New York and New England did not fall much below specie after the suspension of 1857; and the Bank of France from 1870 to 1878 generally kept its inconvertible notes close to par. Considering the difficulty found even by the present generation in comprehending such cases, it is not surprising that in the seventeenth century the Bank of Venice should have seemed to have in use an "imaginary money," independent of any cash basis, and, nevertheless, of higher credit than even coin itself. But the Venetian Senate was not always cautious as to the use of credits in bank, but, as in the case referred to above, yielded to the temptation or necessity of over-issue. The inevitable result then followed, — the ducat *banco*

¹ In Matthew Lewis's "Proposals to King and Parliament" (London, 1677) there is some account of a suspension, apparently not very recent, given by him on the authority of Venetian merchants, as evidence that credit is better than cash.

depreciated, notwithstanding its use in settlements for exchange and the supposed credit of the republic¹ The evil was of the simplest nature possible; and the remedy was as simple. After the long suspension from 1717² to 1739 the Senate finally, as an expedient, "a togliere ogni alterazione alla partida del Banco," to cite the words of the act,³ reopened the cash office, and, to insure its ability to continue its payments, devoted to this purpose 250,000 ducats then at the command of the government. In other words, depreciation was ended by resuming payment and restoring the convertibility of the ducat *banco*. No fiat of the Senate had given the ducat *banco* an invariable value when the bank was not paying its debts, and no such fiat was needed when these debts, to use an emphatic phrase from our own legislation, were again "payable and paid on demand."

Such a case falls strictly into line then with what happened to the Venetian private bankers when they suspended and again resumed, and with what happens in the nineteenth century when any bank of issue or of deposit goes through the same changes. That any mystery should have grown up as to the amenability of the Bancogiro to the recognized laws of value, is perhaps due in part to the belief that no depreciation took place when the bank suspended, which was industriously and ignorantly spread by some foreign writers, as has been noticed above. In part, also, the mystery is due to the failure to comprehend the meaning of the *agio*, in which, however, the merchant of the last century found nothing wonderful, as is clear from the matter-of-fact treatment of the subject by the commercial writers. The meaning of the *agio* is confused no doubt by the occasional efforts of the law to limit it to the regular rate, and to prevent speculation at times when either the scarcity of standard coin or the suspension of business at the

¹ As to the fact of depreciation, Savary may be cited, "Parfait Négociant," i. 464, where he remarks rather contemptuously that little harm was done, for those who lost confidence could easily find persons who would relieve them by purchasing their credits in bank at ten or fifteen per cent discount. Cantillon, "Essai," p. 412, apparently referring to the suspension of 1690 and using intelligence obtained from Venice, speaks of a depreciation of twenty per cent. Daru, "Histoire de Venise, iii. 135, says, "Les valeurs de banque continuèrent de circuler sans défaveur." But Daru, although he catalogued the "Discorso," seems to have overlooked among other things its express affirmation that the bank credit fell twenty per cent in the Ottoman War, and that the condition of credit was critical.

² See p. 107, below.

³ See Rota, "Storia delle Banche," p. 116.

cash office made it possible to “corner” the medium in which large commercial payments had to be made. Still, with the mind freed from the notion that credit can be worth more than cash otherwise than accidentally, — or, in other words, that a promise is worth more than the thing promised, — the *agio* falls into its natural place as the mark of a currency which is below the standard fixed by law or usage, and the transactions of the *Bancogiro* are seen to exemplify and confirm principles now recognized as of everyday application.

The proper limits of this paper do not permit a review of the daily operations of the *Bancogiro*, as described by the writer of the “*Discorso*.” His account of the Depository taking his place in full view of the *Piazzetta*, ringing his bell when the concourse of merchants on ‘change shows that the time for banking has come, and setting his hour-glass to mark the beginning of the two stated hours, the *viva voce* dictation of transfers by depositors so that the clerks may make the entries in duplicate, the peremptory close of transactions at the sound of the bell and the drawing of the *marcella*, the removal of the books to the grated chambers, the careful separation of the two sets of books and of clerks, so that no collusion may invalidate the comparison of the balances when finally drawn off in duplicate, the use of Roman numerals in some of the accounts rather than Arabic, — all this gives us the picture of a leisurely, punctilious, and traditional movement, well adapted perhaps for a city with declining commerce, but not for one in the hurry and bustle of full prosperity. The private bankers, more ready to adapt themselves to the needs of the community, had served their purpose, but had paid the penalty of inexperience in dealing with credit. The public bank had replaced them, had discarded a part of their functions, and had reduced the remainder for safety to an inflexible routine. In this form, however, the public bank had no longer the power to adapt itself to the needs of commerce in a rapidly changing world; nor was it saved from loss of both cash and credit by the hand of the government. Even without the shock of the French Revolution, then, and without the final order for liquidation from Napoleon, it is not probable that its importance could have continued long. The *Bancogiro*, like the Bank of Amsterdam, could have found no place in the nineteenth century.

POSTSCRIPT¹

In the article on the origin and nature of the Bank of Venice, the remark was made that the history of the Bancogiro from its establishment in 1619 has never been written; and it was added that, although much material exists, "nobody has thought it worth while to follow the bank carefully through its vicissitudes, and it is not certain that the gain from doing so would be great." The writer of the article regrets that by his failure to observe the monograph *Il Banco Giro di Venezia* of Professor Soresina,² he has done injustice to a valuable work and a meritorious writer.

Professor Soresina, in preparation for his work, made a laborious examination of the material existing in the Marcian Library and in the Archives of the Frari, and appears to have thoroughly explored these sources. This investigation enabled him to make a careful review of a period of Venetian banking history which the present writer was obliged to dismiss in two pages, and to present a body of information as to the actual operations of the bank far more important than had ever before been made public. The course of legislation with respect to the bank is followed closely, some statements of account which have survived are presented, and several documents of great interest are given in full. Among these are the offer made by Giovanni Vendramin, in 1619, to supply the mint with a large amount of silver, which led to the establishment of the Bancogiro, and the text of the act which closed the Banco di Rialto in 1637.

In several particulars the accurate information secured by Soresina corrects or explains statements previously current as to the affairs of the bank, and particularly with respect to its suspensions of payment. The period beginning with 1630, in which the bank was supposed to have suspended payment perhaps more than once, now appears to have witnessed a continuous suspension from 1630 to 1666, when the opening of the cash office put an end to the forced payment by transfer of bank credits. It was to this long suspension, then, that Matthew Lewis referred in his "Large Model of a Bank" in 1678 as the expenditure of all the cash in the bank "in the late Turkish wars." The effort in 1630 to take

¹ *Quarterly Journal of Economics*, January, 1893.

² Amaleo Soresina, "Il Banco Giro di Venezia." Venice, 1889. 8vo, pp. 94.

measures *a saldare ed estinguere il Banco* appears to have contemplated, not the closing of the bank, but provision for extinguishing its debt, which was then overwhelming. Of a suspension of the bank in 1691, mentioned by McLeod and others, Soresina gives no notice; nor was any trace found by Signor Siboni in the documents at the Frari.¹ On the contrary, the cash office appears to have remained open from 1666 to 1713.

The second long suspension then began, which ended with the second reopening of the office in 1739. The date of this failure, which had been incorrectly given by the present writer as 1717, shows that the occurrences of which Cantillon received information ("Essai sur le Commerce," pp. 409-412) related to the second, and not to an earlier suspension; and the measures which he mentions, without dates, as taken for the purpose of raising the credit of the bank, are apparently the steps taken for that purpose in 1718, and described by Soresina (page 41).

¹ *Giornale degli Economisti*, September, 1892, p. 292, note.

ACCOUNTS OF THE FIRST BANK OF THE UNITED STATES¹

THE first Bank of the United States was obliged by its charter to report its condition to the Treasury Department as often as required, not exceeding once a week. It is well known that Mr. J. J. Knox, when Comptroller of the Currency, found that the existing records do not show that any formal reports were ever made. Two balanced statements were given to Congress by Mr. Gallatin, one in March, 1809, and the other in January, 1811; and it has sometimes been assumed that these were the only reports ever made.

That Mr. Knox's search in the Treasury Department brought no reports to light proves but little. The Treasury Department, it will be recollected, was burned when Washington was occupied by the British forces in August, 1814; and it was burned again in March, 1833. The official statements made to Congress as to the documents and books lost and saved on these two occasions raise a presumption that any such reports, if in existence at the time of either conflagration, would not have been among the papers saved, the effort being made in both cases to save primarily what was needed for the current public service. The failure, therefore, to discover at the present time a set of papers, which even in 1814 had only an historical value, cannot be regarded, under the circumstances, as having any weight.

There are, however, many pieces of evidence scattered in the public documents tending to show that the bank was required by the Treasury Department to make frequent report of its condition, and that it did so in obedience to the law.

The most complete account which we have is that which was sent to the House in January, 1811, as above stated, and is given in "State Papers on Finance," Vol. II., page 468. This statement, made in much detail, is said by Mr. Gallatin in the letter

¹ *Quarterly Journal of Economics*, July, 1892.

communicating it to be “extracted from the latest returns received at this office from the bank.” It was then one of a series. The return of 1809 above referred to, printed *ibid.*, page 352, although a balanced account, is given in round numbers and has been stigmatized as an account “trumped up”; but Mr. Gallatin’s letter transmitting it states expressly that the amount of the principal items “is taken on a medium,”—that is, it is an averaged account, and no more “trumped up” than the averaged accounts now published weekly by the clearing-house. Mr. Gallatin’s language shows that he preferred to give an averaged account, because it better represented the ordinary condition of the bank than the actual figures at the date of his report; and, as the question before Congress related to a renewal of the charter, it was the ordinary condition of the bank which Congress most needed to understand. For the present purpose, however, the important point is that, in making a statement “taken on a medium,” Mr. Gallatin probably had before him the various detailed statements of which this medium is the average. In one other instance we have direct evidence that an account of the bank was in possession of the government. In Gallatin’s “Writings,” Vol. I., page 59, Jefferson writes to Gallatin, November 11, 1801, giving a comparative table of certain items in the accounts of the Bank of the United States and of banks in several of the principal cities. If we take the items relating to the Bank of the United States and arrange them in their proper form, we find that they make up an account as follows:—

LIABILITIES		RESOURCES	
Capital,	\$10,000,000	Discounts,	\$12,150,000
Undivided Profits, . . .	40,000	Six per cent and ad-	
Notes,	5,200,000	vance to government,	5,460,000
Deposits,		Due from banks, . . .	1,450,000
Government,	3,560,000	Specie,	5,000,000
Individual,	5,240,000		
	<u>\$24,040,000</u>		<u>\$24,060,000</u>

It is sufficiently evident that Jefferson in this case had a balanced account of the bank which he simplified by throwing off the thousands, this process causing the discrepancy which appears in the totals of debit and credit.

Besides these references to other statements than those now known to exist, there are numerous significant allusions to be found in Gallatin's correspondence and in the debates in Congress upon the proposed renewal of the charter. Thus, in Gallatin's "Writings," Vol. I., page 80, we have Gallatin, in June, 1802, comparing the condition of the Bank of Pennsylvania with that of the Bank of the United States. To cite only one passage from the debates, we find Mr. Finley, on April 30, 1810, saying in the course of his speech that "the Secretary of the Treasury has, for the time being, had authority by law to inspect the directors of the bank, and did do it, and obtained weekly returns of its situation." In Gallatin's communication to the House, January 10, 1811, in "State Papers on Finance," Vol. II., page 460, there are significant references to "the returns made to the Treasury," and "the official statements transmitted in conformity with . . . the charter," and the like. And in Mr. Gallatin's well-known "Considerations on the Currency and Banking System," published in 1831, we find him making a general statement as to the proportion which the loans made and stocks owned by the bank bore to its capital for the whole of its existence, — a statement which a man of his caution would not have made without full documentary evidence. In short, there is ample reason to believe that, when the stockholders declared in their petition for a renewal of the charter, in April, 1808, "that the confidence of the government [was] founded upon a constant knowledge of the interior management and condition of the bank," they told the truth. Indeed, it is inconceivable that they should have made this statement to a Congress in which their opponents had the majority, if there had been any possibility of a denial.

That the accounts given to the Treasury Department were not made public, as they would be in our own day, is not surprising, when we see the different view then commonly held as to giving publicity to such statements. For example, in Jefferson's letter of November, 1801, referred to above, it will be observed that he suggests that statements from the state banks should be generalized, and the total of the yearly average should be presented to Congress. "It would give us," he says, "the benefit of their and of the public observations, and betray no secret as to any particular bank." And it will be recollected that at that period the

Bank of England, on which the Bank of the United States was closely modelled, made no publication of its accounts, and that it was not until 1834 that even a quarterly statement was required to be made. In the earlier part of the century the public could learn nothing as to the condition of the bank, except the selected facts cautiously given out in Parliamentary investigations. Mr. Tooke, in his evidence before the committee of 1832, in "Parliamentary Documents," 1831-1832, Vol. VI., described the accounts thus given of the cash held by the bank at some critical periods as "mystical"; and some important witnesses, even in 1832, maintained that to give the bank accounts to the public, especially to state the amount of bullion held, might be a mischievous practice. It is not surprising, then, that the accounts of the first Bank of the United States down to 1811 were regarded as confidential. That under the seal of confidence they were regularly made, from an early period and probably for the whole of the bank's existence, seems to be more than probable.

DEPOSITS AS CURRENCY¹

IN the discussions upon the various phases of the currency question during the last twenty years, the popular dread of contraction and its consequences has seldom been appealed to in vain. Congress has been a good index of public opinion in this respect, and in Congress there has steadily been an element which seemed to have grasped the idea of a connection between contraction and falling prices, as the one and sufficient key to the practical questions which were to be settled. To this fact were due the weak legislation of 1874, to go back no farther, and the necessity in 1875 of so framing the Resumption Act as to leave its meaning open to opposite constructions and its operation uncertain—a necessity which Mr. Sherman, in carrying the bill through the Senate, did not seek to disguise. Nothing else than a deep conviction in Congress that “the people would not stand contraction” can explain the fact that the act of May 31, 1878, “to forbid the further retirement of legal tender notes,” was carried through the House of Representatives under a suspension of the rules and without a word of discussion, the decision of the question as to the meaning of resumption and the perpetuity of the legal tender issues being treated as of less consequence than the appointment of a doorkeeper. And, in the discussions of the national banking system, the same dread of contraction, or of a supposed popular fear of contraction, constantly appears, and shapes the expedients offered by the opponents, and sometimes by the friends, of the present system.

This, however, brings forward in a convenient form the question, What is the currency of which the contraction is thus dreaded? In the resumption discussions, it was assumed that, apart from specie, the legal tender and bank-notes make up the currency; the amount of each kind outstanding was anxiously computed, and the increase or diminution of the aggregate

¹ *Quarterly Journal of Economics*, July, 1887.

noted as a decisive fact. And so, too, in later discussions, the sinking of bank-note issues, while the legal tenders are constant in amount, is often treated as a portent, the lesson of which is either the remodelling and renewing of the system or the substitution of government paper for bank-notes, as may be preferred. Without attempting a formal statement of the constituents of the currency, the writer wishes to recall the fact that there is a kind of bank circulation more important than bank-notes, and that the theorems of currency cannot be correctly applied if this is ignored.

The ease with which we ignore deposits as a part of the currency seems the more remarkable, when we consider that few men in business fail to recognize the true meaning of this form of bank liability; that it is a circulating medium in as true a sense and in the same sense as the bank-note, and that, like the bank-note, it is created by the bank and for the same purposes. McLeod's remark, that "every bank is a bank of issue," may seem a hard saying: still, every man of affairs would be found applying it in practice and recognizing the essential truth contained in it in a tolerably distinct manner; and probably one reason for the moderate interest which practical men are apt to take in discussions of currency is, that such discussions so commonly deal with what experience shows to be only a part of the essential elements of any actual question.

It is interesting to observe that, in the early efforts to deal with the subject of credit currency in this country, the greatest of the financiers on each side recognized plainly and constantly the true significance of bank deposits. Hamilton at the start made a statement which could hardly be improved upon:—

Every loan which a bank makes is, in its first shape, a credit given to the borrower in its books, the amount of which it stands ready to pay, either in its own notes or in gold or silver, at his option. But, in a great number of cases, no actual payment is made in either. The borrower frequently, by a check or order, transfers his credit to some other person, to whom he has a payment to make; who, in his turn, is as often content with a similar credit, because he is satisfied that he can, whenever he pleases, either convert it into cash or pass it to some other hand, as an equivalent for it. And in this manner the credit keeps circulating, performing, in every stage, the office of money, till it is extinguished by a discount with some person who has a payment to make to the bank to an equal or greater amount.¹

¹ "Report on a National Bank" (1790), iii. 128, of Hamilton's "Works" (Lodge's edition).

Gallatin was quite as explicit as Hamilton, stating his proposition more than once,¹ with a wide interval of time, substantially as follows:—

The bank-notes and the deposits rest precisely on the same basis. . . . We can in no respect whatever perceive the slightest difference between the two; and we cannot, therefore, but consider the aggregate amount of credits payable on demand, standing on the books of the several banks, as being part of the currency of the United States. This, it appears to us, embraces not only bank-notes, but all demands upon banks payable at sight, and including their drafts and acceptances.

These citations, embodying a principle which perhaps stands in little need of formal exposition, show plainly enough how far much of our discussion and even of our legislation has drifted from the position taken at the outset. The current of our legislation for years has not only treated note issue as the subject of chief interest, but has often proceeded on the theory that nothing else need be considered; and the debate, in Congress and out, has run chiefly upon the greenback and the bank-note. This absorption of all interest by the inferior constituent of our credit currency is easily explained. Besides the apparent ease of legislating upon note issues and the obvious difficulty of legislation upon deposits, the notes were, in the earlier decades of our history, the more important of the two. The comparative sparseness of population and the imperfect development of the banking habit, in a new and more slowly advancing country and in a less advanced age than the present, created an early preference for the currency which passes from hand to hand, and discouraged the use of that which implies a resort to the bank. Even in the abnormal years 1809 and 1811, when all business was stagnant as the result of the embargo and subsequent non-intercourse, the note circulation of the Bank of the United States was little below its debt to individual depositors, as shown by the only statements of that institution ever given to Congress; and, in the accounts even of the best developed state banks of that date, the notes have clearly the first place. The figures collected by Gallatin for 1820 and 1829 show the same preponderance of note circulation. The returns collected by the Treasury for many years, under the resolution of July, 1832,

¹ See his report to the Senate (March 3, 1809), in "State Papers, Finance," ii. 351; and his essay on the "Currency and Banking System," "Writings," iii. 267, 268.

show that it was not until 1855 that the deposits of the banks taken in the aggregate rose above their circulation. Even under such special circumstances as those of Massachusetts, the notes continued to be the more important element until 1858, with the exception of an irregular period from 1806 to 1823, and two or three scattered years of exceptional conditions.¹

And not only were the notes practically the more important during these years, but events riveted the attention of the public upon them. The suspension of specie payments at the close of the second war with Great Britain, the history of the second Bank of the United States and the struggle for its recharter, and the hard-money movement which finally led to the independent treasury system, all tended to keep the notes in the foreground, and to give the impression that banking is synonymous with note issue, as the old acts of Parliament treated it. The long-continued suspension of 1861 and the later controversies, turning primarily on the questions raised by the greenbacks, but involving the bank-notes, have easily and naturally followed the same line.

Our experience resembles that of other countries in this respect. Even in England, where modern deposit banking had its earliest development and has reached its highest point, and where for more than forty years legislation has set the note circulation apart in such a way as to bring into the strongest possible relief the currency function of deposits, there is the same trouble in realizing a patent fact, and, if we may trust Bagehot, from the same cause:—

Probably up to 1830 in England, or thereabouts, the main profit of banks was derived from the circulation; and for many years after that the deposits were treated as very minor matters, and the whole of so-called banking discussion turned on questions of circulation. We are still living in the *débris* of that controversy; for, as I have so often said, people can hardly think of the structure of Lombard Street except with reference to the paper currency and to the act of 1844, which regulates it now.²

Even a writer usually so much in sympathy with the practical movement of the times as Jevons, in his "Money and the Mechanism of Exchange," shows a singular inability to free himself from the old notion that money and bank-notes are nearly all that need

¹ See Gallatin, "Writings," iii. 291, 296; and *Report of the Comptroller of the Currency*, 1876, pp. 38-46, and Appendix.

² "Lombard Street," p. 85.

be dealt with in treating of currency. The real importance, however, of the neglected element is shown by the published returns. At the close of 1886 the total note issue of the United Kingdom, including that of the Banks of England and Ireland and of all private banks and joint-stock banks, was slightly over £50,000,000.¹ At nearly the same date the deposit accounts of the joint-stock banks of the kingdom, nearly all shown by published accounts, amounted to £446,800,000, and the "other deposits" of the Bank of England to £29,000,000: so that, with allowance for private banks and others for which estimates only can be had, it is probable that there was an aggregate of £560,000,000 to £570,000,000.² The chief expansible element of the currency, on which the growth of English domestic trade and the adjustment of a constantly swelling mass of transactions have mainly depended, has been this vast system of transferable credits, which still waits for its due share of attention in economic discussion.

England is still cumbered by the *débris* of the old controversies over note issue, but the continental countries are still in the heat of controversy itself. The question as to the close monopoly held by the Bank of France and the monopoly held by groups of banks in Germany and Italy, together with the imperfect development of what we have called the banking habit, has curiously narrowed all current discussion as to "banks of issue," and has made questions of banking seem to turn upon the kind of evidence by which the existence of similar debts may happen to be certified. The whole continent is, in fact, in much the same stage as England and the United States before 1830 as regards practical methods. The "account current" holds its place in the statements of the continental banks, but the place is not an important one. The check has helped to introduce the clearing-house; but progress is slow, and the scale of operations—while it shows a gain of convenience for the banks concerned—does not indicate the use of the machinery as a vital part of the circulating system of a country. Continental writers, therefore, have naturally done even less than English toward setting the deposit and check system in its true light.³

¹ *Journal of Statistical Society*, March, 1887, pp. 251, 252.

² See *Economist*, May 21, 1887.

³ Courtois, who recognizes with tolerable distinctness the similarity between the issue of notes and the opening of a deposit account, makes the *naïve* remark: "On a

In making the inquiry as to the share taken by deposits in the active circulation of the United States, we happily have a good source of information in the reports of the Comptroller of the Currency. These reports give, with precision, five times a year the circulation and deposits of all the national banks; and from these statements a sufficiently fair average for any year or any six months may be struck. The tax formerly levied by the United States upon deposits also brought into the Treasury returns from all banks and trust companies doing business under the laws of the several States and from private bankers, which may fairly be taken as accurate down to November, 1882, when the repeal of the tax put an end to the series. Since that date, moreover, the successive comptrollers have obtained from official sources such information as could be had respecting state banks and trust companies; and this, although imperfect and not given for uniform dates, is an approximation to the actual movement down to the present time. Of the reported deposits of trust companies only a small proportion represent the trusts held by these companies; but by far the greater part belongs to the banking business, which is their chief function. And, although the action of parts of their deposit accounts may be sluggish from their methods of dealing with customers, — as is also true in some degree of any bank, national or state, — it seems not unfair on the whole to let these deposits stand on the same footing as those of the ordinary banks, especially in view of the probability that the figures are within rather than beyond the truth. Unfortunately, there are no longer the means of determining the amount of the deposits with private banks and bankers; it was probably not overstated before 1883, and it can only be said that the amount, if it could be known, would probably show that the increase observed down to that date has continued since. Taking then, for comparison, the six months' averages which the Comptroller's reports give for the banks other

créé un concurrent au billet de banque, il est vrai, mais un concurrent bien faible; quel stimulant à déposer des espèces en compte courant à la Banque, si on ne vous sert aucun intérêt?" "Histoire des Banques en France," p. 241. Wagner, in his article in Schönberg's "Handbuch" on "Credit und Bankwesen," has some important remarks on the origin of "book-credit deposits" and their use as a real substitute for notes. See §§ 54-57. Knies, in "Geld und Credit," fails to reach any clear conception of the function of deposits.

than national, the figures from these sources may be grouped as shown in the following table:—

[In dollars, 000,000 omitted.]

	NOTES		DEPOSITS			
	Nat. Banks	Nat. Banks	State Banks	Trust Cos.	Priv. Bankers	Aggregate
Average for 6 months ending						
November 30, 1875	318	675	—	487	—	1,162
May 31, 1876	308	617	—	480	—	1,097
May 31, 1877	293	640	—	471	—	1,111
May 31, 1878	301	611	230		184	1,025
May 31, 1879	304	614	257		140	1,011
May 31, 1880	321	799	319		183	1,301
May 31, 1881	309	989	386		242	1,617
May 31, 1882	321	1,047	452		296	1,795
November 30, 1882	312	1,095	490		289	1,874
For year 1883	311	1,054	335	165	?	[1554]
1884	292	1,010	325	189	?	[1524]
1885	271	1,071	344	188	?	[1603]
1886	242	1,146	343	214	?	[1703]
Amount on March 3, 1887	186	1,225	—	—	—	—

There can be little doubt, then, that in 1886 the aggregate deposits of banks and bankers in the United States, savings banks being of course excluded, were on the average above two thousand millions; and there may be said to be a high degree of probability that at the present time the aggregate stands at nearly double the amount which was returned for 1875. The increase has not been without interruption. The total has fallen in periods of depression, and it has risen with regaining confidence. Indeed, the changes in the business situation of the country, acting through the demands of persons dealing with the banks, of necessity leave at this point a permanent record of their passage. But the fact which it is chiefly desired to emphasize here is the complete elasticity of this section of our currency. It adapts itself to the demand of the moment without visible effort and either by expansion or contraction, as the case may be; and it does this quite irrespective of legislative purpose or guidance. From the

figures, indeed, the conclusion is irresistible that, if for any reason the creation of deposit currency through the agency of the national banks is hindered or limited, it will make its growth by means of state banks; and, if not by these, then by a system of private banking, which no legislation can touch, until the government shall assume the power of declaring whether A may owe B or not. The growth of this kind of credit may be guided and it may be made more or less sound according to the wisdom of legislation. The stability of the standard to which its value relates is wholly within legislative control, and the continuity of the test of its solvency by reference to that standard is within the scope of legislative influence. But, whether the legislation be good or bad, here is the adjustable part of our system of credit currency, and the part of it which will continue to adjust itself to the scale of the transactions to which current business naturally gives rise.

In view of the extraordinary growth of this kind of credit currency, the mere question of the amount of national bank-notes in circulation sinks into insignificance, and with it the question whether their place must be made good by other descriptions of paper, as, for example, by greenbacks. There is a real question as to the convenience of using coin, in place of a part of the paper which the community uses in its small transactions; there is a question as to the wisdom of depriving a great system of banks of the ability to supply whichever form of credit may be required by the public; and there is a grave question as to having any larger part of our credit currency, or any part of it, subject to control as regards its amount, by any legislative body whatever. But as regards the mere question of contraction, still sometimes brought forward with respect to the paper currency, the grounds for it have ceased to exist. For, besides the fact that since resumption specie has come in and must continue to come, through an ever open door, to make good any deficiency of circulating medium, the growth of deposits has covered many times over all loss in the amount of paper circulation. In fact, as soon as specie payments were firmly established and the value of credit currency was settled, by its assured conversion at pleasure into a solid medium, contraction ceased to be any proper object of dread. Indeed, we may go farther, and say that if the United States government were to pay off every legal tender note, and if every bank-note were to

be withdrawn, these changes would produce no real contraction of the currency. With specie thus brought into common use for smaller and everyday transactions, we should, it is true, have a currency far less convenient for its minor uses, and we should no doubt see the use of the deposit and check system thus carried prematurely into classes of transactions and into sections of country where the note now meets a popular demand; but, as regards the mass of exchanges from which the business condition of the country at any given time takes its tone, we should find them carried on as now, by a creation of bank credits on whatever scale the needs of the time might require.

Upon this point sufficient evidence is presented by the operations of the national banks since the resumption of specie payment. Of these operations, the great results are clearly shown in the diagram issued with the comptroller's report for 1886. Inspection of this diagram shows an enormous expansion of the general scale of transactions by the banks since 1879. This expansion has come only in a moderate degree from the application of new banking capital; it has come in spite of the sinking of the line which describes the changes in circulation, and chiefly from the sharp rise of the line of deposits during the flush period from April, 1879, to December, 1881, and again from the fall of 1884 to the present time. The elastic power of the deposit currency, and the certainty with which it fills the void left by the disappearance of paper, could not be illustrated better than by the soaring of the red line as the black one sinks, upon Mr. Trenholm's chart.

The legitimate inference from these considerations is not, however, that the disappearance of the bank-note, or the substitution of government paper for it, is to be viewed with indifference. The business of a country in which the banking habit is firmly seated will, it is true, find a medium of exchange, and in the amount needed; but it is of great consequence that the medium used should be made up of the kinds most convenient for the use of the community, and divided between those kinds in the proportions most convenient. This question of proportion is one which no combination of counsellors, public or private, can determine. No legislature and no conclave of bankers can say that

the people of the United States require any given amount of notes for the management of their exchanges. The amount which is sufficient this year may, and almost certainly will, be either insufficient or in excess the next; and it is partly from a sense of the absolute inability of any human foresight to deal with this problem, that we owe the multitude of schemes proposed in years past "to adapt the amount of the [paper] currency to the needs of the country."¹

Left to itself, the country settles this problem of proportion in a natural way, by the demand which each individual using a credit currency of any kind will make for notes or for a deposit account, as his special conditions may require. But, in order that this natural process should go on easily and without inconvenience to the community, it is requisite that the banks or bankers with whom individuals deal when obtaining loans or receiving payments should have the ability to respond to demand in either form; in other words, that the creditor of the bank or banker should be able to receive the evidence of his claim in the one form, if he expects to use it in large operations or in a closely settled community, or in the other, if in small operations or where hand-to-hand dealings are the rule, and that the lender should find his profit equally in responding to either demand. It is only by being allowed to take one or the other form, as occasion requires, that a given mass of bank credit can perform its functions with the maximum of public advantage. There may be sound reasons of a different order for not giving the power of issue in both forms to every company or individual carrying on the business of banking; in other words, the ideal of a perfectly free system of banking is no doubt beyond reach; but that, for the greatest advantage of the public, the issue of notes by banks should be widely enough diffused to present in every considerable district which uses banking facilities at all the easy choice between the two methods of using credit, seems to be beyond dispute. This choice is given only when the power of issue is substantially in

¹ It is true that there is a party who believe that the issue of notes for the country should be fixed and "have no elastic power." See Mr. Buckner's speech in the House on the extension of bank charters, April 17, 1882. And a Secretary of the Treasury once committed himself to the astonishing proposition, that the issue of bank-notes ought to be fixed in amount and the issue of legal tenders adjustable by the Treasury, according to its conception of the needs of the time. See *Finance Report*, 1872, p. xx.

the same hands which control the loans and the business of banking generally. It is, in fact, one of the great services rendered by the national banking system that, for a most critical quarter century, it carried note issue and deposit banking side by side throughout the greater part of the country, under the management of a class of remarkably sound institutions, giving to the community many of the benefits of free banking with the minimum of its risks. As a substitute for this system, the issue of notes by the Treasury is as little to the purpose as the striking of coins by the mint; nor is there any machinery by which the operations of the Treasury can be made to perform the desired office. Happily, those operations are quite distinct from the commercial movement of the country, and are unsuited by their nature for any closer connection with it, even if such connection were expedient.

To the firm establishment of the right of note issue as a practical alternative given to the banking system of the country, it is doubtful whether any serious opposition would have arisen had there not been an impression that in some way this right is the opportunity, either for an exorbitant profit or, at any rate, for a profit which should be reaped by the government. As regards the amount of the profit coming from circulation, no real answer has ever been made to the computations by which the late Comptroller repeatedly demonstrated in his reports the trifling margin of gain left by the use of credit in this form. Whatever may have been the profits of banks from this source fifteen years ago, with the rates of interest then prevailing, there is no doubt as to the comparative unimportance to-day of using their credit in a form which requires as a preliminary the investment of capital at the rate of two and one-half per cent. Indeed, the figures show that, by jealously maintaining the primitive forms of the national system under altered conditions, note circulation has long been systematically discouraged and its essential advantages for the public sacrificed.

To every practical demonstration of the narrow margin of profit, however, the common reply is, after all, a more or less open appeal to the theory of a supposed double source of profit under a secured issue—a theory which has had a strong hold on the public, and has not always been met with complete perception of

its hollowness, even by the friends of the national system. For the present purpose it is enough to point out that the source of profit for any bank is the investments in securities or loans which it can hold, by the use of its capital, together with its credit in any form; that its profit is not increased by pledging any part of the investment to secure any class of liabilities; and that, therefore, the sources of profit open to national banks issuing notes are of precisely the same order as those enjoyed by state banks and private bankers. The national bank has the great advantage of a choice between methods of using its credit; but, however its choice is made, its investment is necessarily measured by its capital *plus* its credit, which is also the measure for its non-issuing neighbors. The confinement of the national banks therefore to the use of credit in one form, instead of giving them an alternative between two, would not cut off a double profit now enjoyed, but would merely require that the credit by which a part of their profit is earned should be evidenced by book account, and not by demand note, or *vice versa*. In short, the profits of the banks are increased by the right of issue only so far as that right makes it possible to extend the credit of the banks, and so to increase their holding of investments, beyond the point which they could reach by the use of the deposit system alone. But the swift extension of deposits already pointed out makes it extremely doubtful whether the extinction of the note issues would now have any serious effect on the total amount of bank credit used or any practical result other than a certain inconvenience to the public. Barring the effect on some of the smaller interior banks, the probability is that the national banks in the aggregate would, even without the right of issuing notes, continue to expand their business and to earn such dividends as the current rate of interest would have allowed in any case. This is the natural inference from the fact, already noted, that hitherto the displacement of their notes has been far more than made good by the increase of deposit accounts.

That the government makes a saving by the issue of its own notes, so far as these are the substitute for an interest-bearing debt, and that it might make a still larger saving by occupying the whole field of paper circulation, is an independent consideration. It is, however, plainly a consideration of very little practical value, when we take into account the ease with which ordinary sources of in-

come enable the government to reduce its debt as well as meet its expenditure, and the fact that the disposition of a surplus revenue has been so far an insoluble problem. Obviously, the government of the United States can *afford* to settle the currency of the country upon whatever basis is found to be for the convenience and advantage of the public, without being diverted from this aim by any necessity for securing a certain number of millions. It is conceivable that other functions now left to private enterprise might at a pinch be assumed by the Treasury and made to produce a revenue ; but few persons would pretend that there is any fiscal reason which could be of weight in favor of such an assumption, if it appears that the general interest is in any way promoted by leaving the service to individuals. Economy at any cost is not our rule in dealing with other subjects, and there is no reason why it should be a controlling consideration in the regulation of any part of our currency.

Assuming, then, that the profits of note circulation are but the ordinary profits of bank credit, such as will be earned under whatever system may finally prevail, and assuming also that the government can afford to forego the use of its credit in the form of notes, and to allow the banks to continue and extend the use of theirs, the question as to our banking system resolves itself into the inquiry, whether it is for the interest of the public to keep deposit banking as far as possible under the national system, or to allow it to drift more and more into the possession of state banks or into private hands. The optional use of the right of circulation being removed, not much is required, it would seem, to turn the scale as between a national charter, on the one hand, with its numerous safeguards and its strict public supervision, and a state charter, on the other, with its frequent absence of all limitations — to say nothing of the complete license of private banking. The fact of the existence of nine hundred state banks and of thirty-six hundred private banking-houses is evidence on this point. “It is doubtful,” says Mr. Trenholm, “whether the banks would find sufficient inducement to remain in the system without enjoying some privileges as to the issue of currency.”

The doubt whether there is power under the Constitution to charter banks except in connection with an issue of notes may probably be dismissed ; but not so the doubt whether banks would

care to hold national charters if the power of note-issue were withdrawn. For here the comparative soundness and safety of the whole of our credit currency come into question, and we have to ask, What is the safest system for its more important as well as its minor element? If there is reason for demanding that the currency used in the small transactions of the community shall be secure, there is also reason for requiring that the greater currency used in large transactions shall be secure. That complete supervision of the latter is impossible from the nature of the case does not affect the result: it is still for the advantage of all that as large a proportion as possible of the sources of our real currency should be kept under that organization which practically is found to insure the best oversight and the safest management. There is no doubt as to which organization that is. The conclusion seems, then, to be irresistible that, if the national system can retain its control over twelve hundred millions of deposits, as the figures now stand, and perhaps extend its control over a part of the eight or ten hundred millions held elsewhere, the community would buy this result cheaply by allowing the issue of such proportion of bank-notes as this mass of business would imply. The risk of inflation from overissue would not be a serious element in the account. It would not be appreciably greater than at present; for, after all, inflation is as easy and, under favoring conditions, occurs as surely with a system of pure deposit as with a note system, as the operations of our own banks in any period of excitement may testify. And, in any case, the security against the consequences of inflation is not to be found in the limitation or extinction of notes, but in specie redemption for all liabilities, and in the encouragement given to sound banking by steady oversight and publicity. Such security, it may be presumed, we shall continue to have under the national system in as great a measure as at present.

The kernel of the banking question for the United States, then, as it seems to the writer, is to be found in the future of the deposit system. If this is settled upon the best plan practicable, the substance of the question will have been disposed of; and, for the purpose of such settlement, the continuance or perhaps it should be said the revival, of the right of issue might well be allowed as a makeweight. It is not within the scope of this paper to discuss

the various propositions for meeting the practical difficulty arising from the extinction of the national debt. It may be said of these propositions in general, however, that they are expedients for prolonging the existence of the national bank-note issue for such time as any part of the national debt may remain unpaid, postponing the main question, which must present itself with the disappearance of the debt. In this part of the discussion, as in others, the impression created by the success with which the present secured circulation has worked is so great, that it is hard to bear in mind that, after all, the kind of security held is not of the essence of the system. Evidently, the fundamental point is that the notes shall be secured by a preferred claim upon some sufficient portion of the property of the issuing bank. This portion of property, now required to consist of United States bonds, may, however, equally well consist of other securities of assured value. It is, indeed, entirely conceivable, so far as the principle of the system is concerned, that here, as in Germany, a solid circulation might be issued, of which the basis should be those general securities and commercial obligations of short date, which are found sufficient to guard the credit of a bank with its own customers and the public. In short, if we once recognize the fact that the particular set of details which have marked our system so far are obsolescent, the market is not without securities and the world is not without examples, on which a substituted system of circulation could be safely established.

It would no doubt be difficult to arrange a plan for securing notes as simple and perfect in its operation as that which the existence of a great public debt has given us the enjoyment of since the Civil War; but the actual difference to the public, if a new basis of security were to be sought, would probably not be appreciable. We are apt to underrate the extent to which the liabilities of the national banks are protected by the general safeguards of the system, as distinguished from the specific pledge of securities. The deposit accounts of these banks, however, are secured only by the strength of the motives which usually prompt directors to prefer good investments to bad. And it appears that, with an average of such deposits of over one thousand millions for the last five years, the loss to depositors has been less than one-fifth of one per cent, not of the movement, but of the average hold-

ing.¹ A loss, then, which is hardly greater than the mere unnoticed abrasion of some large classes of coin circulation, measures the risk in practice of what would be called an entirely uncovered liability, under a well-organized system like the present. It is to the reduction of a fractional loss like this upon the note circulation that the machinery of any system of pledged securities is directed. To find a working plan which can be used with practical safety within such limits cannot be a hard task for legislative ingenuity.

¹ Down to September, 1886, the proved claims against insolvent national banks since 1863 amounted to \$44,236,247, on which \$22,508,900 had been paid. The last five years of the period were the worst, including the heavy failures of the Mechanics' National Bank of Newark, the Pacific of Boston, the Marine of New York, and the Exchange of Norfolk, which amounted to more than \$12,500,000. For the five years the proved liabilities of insolvent banks, including these four, were \$17,047,245, on which \$7,343,000 has been paid. The average loss of the five worst years, then, has been less than \$2,000,000, or less than one-fifth of one per cent of the deposits.

THE BANK-NOTE QUESTION¹

THE question as to the continued existence of bank-notes as a part of the currency of the United States has recently entered upon a new phase. For several years past the majority of our people and of their political representatives have observed with great equanimity the gradual disappearance of national-bank notes, and the approach to the point where the trifling profits upon circulation and the extinction of the national bonded debt would leave no paper in use except the notes and coin certificates of the United States. This surrender of the whole field to government paper, the result of circumstances, but not designed by law, has been defended, moreover, on the ground that the national Treasury ought to receive whatever profits or convenience may be secured from the issue of credit as a substitute for money, and that the right of issue granted to corporations of any class is an unreasonable addition to their many privileges. We now have the proposition repeatedly brought forward in Congress, discussed and supported in the public press, and embodied in the platform of one of the great political parties, to repeal the tax of ten per cent on the notes of banks and bankers carrying on business under the laws of the several states, and thus to admit to the field of circulation the issues of a vast number and variety of local institutions, which have been excluded therefrom by the practice of the last twenty-five years. In short, the present form of the bank-note question appears to be, not whether the whole right of issue shall lapse into the hands of the national government, but whether that right may not advantageously be extended to everybody whose exercise of it is admitted by the varying policy of forty-four local legislatures.²

¹ *Quarterly Journal of Economics*, October, 1892.

² Bills for abolishing the tax on notes of state banks, or for equalizing taxation on the notes of national banks and of state banks, have been introduced :—

A sudden change of ground like this, involving a proposed revolution in our system of paper currency and in much besides, may betoken a decisive and durable alteration in the lines on which the bank-note question is to be discussed hereafter; or it may only be one more instance of the facility with which large numbers of our people are ready for a brief space to seize upon the last new idea, — especially in matters of finance. That the idea is now to be found in a political platform, we are warranted in saying, proves nothing, except that in the judgment of some persons it has a present hold upon some important classes or sections, and is likely to retain that hold until November. But, whether durable or transient, the change of ground is too important to be neglected. In either case, it probably has its origin in real wants felt keenly in some parts of the country, though perhaps misunderstood. And in either case it is interesting to inquire whether the remedy proposed is safe and appropriate to those wants.

The legislation under which banks are now organized under state authority is, in some cases, the same that was in force prior to the establishment of the national system, in some cases has been revised, and in others is of quite recent origin. In some cases, — as, for instance, in some of the New England states and in New York, — it is extremely elaborate; and in others, as in Missouri, Virginia, and parts of the Northwest, it enters into comparatively few details. In some cases, the grant of powers is wide enough to cover all banking functions, including issue, and in some it will be

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| 1875. H.R., by Mr. Riddle, Tenn. | 1889. H.R., by Mr. Henderson, N. Car. |
| 1876. H.R., by Mr. Atkins, Tenn. | 1889. H.R., by Mr. Dibble, S. Car. |
| 1876. H.R., by Mr. Roberts, Md. | 1889. H.R., by Mr. Richardson, Tenn. |
| 1876. H.R., by Mr. Riddle, Tenn. | 1891. Sen., by Mr. George, Miss. |
| 1879. H.R., by Mr. Vance, N. Car. | 1891. H.R., by Mr. Bland, Mo. |
| 1879. H.R., by Mr. Buckner, Mo. | 1891. H.R., by Mr. Wheeler, Ala. |
| 1879. H.R., by Mr. Davis, N. Car. | 1892. Sen., by Mr. George, Miss. |
| 1882. H.R., by Mr. Gibson, Ga. | 1892. H.R., by Mr. Richardson, Tenn. |
| 1882. H.R., by Mr. Hutchins, N.Y. | 1892. H.R., by Mr. Bland, Mo. |
| 1884. H.R., by Mr. Dibble, S. Car. | 1892. H.R., by Mr. McMillin, Tenn. |
| 1886. H.R., by Mr. Chandler, Ga. | 1892. H.R., by Mr. Cox, Tenn. |
| 1886. H.R., by Mr. Dibble, S. Car. | 1892. H.R., by Mr. Breckinridge, Ark. |
| 1886. H.R., by Mr. Bennett, N. Car. | 1892. H.R., by Mr. Harter, Ohio. |
| 1888. H.R., by Mr. Dibble, S. Car. | 1892. H.R., by Mr. Harter, Ohio. |
| 1888. H.R., by Mr. Chandler, Ga. | 1892. H.R., by Mr. Harter, Ohio. |
| 1889. Sen., by Mr. Vance, N. Car. | 1892. Sen., by Mr. Vance, N. Car. |
| 1889. H.R., by Mr. Chandler, Ga. | 1892. Sen., by Mr. Harris, Tenn. |

found that in the revision of statutes in the last generation the issue of notes has been prohibited. The provisions for regulating the operations of banks vary, from cases like that of Massachusetts, which maintains some restrictions so severe as to prevent the organization of any banks at all under state law, to such cases as that of New York, where a thoroughly organized state system is able to meet the national system at times on something like equal terms. Some of the states have their banking departments fully organized for the purpose of supervision: others have no organization beyond the requirement of returns to be made to the auditor or some other officer of the state. The provisions for returns and for publicity of operations are generally imperfect, and far below the standard of the national system, many states being content with an annual statement only.

The distribution of state banks under these circumstances is extremely irregular. In some states none exist: in others they are strong, and their number is rapidly increasing. But, if we take the statements collected and published annually by the Comptroller of the Currency, we shall find that their great strength is in the group of Northwestern states, in two or three states of the centre, and in a few of the South Atlantic and Gulf States.¹ It will also appear, that the capital of the state banks is not proportional to their numbers, but shows a much lower average per bank than the capital under the national banking system. This is due in part to the general though not universal preference of large city banks for organization under the national system, and also in part

¹ Of the 2572 state banks covered by the *Report of the Comptroller of the Currency* for 1891, two-thirds may be grouped as follows:—

Wisconsin	91	Virginia	93
Iowa	122	N. Carolina	29
Minnesota	93	S. Carolina	19
Missouri	401	Georgia	34
Kansas	134	Kentucky	151
Nebraska	356	Tennessee	64
N. Dakota	51	Mississippi	54
S. Dakota	65		
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	1313		444

New York has 176, Pennsylvania 84, California 144, and the group Ohio, Indiana, Illinois, and Michigan have 196. The remaining 22 states have 215 in all. This account does not include loan and trust companies.

to the great number of banks with small capital organized under state laws. The minimum of capital allowed by the national banking system being \$50,000, the state systems in many cases set the minimum at \$25,000, as in New York and Iowa; in others as low as \$10,000, as in Missouri; and in some cases even as low as \$5,000, as in Nebraska, Kansas, and the Dakotas. For the organization of banks with feeble capital, therefore, whether this is the result of inability to provide more or of limited employment for capital in the particular locality, the state laws often give an opportunity not allowed by the national system. That the demand for the establishment of small banks is increasing, especially in the West and South, is clear from the recent legislation of the states, and from the marked increase in the number of banks organized under state law.¹

¹ The following table, made up from the reports of the Comptroller of the Currency, is intended to show the recent growth in number and capital of state banks and national banks in two important groups of states. The returns given for state banks, being partly official and partly unofficial, leave much to be desired, and in the year 1884-1885 only supply the figures for three States. It should be said, also, that, in the case of Kansas, the figures for the two earlier years probably include some savings-banks, the law of the state not drawing the line distinctly at that time.

[Capital given in millions and tenths.]

	STATE BANKS						NATIONAL BANKS					
	1884-1885		1887-1888		1890-1891		1884-1885		1887-1888		1890-1891	
	No.	Cap.	No.	Cap.	No.	Cap.	No.	Cap.	No.	Cap.	No.	Cap.
Wisconsin . . .	—	—	64	\$3.8	91	\$5.2	50	\$4.4	57	\$5.2	69	\$6.8
Iowa . . .	—	—	74	4.	122	6.4	122	10.1	129	10.2	141	12.1
Minnesota . .	34	\$3.9	61	5.7	93	8.1	50	11.3	57	13.7	59	14.1
Missouri . . .	187	13.	238	13.4	401	16.7	40	6.3	49	11.5	80	23.9
Kansas . . .	54	2.1	177	6.6	134	5.8	60	4.	146	11.2	152	13.4
Nebraska . . .	—	—	69	2.2	356	9.	63	4.8	104	8.4	136	12.8
N. Dakota . .	}	—	23	.6	51	.7	35	2.1	62	3.7	29	2.
S. Dakota . .					65	1.8					39	2.5
Virginia . . .	—	—	64	3.5	93	5.8	24	3.5	25	3.8	33	4.3
N. Carolina . .	—	—	16	1.1	29	1.8	15	2.4	19	2.5	20	2.5
Tennessee . .	—	—	28	2.3	64	5.	33	5.	40	7.5	52	10.
Mississippi . .	—	—	14	1.1	54	3.3	5	.4	12	1.1	12	1.1

So far as the legislation of the several states still retains its provisions for the issue of notes, there is the same variety which existed before the Civil War. The issue of notes by banks incorporated under general acts, the issue by banks under special charters, the issue of notes by private bankers under state regulation, may all be found provided for in one state or another. In some cases provisions have been retained which contemplate the deposit of adequate security, and in others no specific security is called for. In the states which in 1861 suffered the most from the collapse of free banking systems based upon inferior securities, the sections relating to the issue of notes will be found generally, and perhaps in all cases, to have dropped out of the statutes in some later revision; but, so far as issue is still recognized by the states as a theoretically possible function of their banks, there is the same variety of method and even of purpose in the restrictions applied to it. In the event, therefore, of a general revival of state legislation upon this subject, there is nothing in such provisions as now exist, nor is there anything in the character of the other state laws respecting banks, to lead us to look for any greater uniformity of system than formerly. Opinions may differ as to the possible effect in all parts of the country of a more enlightened public opinion in enforcing the demand for the protection of note issues by sound legislation, but there can hardly be a difference as to the probability of great variety in the methods of protection to be adopted, and in their comparative efficacy.

It is clear that the present demand for rejection of what had by common consent been regarded as the most valuable characteristic of our national bank currency — its complete unity — cannot be made by any considerable part of our people except under the spur of some keenly felt demand. The sections where the present movement probably finds its greatest strength are those in which heretofore there has often been a strong tendency to favor the exclusive use of that simplest of all currencies, the greenback. The change of preference from one issue to countless issues, from notes having universal credit to notes limited in their use to a state or perhaps a county, has had some strong reason in the economic condition of the sections where opinion has thus veered. The sections concerned are agricultural; they are depressed by the low prices of their great products; they depend upon others for

no small part of their manufactured supplies; and their people are in debt. In a vigorous statement of the condition of the South a few months ago, Hon. H. A. Herbert, of Alabama, traced the origin of this state of things to the system of federal taxation. The South, he maintained, has worked with incredible industry for fifteen years; but its gains have been steadily drained away by taxation, to be expended in other parts of the country, and in the end the South finds itself as poor as ever. Without discussing the question here raised as to federal taxes, and only noting that, if we accept Mr. Herbert's opinion as to their effect, the logical conclusion would be that the remedy should be sought in a reform of taxation and expenditure, and not in a revolution of the currency, we remark here the same complaints as to insufficient means and pressure of debt which have come from the South during the greater part of its existence. The condition of much of the West and Northwest has been described by Hon. M. D. Harter, of Ohio, in very nearly the same terms.¹ Those sections, as a whole, also feel the present stress of low prices, are large buyers and large debtors. Aside from the question as to federal taxation, they, too, are pressed, as they always have been pressed, by the need of more and more capital for the development of their abundant resources and the employment and support of swiftly growing populations.

Both in the South and in the West evils of this description have been experimented upon for years, without disclosing any cure except that which comes with the gradual accumulation of wealth in a mature community. Every form of currency has been tried by turns, — specie, paper, national, local, — with the sole result of showing that the economic *malaise* might easily be aggravated, but could not be cured. It has its origin in the fact that any country which is being rapidly taken up, and is therefore essentially new, whatever the age of its political fabric, is apt to need for present use more capital than it has had time or opportunity to acquire. As a whole, it is in debt; and, as individuals, its citizens are borrowers. This pressure to borrow is plainly not to be satisfied by dilution of the currency. Although the present need of an individual debtor may be satisfied by mere paper, the relation of the

¹ For the speeches of Messrs. Herbert and Harter, made in Boston, June 13, 1892, see the *Boston Herald* of the following day.

community, as a whole, to other sections and to the outside world in general, requires something more solid, — something as solid as the general standard. And, as now seems to be generally recognized, the pressure is not to be satisfied by an ampler currency for the country at large, however sound. Aside from the temporary effects of any sudden change in the general currency, alteration in its amount does not alter the relation which the sections under rapid development bear to the rest. They are still sure to require large supplies of capital, in one form or another, beyond their own ability to supply, and sure therefore to appear in the market as borrowers.

But, as has already been suggested, the individual's share in this general pressure is felt by him as a need for that which will pay debts, a need for currency, and so as a need for loans from banks or bankers in any form which will provide him with the means of present payment. The rapid multiplication of banks under state legislation is the natural expression of this necessity, on the part of the individual, of finding some means for making his hope in the future available as a present supply; and the opportunity is found under the state systems, because under them there is no requirement that any part of the capital of a bank should be invested at a rate so low as three per cent, and because, in other respects, the state systems are often freer from regulation and from disagreeable restrictions. But the tendency for an increase of banks under state legislation is only the recurrence in a new form of a phenomenon which has often appeared in the history of the farming states. Public opinion on the subject of bank credit has undergone many singular changes in those states. Some of them have at times encouraged the wildest schemes of paper currency, have at times rushed in despair to the opposite extreme of discouraging even sound banking, and again have relapsed into the old toleration of whatever can be passed from hand to hand. But at every stage the real effort has been the same, to supply themselves with capital beyond their possible accumulations, — the necessity under which any quickly developing and enterprising community must needs find itself. It is a real and even inevitable want therefore, and not a mere craze for expansion, which seeks satisfaction at the present time and stimulates the call for a practical restoration of the right of issue to state banks.

Indeed, it may be added here that the increase of banking in the West and South has not hitherto been excessive, nor does it generally tend to excess now. Omitting from consideration the private bankers, as to whom there is unfortunately no longer any means of attaining even approximate information, the increase of national and of state banks together in these sections, in the last twenty years, has not more than kept pace with their general growth, and has fallen behind the growth of some of their leading interests. The natural spread of banking operations has apparently been hampered and held in check; and we should probably be safe in finding the obstacles to be the failure of Congress to encourage organization under the national system, which for some years has visibly checked the increase of national banks, and some reluctance of banking capital to organize under the liberal but still inferior state systems.

But there is an important distribution of banking facilities in progress, in addition to the simple expansion of their amount. Reference has already been made to the establishment, under state systems, of banks with capitals much below the minimum allowed by the national banking law. No doubt many of the banks thus established are below the minimum of safety. With their trifling resources, it is impossible that they should command for their service such experience and capacity as their operations, although on a small scale, really require in the interest of the community. And yet the increase in the number of such small banks, hardly to be distinguished from the smaller class of private bankers, comes from an obvious tendency to carry banking facilities farther and farther from the great centres and to open the way for their more general use by the community at large. In short, there is not only a movement of increase, but a movement of diffusion going on, which is probably the result, not merely of the general pressure of debt in certain sections, already spoken of, but of a healthy desire to use more freely and widely than has hitherto been possible in sparsely settled communities the modern methods and agencies of commerce. The state systems afford an opening for this movement, and have therefore an importance in the business organization of the United States at this moment not always recognized in the more densely populated and wealthier parts of the country. With the quickened movement of commerce pro-

duced by the railway, the telegraph, and the telephone, an economic need for the wider distribution of the machinery of exchange is developing, which the smaller banks under the state systems satisfy, — not perhaps in the best manner, but still in an important degree. When a Western state provides, as Nebraska does by its act of 1889, that banks with a capital of only \$5000 may be established in towns having less than one thousand inhabitants, we must recognize that for that community, under its conditions, the complete diffusion of banking is felt to be a necessity. In this respect, the sparsely settled states are attempting to secure, by the multiplication of independent banks, the same advantages which in England and Scotland have been obtained through the multiplication of branches by a limited number of banks.¹

These considerations undoubtedly show that the state banking systems, in the present condition of the country, have an important sphere to fill; and they raise the question, moreover, whether the national banking system might not be adapted by judicious amendment to meet wants which it cannot now supply. Leaving aside altogether the conditions on which notes are issued, and regarding the national banks merely as banks of discount and deposit, it would seem that this might easily be done. The smaller banks, especially, would be put on far more equal terms if they were relieved from the present useless obligation of a relatively heavy investment in United States bonds. Moreover, the greatest possible diffusion of banking facilities, under an admirably guarded system, might be secured if the establishment of branches were encouraged and facilitated by law. That, in the present state of opinion, the branches of a central bank would have to contend with some local jealousies is probable; but any real improvement in commerce or finance is tolerably sure to make good its footing. It is obvious, also, that, if the multiplication of branches were once fairly recognized again in the United States as a natural method, as it has been in the past, it would be as available for central banks under the state systems as for national banks. For both

¹ The ten great Scotch banks have not far from eight hundred branches in all, carrying their operations into every village. A similar practice in England and Wales gives about two thousand six hundred banks and agencies outside of the metropolis. Both in Scotland and in England there is a sharp competition over the whole field, so that even insignificant towns are apt to have more than one banker.

alike it would have the convenience of making it unnecessary to provide a full board of directors for every establishment, large or small, — a necessity which is often embarrassing in small places, — since a local manager under the direction and supervision of a central board could often perform the duties for which a local board now has to be made up. For both alike it would tend to diffuse business risks over somewhat larger areas than at present, with a gain analogous to that which such diffusion brings in insurance; and for both it would be possible to apply banking capital at a given moment according to the unequal and variable needs of the different parts of any section covered by a given institution and its agencies.

But, besides a demand for the extension and diffusion of banking in the sections referred to above, there is also a pressure, felt more keenly by them, but also observed elsewhere, for greater elasticity in the paper circulation of the country. In the United States — as in other countries having great annual movements of agricultural products — there are tides in the demand for tangible currency for actual use. Increase or diminution of the volume of general exchanges in urban communities is readily enough adjusted by variation in the amount of the more subtle medium known as bank deposits; but the marketing of crops in many states by farmers remote from banks, and little accustomed to transactions through them, means a temporary increase in the use of money or its substitutes. No doubt the extension and general diffusion of banking will finally minimize this increase, as it does in Great Britain, where the annual tide of tangible currency is moderate in its amount, although clearly visible in its flow; and probably the smaller banks in the Northwest do much to meet this necessity for an expansible medium. At present, however, the want is serious, notwithstanding the heavy shipments of currency annually made in the harvest months from the financial centres. With this regularly recurring demand for an elastic medium, the United States have for years been content with a singularly rigid system of paper currency, approaching year by year closer and closer to the condition of absolute inflexibility. The trifling gain made by the government from the issue of treasury notes has been treated as a complete offset to the vastly greater loss caused to the people at large, by their inability to use credit currency at

the times and in the forms which our immense domestic commerce requires. Any reaction from this narrow conception of the public interest as something measured by the footing of a treasury account is a hopeful sign; and it is probably to the long-felt need of some elastic quality in our currency beyond that offered by the export and import of metal, that much of the existing desire to find some terms on which state bank-notes can be issued is due. That notes issued by banks in response to a commercial demand for loans, and redeemable at sight in specie, are in general the most convenient form of elastic currency, and the most quickly responsive to the needs of the community, is recognized. That such notes are the form of currency best adapted to meet the tidal demand referred to above seems to be clear. But to make their issue safe, to avoid the needless rigors of the national banking system and not to lose its palpable advantages, is the problem.

Of the solutions offered for this problem, looking to the renewal of issues by state banks, two now seem to invite special attention: first, the proposition to simply repeal the ten per cent tax which has excluded state bank issues from the field since 1866; and, second, the proposition to allow notes to be secured by the deposit of a very wide range of securities, and then to extend the right of issue, upon terms not settled, to all banks, state or national.

The naked proposition to repeal the ten per cent tax must be treated as, in fact, a proposition to return to the state of things existing before the war. It is vaguely said, indeed, that such a return is now impossible; that no state would consent to the issue within its borders of unsound notes; that it is an insult to the intelligence of the state legislatures to suppose that any of them would be less scrupulous than Congress in providing for the absolute security of every dollar authorized by it. But all this confident assurance is unsafe ground for legislation. The paper currency of the country is too important to be left for its regulation to our faith in human nature alone; and though we may hope, or even believe, that the past will never return, it is well to be admonished by experience. Trust as we may in the universal desire of the state legislatures to keep on the solid basis of hard money, the repeal of the tax would indisputably open the door for evils which

were rife only a generation ago, and were no worse than those threatened within that period by popular crazes over large sections of the country. That the loss, in case of bad or mistaken local legislation, would be local, as is sometimes urged, is not to be taken for granted. On the contrary, with the present close commercial network covering the whole country, it may be fairly assumed that injury to any state by reason of a vicious local currency would mean injury to others also, and that in this respect, as in others, all are concerned in the welfare of each.

At its best, therefore, the simple repeal of the ten per cent tax means the substitution of multifarious issues for the uniform currency of the national banks. This follows as a necessity if note issue is left to local legislation, the agreement of legislatures upon a uniform type of bank-note and upon uniform conditions of security being as impossible as their agreement upon any other matter of public concern, with the added difficulty that with respect to banking the real or supposed interests of the different local constituencies are notoriously at variance. Federal supervision of issues made under the authority of the states is sometimes hinted at, but can hardly be said to be distinctly proposed. Indeed, it would probably be far from satisfying the wishes of those who urge the simple repeal, their object being apparently to secure something far more free, flexible, and responsive to local opinion than any federal regulation would allow. But, however this may be, the notion of a federal control of issues made by state corporations acting under the laws of the states presents legal and constitutional difficulties grave enough to authorize us to lay it aside until some distinct scheme for establishing such control is formulated.

Looking forward, then, to a state of things in which each state should have its own system of issue again, with a possible uniformity among the notes of all banks in any one state, we must contemplate the introduction of a bank circulation of unequal value in different parts of the Union. The uniform value which national bank-notes have in every state — the quality which was relied upon from the start as a chief recommendation of the system — comes from the universal knowledge that all essential conditions affecting one note are like those affecting any other, and from the uniformity of type which spares the receiver of bank-notes the trouble of even reading the name of the issuing bank. It may even be doubted

whether the engagement for redemption at the Treasury gives them any considerable addition of credit, or has any practical effect in increasing the confidence with which they are taken at a distance from the place of issue. The fact that one note is substantially like another in all essentials and is receivable in payment by any national bank in any part of the Union, secures absolute uniformity of values and ease of flow in circulation. But this advantage is necessarily abandoned when the conditions of issue and the degree of ultimate security vary from state to state and become matter of inquiry whenever unfamiliar notes meet the eye, — possibly matter of special knowledge, attained by experts only. The rich experience of 1850–1860 showed that even notes of unimpeachable strength found some resistance to their circulation, and so lost something of their value, when far from home. The dealer in un-current money in those days was a well-recognized figure in large cities, dealing not necessarily in bad bills, but in bills not current on the spot, and therefore subject to discount. Inequality of value like this, even if it is the result of mere unfamiliarity and doubt affecting the notes of distant banks, is a defect in a paper currency, and a return to it would be a long step backward. Uniformity and instant recognition are nearly as important for the paper of the country as for its coin, and can only be secured by analogous concentration of control.

It is to be remarked here that the practical confinement of local issues to their own territory has been advocated, especially within the last few months, as an arrangement to be desired on its own account. Certain sections, it has been contended, suffer for lack of sufficient currency, and their needs can be supplied by ample local issues, and this with all the more ease and certainty if such ample issues have only a restricted circulation. This is doubtless true on condition that the local issues are of inferior value, or, in other words, depreciated in comparison with the currency of the country at large. It is not many years since the whole country, indeed, had a local currency available for use only within the United States, and altogether cut off by its depreciation from the currency of the world. It is not probable, however, that, in contending for localized issues, any large number of persons would now seriously propose the establishment, or the possibility of establishing, ten, twenty, or forty local currencies, each with its own special scale of deprecia-

tion and discount. But whether such local issues can be established, and have the effect of insuring local abundance of currency without depreciation, is a question which will be considered further in the latter part of this paper.

The proposition, then, to simply abolish the ten per cent tax, or by any other process to remit the control of note issue to the several state legislatures, appears to the present writer to destroy the security of the bank-note by opening the door for abuse and mistake, and to sacrifice the immense advantage of a currency of uniform value afforded by the national bank system. We have, then, to consider next the proposition to widen the range of securities on which the issue of national bank-notes is allowed, and to extend the right of issue to all banks, whether state or national.

This second proposition may be taken most conveniently in the forms in which it has been stated at different times by Hon. M. D. Harter, of Ohio. It contemplates, in the first place, the admission of many varieties of first-class securities, as well as the bonds of the United States, as the basis of an issue of notes, on the general ground, no doubt, that the securities which the community finds to be solid enough for the investment of trust funds and of other moneys requiring absolute safety are also solid enough to be held as a part of the protection required for bank-notes. In Mr. Harter's own statement of this plan,¹ long considered and carefully weighed as he assures his readers, he proposed to admit state, county, city, and railway bonds. In a bill for similar purposes, to which he has more recently given his support,² state and county bonds are omitted from the list, probably on the ground of some practical difficulties of discrimination between the good and the doubtful, and, possibly, in view of some difficulties in the way of enforcing payment in case of default. In both forms of the proposition, the listing of the bonds for five years upon the stock exchange of some large city, the maintenance of their price at a premium of not less than five per cent, and the steady payment of interest, the obligation for which must be expressly on the gold standard, are among the conditions to be observed, in order that bonds may be deposited by any national bank desiring to issue notes. So far, then, the proposition is in the line of others which have been suggested in the last few years, but for some reason

¹ The *Forum*, October, 1891, p. 186.

² *Boston Herald*, June 14, 1892.

never thoroughly investigated, looking to the enlargement of the present shrunken basis of the national bank note system. In the method of extending the right of issue to state banks, however, the two forms of the plan differ radically. In its earlier form Mr. Harter proposed that the tax upon notes of state banks should cease, provided such notes are secured in the same manner as notes of national banks by bonds deposited with the auditor or treasurer of the state, and provided that each state should guarantee the payment of the notes issued by its own banks, the amount of notes to be issued by state banks being determined by each state for itself, and the state banks not being required to redeem elsewhere than at their own counters. In the later form of the plan, after providing that the United States shall no longer guarantee the payment of national-bank notes, — a provision which is strengthened by the proposed abolition of the present five per cent redemption fund, — it is simply proposed that the notes of state banks shall be subject to the same tax as notes of national banks, and no more.

In its later form, this plan, to which Mr. Harter has now committed himself, is not to be distinguished from the naked proposition to simply repeal the tax on state bank issues, leaving them to enter the field upon such terms of security and in such quantity as the state legislatures may severally prefer, — allowing the national banks to compete with them upon terms in some respects better than at present and in others worse. The unity and the uniformity of value of the bank circulation is to be destroyed, and our only security from unsound and depreciated local issues is to be found in the chance that all state legislatures may have learned equally well the hard lessons of financial safety.

In its earlier form, Mr. Harter's proposition appears to have been more promising. It held out the prospect of a uniform basis of security for state issues and national alike. No doubt the first attempt to throw into shape rules for its practical operation would have shown the necessity of placing both kinds of issue under national supervision and control. This would have given the system a strong resemblance to that embodied in the first national bank act (the act of February 25, 1863), for enabling banks, while still carrying on business under state laws, to issue national currency secured by the deposit of United States bonds in the Treas-

ury at Washington.¹ This provision, which at the time answered the purposes neither of the friends nor of the opponents of the national banking system, was strongly disapproved by Mr. McCulloch, then Comptroller of the Currency² and deeply interested in extending the national system, was struck out from the revised act of 1864, and thus never took effect. At that particular juncture, when Congress had undertaken to obtain the whole field of circulation for a secured national currency, there was no place for such a halfway measure. At the present time, when the national-bank notes are being pinched out of existence by the failure of Congress to provide a wider basis for them, and when unlimited license for state issues is demanded as the alternative which is to save us from a paper currency depending for its amount upon the bare dictate of Congress, the opportunity for a measure which should place state and national issues upon the same footing and under the same guardianship would seem to be better. But Mr. Harter's proposition, while proposing the same basis of bonded security for all issues, falls immeasurably below the short-lived scheme of 1863, inasmuch as it lacks the unity of control which is the only possible guarantee for faithful and uniform enforcement. It is not surprising, then, that, having once set himself in opposition to national control, he should now have taken the further step of proposing to leave the regulation of state-bank issues altogether to the discretion and prudence of the state legislatures.

In these propositions, which we have taken as somewhat typical, and in a large part of the current discussion of this subject, there is expressed, as we have said, a strong desire to provide for ample local currencies in particular sections. This is quite independent of any judgment as to the feasibility of widening the basis of the national currency and so rehabilitating that system of issue. It is urged as a defect of the national-bank note that it goes into circulation "with no localizing tendency, with no habitat, but endowed with every attribute tending to induce its centralization at the great financial cities and its removal from the country districts."³ In short, it is objected that the bank-notes now have

¹ See sections 61-64 of the national bank act of 1863.

² *Report of the Comptroller of the Currency*, 1863.

³ *Commercial and Financial Chronicle*, May 14, 1892, p. 782.

the quality of metallic money, and, like gold, will flow and accumulate as the current of internal commerce may require, having hardly more tendency to remain near the place of issue than coin has to stay in the neighborhood of the mint, except so far as their movements are arrested by redemption at the Treasury.

It will assist us in weighing the force of this objection if we first consider the movement of a currency exclusively of coin. It is distinctly recognized that a coin medium will not distribute itself with equal depth over sections of a country which differ in resources, industry, and acquired wealth. Notwithstanding the immense volume of transactions settled finally by exchange of products, the farming sections will steadily keep themselves bare of coin by their heavy purchases in anticipation of the future, and by their normally increasing payments for interest on the capital invested among them by non-residents. If they were less enterprising and progressive, payment in products might keep pace with their obligations; but their vigorous industry constantly impels them to push the use of their credit and to keep their stock of money low. As communities, they invite loanable funds by high rates of interest; but no transfer effected in this way gives anything more than a temporary relief from the dearth of coin. In the present stage of their development they have uses for goods which stand higher in their estimation than their uses for money.

In describing the unequal distribution of a medium supposed to be exclusively of coin, the language used runs of itself into the present tense, as though the imagined medium were really existent, because that which is true of coin in this particular is true also of a paper currency which is really redeemable in coin and is of universal credit. Such paper will serve the purpose of remittance and payment as well as coin, and will be collected and remitted accordingly, when the conditions of trade would cause coin to be so used. This will be effected directly or indirectly by the people themselves in making their necessary payments; and the convertible paper, like the coin in its distribution over the surface of the country, will be found in greater depth at the financial centres, because it is there that payments are due, and because, under existing conditions of supply and demand, payments, if made in products alone, can only be completely so made when the local

currency is at the minimum quantity. This state of things, which we believe is also as well recognized as the inequality with which coin alone would distribute itself, is not to be remedied by raising the general level of the supply of convertible paper in the country at large. Aside from the effect which might thus be produced on the movements of money between this country and others, the increase of the general mass would only temporarily change the relations of the farming sections to others, even if the whole addition were first to come into circulation in those sections. Their industrial conditions would still cause them to part with all but their quota of the increased amount, and they would soon be found in possession of only their customary proportion of coin and paper, and subject to the same inconveniences as ever.

But let us now suppose that, instead of a redeemable paper having universal credit, each section uses a redeemable paper having only local credit, having a "habitat," therefore, and certain to circulate only within or near the state in which the issuing bank is established. Is it not certain that, if the trade relations of an agricultural section are such as would draw away from it coin or its paper of universal credit, if such a medium existed, they will now equally draw from it coin or legal tender paper, these being obtained by sending in bank-notes for redemption? The bank-notes are not themselves available as a remittance; but, if redeemable, they can instantly be turned into that which is available. This would leave a really redeemable local currency in the same scanty condition, and for the same reasons, as a medium of national credit would be under the same circumstances. We may, indeed, suppose that the local banks, the issuers of currency, continue to issue notes in place of those which are redeemed, and attempt thus to raise materially the level of paper in their neighborhood. In that case, their vaults become the ready source from which gold may be drawn for export from the section, and the relative cheapness of gold in the section gives a motive for its export, either to pay for fresh purchases of goods or for use in other money markets. In short, so long as the redemption of paper is real, the restricted area of its circulation will not supply the means of raising the level of a local currency permanently above the mark which is settled by the normal course of payments to and from the state or section concerned. It is true that, if the

redemption is not real, if the paper is openly or disguisedly inconvertible, it may be heaped up within the given area to an indefinite amount and with a corresponding depreciation.

The question, then, whether the restoration of the state-bank issues and their regulation at the pleasure of the states is to be followed by real specie payment by state banks or by suspension, is of critical importance; and it may be doubted whether it has been faced squarely by those who advocate such issues as a source of locally abundant paper. But here, after all, would seem to be the kernel of the whole question; for, on the supposition that specie payments are to be maintained everywhere, — as most of the advocates of state issues must be supposed to intend, — the proposed change must be futile for its avowed purpose; and, if suspension is to follow or to be risked anywhere, the measure is an abandonment of that solid ground of hard money which our people, after a long and bitter experience, finally reconquered under the resumption act of 1875.

In this discussion the varied political aspects of the question before us have had hardly a passing glance; and it is not worth while to enter upon them now, except to notice the frequency with which, in one form or another, the argument *in terrorem* is advanced, — the argument that the state-bank issues should be freed from restriction lest a worse thing befall us. We are told that it is idle to hope for action which shall give a future to what is called the national-bank monopoly, and that the state banks, therefore, afford the only chance for a credit paper issued in response to commercial demand; and that state-bank notes alone can save us from complete surrender of the field to government issues; and that the restoration of local currencies is alone able to divert a large section of our people from the crusade in favor of the free coinage of silver. It may be true that there is ground for anxiety in one or all of these directions. But, if the financial history of the United States teaches any lesson, it is this: that, with the American people, sound doctrine and salutary measures are strongest when their advocates are fearless, and refuse to yield ground to the suggestions of timid expediency.

THE SAFETY OF THE LEGAL TENDER PAPER¹

THE legal tender notes of the United States present now, as they always have presented, an appearance of great simplicity. There are still but two such issues, the United States notes of the Civil War and the coin notes of 1890: their legal tender power has few exceptions, and the obligation for their redemption is to be read in a few lines. Take away the confusing element introduced by the silver agitation, which is quite extraneous to the original conception of the legal tender paper, and what is in itself better suited for easy comprehension or has more *prima facie* attractions than a system of government notes, established by the authority and resting on the credit of the nation?

But, simple as the notes themselves may appear, it is by no simple process that the conditions under which they are now issued have been arrived at. Our legislation on this subject now covers a period of thirty-five years. During that time there has been a rapid succession of important legislative acts bearing upon the legal tender paper and some administrative acts of equally serious import. The system, as we have it to-day, is, therefore, a product, not of any compact declaration by the law-making power, but of a singularly complex series of laws and executive orders. It is to some aspects of this series, — or, in other words, to some aspects of the history of the legal tender issues, — and to some considerations flowing therefrom, that I desire to direct the attention of readers of this article. Accepting the constitutionality of the legal tender acts, as settled by the repeated decisions of the Supreme Court, and waiving all questions as to the necessity of the acts or of either of them, as foreign to my present subject, I wish to inquire what inferences are to be drawn from the manner, in which the authority of Congress has been exercised, and how far the *prima facie* attractions of our paper legal tender are

¹ *Quarterly Journal of Economics*, April, 1897.

thereby affected. For this purpose, it will be necessary to make a short recapitulation of the chief legislative and executive acts which mark the period opened by the first Legal Tender Act and relate to the same subject-matter, and to do this even at the risk of stating much with which the reader must be supposed to be familiar.

1. The leading advocates of the act of February 25, 1862, pressed that measure upon Congress as a temporary expedient forced upon the country by the stress of war (1861-1862, ch. 33). They also pressed it as a measure which had its place in a large scheme of legislation, by which they expected to provide a permanent paper currency exclusively of bank-notes. To meet the urgent needs of the Treasury, a limited amount of legal tender notes were to be issued, exchangeable at the pleasure of the holder for United States bonds, and the bonds were to be made the basis of a bank currency. Issued, exchanged, and reissued, the notes were expected to open a market for a large amount of bonds, and finally to be absorbed and disappear. It may be doubted whether the majority in Congress were then ready to accept the whole of this comprehensive scheme, but there is no doubt that the majority agreed to the issue as something not intended long to survive the exigency which called it into being. Even with this restricted view of the scope of the legislation, the provision making the notes exchangeable for bonds was plainly a matter of prime importance. It was looked upon as offering a possible outlet for the notes in case the circulation were overloaded with them, and it provided the means for their withdrawal when the present need should have passed by and the public credit should have begun to advance. The bonds having been made coin bonds, the exchangeability of the notes was the ground of hope for their present credit and ultimate redemption.

2. But the expectations of the advocates of the first Legal Tender Act were disappointed. Although some sanguine leaders had predicted that the whole of the first issue would not be used, a second issue was called for by the Treasury, and a third. It was also discovered that, so long as notes could be exchanged for bonds at par, the price of bonds could not rise above that point, and that with this limitation of possible profit the present induce-

ment for exchange was too small to invite large operations. At the instance of the Treasury, therefore, and in order to facilitate the sale of bonds, Congress, in the Ways and Means Act of March 3, 1863, declared that the right to exchange the notes should cease from the first day of the following July (1862-1863, ch. 73, § 3). One year, therefore, saw the central provision of the original system abolished, and without debate in either House. "This act," says Mr. Sherman, in one of his numerous references to the subject, "though convenient in its temporary results, was a most fatal step, and for my part in acquiescing in and voting for it I have felt more regret than for any other act of my official life."¹

3. The summer of 1864 saw the worst fears as to a resort to a paper legal tender fully justified. At the end of June the outstanding United States notes were \$431,000,000; there were also in circulation \$168,000,000 of interest-bearing notes which were a legal tender for their face; and, in response to the urgent demand of the Treasury, authority for an additional issue of \$200,000,000 of similar interest-bearing legal tender notes was to be embodied in the Ways and Means Act. Gold, which in April stood at 180, was starting on the rapid ascent which carried it to 240 on the 1st of July. Congress was engaged in an unsuccessful effort to prevent time-sales of gold and of foreign exchange, by means of what has been known as "The Gold Bill"; and confusion, distrust, and discredit were rapidly gaining ground. As a reassuring measure, therefore, to quiet public alarm, a clause was incorporated in the Ways and Means Act declaring that the total amount of United States notes should never exceed \$400,000,000, and a possible temporary addition of \$50,000,000, if required for the payment of private deposits then held by the Treasury (1863-1864, ch. 172, § 2). This limitation of the issue of United States notes was a wise concession to public opinion, and without doubt had its influence in the next few months in raising the public credit; but the ability of Congress to maintain such a restriction under the pressure of any great exigency was never put to a severe test, and the happy ending of the war nine months later abruptly introduced an entirely new order of questions relating to the legal tender issues.

4. So far as the temper of the public was concerned, the first months of peace were remarkably favorable for measures looking

¹ Speech in the Senate, March 6, 1876; to be found in his "Speeches," p. 496.

towards specie payment and the withdrawal of the legal tenders; and it was probably a misfortune that Congress was not then in session to improve a moment which in other respects was opportune, and to do this before the apprehension of contraction or any of the real dangers of that process should be seriously felt. But when Congress met in December, 1865, — after the announcement of his policy by Secretary McCulloch, — the strength of feeling was still such that, by a vote of 144 to 6, the House of Representatives adopted a resolution of cordial concurrence “in the views of the Secretary of the Treasury in relation to the necessity of a contraction of the currency with a view to as early a resumption of specie payments as the business interests of the country will permit,” and pledged its coöperation to that end.

5. A secretary gifted with tact in dealing with other men, and standing aloof from the political contests of the time, might perhaps have made this proffer of concerted effort the basis of a successful policy; but Mr. McCulloch had not that tact, and was so far identified with the reconstruction policy of President Johnson as to share the odium incurred by the latter in his struggle with Congress. Four months after the declaration of December, 1865, Congress, in making provision for the retirement of Treasury notes, forbade the Secretary to retire more than \$10,000,000 of United States notes within the next six months, or more than \$4,000,000 in any one month thereafter (1865–1866, ch. 28).

6. The Secretary did not use to its full extent the authority allowed him by Congress. The commercial revulsion which began in London in 1866 was followed by continued depression in this country, the public mind became more and more sensitive on the subject of contraction, and wild demands began to be made for the payment of the five-twenty bonds in legal tender notes. The Finance Committee of the Senate, in December, 1867, reported a bill providing for the exchange of these bonds for a five per cent coin bond, the offer resting upon the avowed calculation that the right of the public creditor was doubtful, and that he would find it for his advantage to take a bond bearing a lower rate of interest and free from cloud. In the discouraged state of mind indicated by this proposition, Congress, in February, 1868, “suspended” altogether the authority previously given to the Secretary “to make any reduction of the currency by retiring and cancelling

United States notes"; and thus the first movement for a return towards specie was peremptorily closed (1867-1868, ch. 6). The notes outstanding had been reduced from about \$400,000,000 to \$356,000,000; but this reduction had been offset by an increase of national-bank notes during the same months.

7. Happily, the Republican National Convention in July, 1868, planted itself on firm ground as to the payment of the five-twenty bonds, and in its platform denounced "all forms of repudiation" and called for the payment of all creditors, "not only according to the letter, but the spirit of the laws." The Democratic party a few weeks later gave its support to what was supposed to be the popular craze of the day, and upon this issue and others was badly beaten. General Grant was elected after an excited canvass; and the popular verdict was registered in an "Act to strengthen the Public Credit," approved in March, 1869, being the first act passed under the new administration. This law declared the faith of the United States to be pledged to the payment of both notes and bonds in coin, except when the law under which they were issued had expressly provided for payment otherwise, and closed by further pledging the faith of the United States "to make provision at the earliest practicable period for the redemption of the United States notes in coin" (1869, ch. 1).

8. Nothing was done towards giving effect to this pledge. Secretary Boutwell, in December, 1869, suggested that authority should be given for reducing the circulation, as occasion might offer, by an amount not exceeding \$2,000,000 in any one month; but it was clear that he did not regard the matter as of any present importance, and no action was taken. Congress had apparently acquiesced in the policy of allowing the country to "grow up" to a currency admitted to be excessive. A year or two later, however, it appeared that the Treasury had on more than one occasion issued legal tender notes in lieu of a part of those "retired and cancelled" by Secretary McCulloch. The question as to the legality of any such reissue was referred by the Senate to its Finance Committee; and the majority of that committee, headed by Mr. Sherman, reported a resolution that the Secretary "has not the power under existing law" to issue notes for any portion of those retired under the act of 1866. The question involved was of moment; for, if \$5,000,000 could be issued by the

Secretary at his discretion, so could \$44,000,000, and the whole of the ground supposed to have been gained by the payment of this form of debt might thus be lost. The resolution, however, was not called up for action, and at the end of the session the Secretary might easily have felt that his action had the tacit acquiescence of Congress.

9. Mr. Boutwell's successor, Secretary Richardson, having paid out in the revulsion of 1873 a large part of his cash balance in the vain effort to relieve the money market by the purchase of bonds, soon found himself so crippled by the decline of revenue that in October, 1873, he began paying out the retired notes for ordinary expenses; and this reissue was continued until, at the beginning of February, 1874, when the revenue had recovered from its collapse, \$26,000,000 of the notes were again in circulation, raising the total to \$382,000,000.

10. At the long session of 1874 Congress first passed the so-called inflation bill, vetoed by President Grant, by which the issue of legal tender notes was to be increased to \$400,000,000 and the possible issue of national-bank notes was to be raised to the same point, and then adopted the Compromise Act of June, 1874, by which, among other provisions, it was declared that the amount of legal tender notes should be fixed at \$382,000,000 (1873-1874, ch. 343, § 6). The amount reissued by Secretary Richardson was thus made a part of the permanent currency, and so remained until the work of withdrawal began anew under the Resumption Act of 1875.

11. The Resumption Act was not prepared with open doors; and, doubtless, there is much in its secret history which would be of great interest. Certainly, its public history, if we view it as a measure for financial reform, is unique. The bill, introduced by the Finance Committee of the Senate, was admitted to be the work of a party caucus, in which no agreement could be reached except by consenting to leave a principal point unexplained. Whether legal tender notes, when "redeemed" in the language of the bill, could be reissued or not, Mr. Sherman, who had charge of the measure, steadily refused to say, knowing well that any explicit answer would drive off one wing or the other of his expected majority, and deeming it his business to carry the bill through by whatever means. It was passed by the Senate, there-

fore, with an obstinate refusal on the part of its chief advocate to state the meaning and effect of its leading provision. In the House all risk of explanation was avoided, by forcing the bill through without debate under the operation of the previous question; and thus the great work of resumption was entered upon, with absolutely no authoritative determination of the main question whether redemption would end the legal tender currency or not (1874-1875, ch. 15). It was only certain that, when the measure should finally be interpreted for purposes of administration, one section or the other of its supporters would meet with bitter disappointment.

12. As a preparation for actual specie payment in 1879, the Resumption Act provided for a gradual reduction of outstanding legal tender notes from \$382,000,000 to \$300,000,000, so far as such reduction could be offset by the issue of national-bank notes by new banks, or by old ones increasing their circulation. This device for avoiding a contraction in the total currency was defeated by an unexpected surrender of bank circulation under the pressure of the times; and the consequent net reduction of legal tender notes and bank-notes came to be regarded in some parts of the Union as the cause of the depression, which deepened in this country in 1876 and 1877 as it did in the greater part of Europe. When Congress came together in October, 1877, a bill was at once reported to the House by the Committee on Banking and Currency to repeal the third section of the Resumption Act, this section containing all the provisions as to the redemption of the United States notes. With an amendment exempting from repeal the provision for free banking, this bill was passed in the House and went to the Senate. That body amended the House bill so as to make it simply a bill for making United States notes receivable in payment for the four per cent bonds and also for customs duties, and finally passed it in this form in the following June by a vote of 45 to 15. But, while this measure was pending in the Senate, and in view of the probable disagreement of the two Houses, the mover of the House bill introduced there a short bill to forbid the further retirement of legal tender notes; and this was hurriedly passed through both House and Senate, and became a law May 31, 1878 (1877-1878, ch. 146). This momentous act, which finally settled the question as to the meaning of "redemption" in the Resumption

Act and completed the conversion of the United States notes into a permanent currency, — an act scarcely inferior in its importance to the Resumption Act itself, — was adopted almost without debate. The issue at that moment stood, as it stands at present, at \$346,681,016.

13. The reserve of gold, accumulated for the redemption of legal tender paper under these changed conditions, received a tardy recognition from Congress in 1882, when, under the act for extending the charters of the national banks, it was provided that the issue of gold certificates by the Treasury should be suspended "whenever the amount of gold coin or gold bullion in the Treasury reserved for the redemption of United States notes falls below one hundred millions of dollars" (1881-1882, ch. 290, § 12). No means of replenishing this reserve have ever been provided, except those named in the Resumption Act, — surplus revenues and bonds of the descriptions authorized by the Refunding Act (1869-1870, ch. 256).

14. The winter of 1889 and 1890 brought a fresh outburst of agitation for the free coinage of silver, at a time when the compulsory coinage of silver dollars under the Bland Act of 1878 was finally submerging the Treasury. The result of several months of debate in Congress was the passage of the Silver Purchase Act of 1890, by which Congress required the purchase of 4,500,000 ounces of silver per month, payment therefor to be made in "coin notes," which were to be a legal tender and to be withdrawn from circulation only when replaced by an equal amount of the silver dollars (1889-1890, ch. 708). This provision for adding to the legal tender paper is the only part of the act which there is occasion to consider here. The reduction of legal tender circulation had been made impossible by the act of 1878; and Congress now ordered its periodical increase, by such an amount as should be required by the stated purchases of silver, without limit, and with no discretionary power of suspension in any exigency. It was declared to be the policy of the United States to maintain the "parity" of gold and silver; but no provision was made for an increase of the gold reserve established for the protection of the United States notes, in case "parity" meant the maintenance of the gold standard. It was provided on the other hand that the coin notes might be redeemed in silver at the pleasure of the Secretary, so that the decline to the silver standard appeared to be a matter of probable ultimate

necessity. The new measure was, therefore, a surprising sequel to the long effort made to place the legal tender notes on the solid footing of gold.

15. Not many months had passed before the saturation of the currency with legal tender paper and silver was proved by the slackening of gold payments for customs duties. In the spring of 1893 the new coin notes outstanding had risen to \$140,000,000, and the increase then going on was not far short of \$4,000,000 per month; gold receipts at New York were nearly dried up, and the gold reserve in the Treasury was falling below the prescribed \$100,000,000. The visible danger of the suspension of gold payments precipitated the violent monetary panic which culminated in July. Congress was called together in August to provide the means of financial safety, and the repeal of the clause in the act of 1890 requiring the purchase of silver was carried, after a parliamentary contest which lasted for eighty-two days (1893, ch. 8).

These are the leading points in the history of a currency now old enough to have had its trial in every variety of national fortune,—in prosperity and in adversity, in war and in peace. As an exhibition of unsteady purpose, the record appears to me to be without a parallel, considering the gravity of the subject-matter. This is the manner in which the nation has dealt with the paper legal tender which practically lies at the base of the great mass of its credit transactions,—used concurrently with gold no doubt at present, but for many years used almost exclusively, and possibly in some contingency destined to be so used again. The customary paper circulation, which should rest on a bed-rock of law as unchangeable as anything of human institution can be, has lain upon a quicksand. Instability has been the leading characteristic of our legislation on this subject for a third of a century.

If we consider the course pursued by the other leading nations in their management of currency and kindred matters, the contrast is remarkable. England has made no important change in her currency system for over fifty years, and, notwithstanding the inviting field which it presents for the reformer, still prefers not to risk her reputation for absolute safety upon possible, but still uncertain, improvements. France has kept her system without substantial change, except in the scale of its operations, ever since the

absorption of the departmental banks by the Bank of France in 1848. The war with Germany, suspension of specie payments, revolution, invasion, and defeat tried the strength of her legislation and of her confidence in it; but it stands to-day nearly as it stood before 1870, except for the legal tender power then given to the notes of the Bank of France. Germany laid her course in her coinage and bank acts of 1871 to 1875, and has followed it from that day without deviation, her occasional legislation upon this subject being directed steadily to the completion of the system as originally planned. These nations now have an unflinching confidence in the steadiness, permanence, and soundness of their own monetary arrangements; and a chief element in that confidence is the certainty that serious change is not within the range of probability.

This contrast, though still disadvantageous, would be less painful if in the rapid succession of changes made by our government there were discernible any approach to continuity of purpose. A consistent policy might be developed or a system might grow up by a succession of short stages, and the wisdom of the process might be justified as regards its intention, if not as regards its skill. But no such continuity is to be found in the series of measures recapitulated above. Fundamental principles are adopted at one time and abandoned at another. The automatic absorption of notes by bonds, their systematic retirement and cancellation by the discretionary authority of the Treasury, the payment of them as a debt, the idea of fixity of amount, and that of an adequate reserve in proportion to the amount,—such conceptions as these have been held for a time, then dropped, then succeeded by others, perhaps equally short-lived. The series of acts, as a whole, points to no particular end, its several parts have no systematic tendency or common direction. The steps taken have been without logical order, and the important consequences following have often been neither expected nor desired. The line traced by these measures is in fact a legislative zigzag, not a line of development.

When we inquire for the cause of such a mortifying result from thirty-five years of constantly renewed financial anxiety and debate, we must find it in the general absence of any sense of responsibility for the formation and maintenance of a consistent policy. Not many of our Secretaries of the Treasury have found it worth while

to plan and act for any distant future, they knowing well that executive initiative counts for but little in the end; and, moreover, whatever secretaries may desire, no Congress can be relied upon to carry out the purposes of a predecessor. Inspection of the list of acts shows that usually some accidental conjuncture or some supposed popular demand has been the real spring of action in each case, and that for the individual legislator a supposed mandate for the passing moment has generally been enough to discharge him from all personal responsibility.

Consistency in the popular demand is not a characteristic of our politics. The American people can be relied upon with confidence in a sufficiently alarming crisis, finally and after great travail, to rally in support of the honest and wise course in any matter of high policy; but this result is often reached only after a season of painful doubt and seeming vacillation, and after much mischief. The last year, for example, witnessed the latest of a series of occasional appeals to the sound common sense of the plain people, in which the result was fortunate, to be sure, and emphatic, but was obviously too long left in uncertainty. How should we expect the sense of legislative responsibility for a continuous course of action to be developed under such conditions? How can we wonder that the congressman is too anxiously mindful of the shifting mass of opinion behind him, on which his political future depends, to resist the passing demand for change? Or why should our financial legislation be less changeable and inconsistent than our tariff legislation, in which we are now expecting the third radical alteration, not to say revolution, effected in the space of seven years?

Is it even surprising that, on the whole, the net result of conflicting financial acts should be a general weakening of our system and a loosening of the grip upon hard money? The fact is indubitable. For proof of it we need only compare, first, the condition of things in 1865, when there was a general consensus of opinion that the return to specie payment was a manageable problem for early solution; second, the condition in 1875, when, after a year of painful tergiversation, a Resumption Act was finally carried through in deference to a manifest public opinion, although by means of an agreement that its terms should be unintelligible; and, third, the recent state of affairs, when the country has repeat-

edly found itself brought dangerously near the verge of a fresh suspension, and has still found it impossible to obtain a line of legislation demanded for the better protection of the national honor and well-being. The reason for this irregular, but on the whole progressive, relaxation on the side of political morals, at the same time that we have secured specie payment, is not far to seek. In any debate where the fateful words "contraction" and "relief" are heard, the fears and demands of a sufficiently noisy minority have extraordinary potency, especially in the even years which witness the national elections; and ground once lost by any weakness in this part of the field of politics is regained with great difficulty. The country is now and then roused to the fact that it is slipping down a dangerous declivity; but, after all, even under a government of and for and by the people, it is not always easy for the clear will of the majority to find expression in law.

It is not to be assumed that the cause of this legislative incapacity to deal firmly with a subject of the gravest importance is to be found in special defects of character, intellectual force, or proper purpose among the men who make up the Congress of the United States. The parliamentary bodies in other countries as well as our own suffer from the follies of individual members, often fail to do their duty, and are the objects of criticism and satire. Under their forms of parliamentary government, however, they are in a measure protected from what might prove to be their own incapacity, — sometimes by traditional modes of procedure, sometimes by positive rules, and generally by established forms of political organization and leadership. Without the defences of this kind which time and habit have thrown around the House of Commons, that body might easily find its action as much a matter of chance, and as little to be relied upon under the strain of an unsettled public opinion, as that of the House of Representatives. Add to the differences in customary procedure the fact that it is our usual practice to elect to Congress no one who is not a resident of the district to be represented, — so that disagreement with local opinion often means for the member not merely failure at a new election, but political death, — and there are reasons enough why Congress should have failed so conspicuously to frame and defend any consistent line of policy as to the paper currency.

A few words should also be said here as to a phase of popular

opinion with which members of Congress have long had to reckon, — a phase of opinion singularly persistent and general, showing itself in an extreme dread of “contraction.” The long depreciation following the great issues of United States notes during the war impressed upon the public mind the consequences of inflation, so deeply that the lesson is nearly as vivid to-day as it was thirty years ago. The majority, no doubt, have a wholesome dread of any tendency in that direction; and a minority, perhaps, desire such a tendency in some form or other, with more or less crude notions as to controlling the results. But, whether resisting inflation or favoring it, the great mass of our people clearly have a strong belief in the effect of quantity upon the value of a circulation; and this appears to make up the greatest part of their simple creed as to money. To hold the currency where it is becomes the ideal of steady management; and contraction becomes an evil in itself, and perhaps more dreaded even than inflation, because its earlier stages are more painful.

The dread of contraction was the one argument against resumption which had any strength with the public; and it has not lost its power since, although we plainly have the whole world upon which to draw, if our own supply is below our needs. A morbid anxiety as to the sufficiency of the currency to-day possesses the public mind, as is shown by the copious statistics with which the government publications constantly strive to reassure the people, and by the frequent efforts of Presidents and Secretaries to satisfy public opinion as to the care with which the supply of currency is insured. No other country of importance shows this hypochondriac anxiety as to its symptoms, or gives a tithe of the attention given by ours to the mere quantity of its money; and no one of the leading commercial countries, it must be said, is either so favored by fortune or so constantly in trouble in this respect. But our excessive sensitiveness on this point is obstinate: it has apparently been increased by the course of the discussion as to silver, and we are still absolutely unwilling to trust to the operation of natural laws for the adjustment of the amount of our active currency.

The necessary conclusion from our experience with the legal tender notes plainly is that a government currency, under our conditions, is an unfit subject for national legislation. Many subjects required legislation in the heat of civil war which are recog-

nized as having no place in time of peace; many powers were then called into use, from stern necessity, which have been laid aside, like disused weapons consigned to the arsenal. A system which makes the usual legal tender of the country a subject of current legislation risks too much upon the chances of mistake, attack, and uncertainty. It is a familiar and useful practice in our legislative bodies to recognize some subjects as fitted for treatment by general laws, in order that they may be freed from the uncertainties and may not add to the temptations which beset the work of every legislature. The case of the paper currency of the country is analogous to this, in that for safety it requires to be placed upon such a basis as shall reduce to the minimum the chances of its coming up for action and shall prevent a constantly recurring anxiety as to its future.

What happens with a paper legal tender is far different from the course of legislation as to the legal tender coin. With regard to the latter the government fixed its standard and established its system of coinage in 1792, and then found at the most only two occasions for legislation as to other matters than mere detail, until the silver question presented itself in 1878. But the paper legal tender never has been, and it is safe to say never can be, put upon a basis where it can have a like course of freedom from change. Resting purely upon credit, and regarded as a creation of money by mere act of Congress, it steadily invites alteration, the removal of this limit or that, the increase of its amount, or the alteration of its coin basis. The reserve to be held in the Treasury under any safe adjustment can never fail, from its magnitude, to attract the covetous gaze of the schemers who throng around the great source of government bounty. In addition to these risks to which the paper legal tender is exposed, it has also to meet those arising from the silver controversy now threatening the coin. It was well recognized six months ago that in the event of Mr. Bryan's election the legal tender paper might be suddenly lowered to the silver standard, by the mere substitution of silver redemption for gold, and by mere executive order. It is not fit that the paper currency of the country should thus be kept adrift, or that the people of the country should be called upon periodically to rally for the safety of something which fails of one of its main purposes if it is not kept free from any suspicion of danger.

The passage of the Silver Purchase Act of 1890 is a striking illustration of the peril of the present situation. Two explanations have been given of the causes which united a majority of both Houses in favor of an act which proposed a steady dilution of the paper currency, involving the ultimate suspension of gold payments and final degradation of our standard to the level of silver. One explanation, current at the time and long afterwards, was to the effect that a majority of both Houses favored the free coinage of silver, that President Harrison could not be relied upon to veto a bill framed for that purpose, and that the insane "experiment" of buying the domestic product of silver by new issues of paper was resorted to as a compromise, in dread of a more rapidly working measure and one which would leave no *locus penitentiæ*. The other explanation—given in the Senate nearly a year ago by Senator Teller—was to the effect that the Silver Purchase Act was the consideration for which the silver interest, holding the balance of power in the Senate, was induced to give its support to the Tariff Act of 1890, then on its passage. This statement of the transaction, made by one who did not hesitate to declare himself one of the contracting parties in the case, has the greater intrinsic probability; but, be that as it may, let the one account or the other be the correct statement, it is true in either case that legislature and executive were alike ready to cut the paper currency adrift from the solid standard and to let it float towards depreciation. In the one case this would be for the reason that a sound currency was doomed in any event; and in the other case for the reason that neither Congress nor President regarded its sacrifice as anything more than a proper makeweight, to be thrown in for the sake of securing a higher scale of customs duties.

Is there another country in the world, outside of South America, in which a paper legal tender, with all the possibilities implied in its misuse, would be dealt with in this fashion? The election of 1896 and all that has followed inspires confident hope of a less troubled future; but, after all, what guarantee have we that the amazing defection of 1890 may not be repeated within half a dozen years? Such an untoward result would mean no greater revolution than that which took place in the half-dozen years ending with 1890: indeed, it may be doubted whether in the minds of most men

the assurance of safety is not sensibly weaker now than it was before that year.

The case of 1890 shows the peril that may come from positive action by Congress, and the last three years have shown with equal distinctness the dangers to be feared from its inaction. Since the beginning of 1894 there has been a necessity for the periodical replenishment of the gold reserve. Withdrawals, sometimes for export and sometimes from precaution, have brought the stock of gold down to the danger point; and it has been filled up by the proceeds of successive loans, amounting to over \$260,000,000. It is immaterial whether the cause of this steady borrowing, for the payment of a debt which is not thereby diminished, is to be found in what has been called the "endless chain" of notes redeemed, reissued, again redeemed and again issued, or is to be found in a deficiency of revenue. In either case the evil was flagrant, and it was the business of Congress to apply an appropriate remedy, — by fresh taxation in the one case, or by modifying the system of reissue under the act of 1878 in the other. But it will be within the recollection of every reader that Congress found itself absolutely unable to act. Four times the necessity for borrowing has presented itself, with a suspension of gold payments as the only alternative. On three occasions out of the four Congress was in session at the critical moment; but it uniformly appeared that action was out of the question. Grant that the responsibility for failure lay with a factious few and not with the majority, and the fact still remains that the Congress of the United States was unable to act in an emergency created by its own legislation. It was even unable to apply the palliative of providing for the issue of shorter bonds, bearing a lower rate of interest than those to be issued under the act of 1870, a bill for that purpose passed by the House in 1896 having been converted by the Senate into a bill for the free coinage of silver. For three years, therefore, the credit of the government and the standard of prices and payments have remained, not without defence, — for the executive still performed its duty with the means afforded by the half-forgotten provision in the Resumption Act, — but so shaken at intervals as to cause constant dread, sometimes nearly degenerating into panic.

A currency which is exposed to such dangers as these cannot be called safe in any proper sense of the word. The wealth of

the promisor of the note is unspeakable, but from time to time the application of that wealth in fulfilment of the promise is not beyond question. The power to enforce the legal tender of the note at its face in payment of debt is absolute, but the standard of its value has never been made secure. For thirty-five years the policy of the law in regard to this currency has been uncertain, and the causes of this uncertainty have gained in strength and multiplied as time has gone on. One ingenious expedient and another is suggested for regulating the use and redemption of the notes, in the hope of giving them steadiness and securing somewhere a power of control; but there is no escape from the fatal objection, that the direct power of legislation is not only paramount but is beyond the controlling force of any steady political influence. In short, not only is there no guarantee, but there is no probability that the history of these issues, if they continue for another generation, will be any less checkered than it has been in the last. Without dwelling upon such forebodings, however, it is enough to say here, that while the very foundation of all credit is thus left doubtful neither the credit of the nation nor that of the mass of its citizens can reach its proper strength. None can profit by such uncertainty except those whose command of wealth enables them to secure themselves, at the expense of others, against the hazards of the future.

The necessary alternative to the issue of paper currency by the government is the delegation of this function to banks and the complete substitution of private credit for public as the medium of exchange in domestic operations. A large proportion of these operations are already performed by means of bank credit, with an adjustment to the needs of the day which is nearly automatic; and the only relief from the increasing perils of the present situation is to be found in the same direction. This reliance upon banks would not, necessarily, mean the absorption of the whole right of paper issue by the national banks, although this absorption would have much to recommend it; but it would clearly imply the confinement of the right to banks working under tolerably uniform conditions, as the guarantee of their safety and wide credit, and therefore presumably under some kind of national regulation and supervision.

Even with the use of bank-notes, then, the paper currency must continue to be a subject of national legislation. There is,

however, an important distinction in the kind of legislation called for by government paper and by bank paper respectively, and a great difference in the risks to which we may be exposed in the two cases. Congress has had the national bank system before it, for any necessary legislation, for almost the same length of time as the legal tender issues; but the course of action in the two cases offers no point of resemblance. Inconsistent and essentially weak as the dealing of Congress with the legal tender issues has been, its legislation as to the banks has on the whole been marked by steady purpose, has tended to complete the original system, and as a general result has materially strengthened it. Deservedly or not, the banks have from the start had abundance of enemies, in Congress and out of it; but the bank legislation, if not uniformly wise, has been sparing in amount and usually directed to the details rather than the general structure and credit of the system. Comparison shows clearly that for thirty odd years the legislator has approached bank questions from an entirely different point of view and in a different frame of mind from that which has led him to such unfortunate results in acting upon legal tender notes. He has not felt the same temptations, he has not been under the same outside influences, the pressure of the times has not turned his thoughts in the same direction. The fundamental difference in the two cases is no doubt explained by La Rochefoucauld's familiar maxim, that "it is easier to be wise for others than to be wise for one's self." The legislator has found it congenial and easy to hold others to the strict line of their obligations and of sound public policy, but not so easy to observe this line in deciding as to what lay within his own hand. His greatest folly in dealing with the banks—the absurd attempt, made by Congress in 1881 and foiled by the veto of President Hayes, to force a reduction of the interest of bonds held by the banks—was after all not a measure of relaxation towards them, but one of severity.

This natural tendency of Congress, considered merely as a collection of human beings, to exact more from others than from themselves, is undoubtedly strengthened by the kind of presumption established in the popular mind to the disadvantage of any corporation, in questions of responsibility or of seeming conflict of interest. The national banks have felt the pressure of this

influence against them, in cases where they have sought for changes of legislation which would have been for the general advantage. No doubt in such cases impartiality of judgment would better have befitted the legislator than unfavorable prepossession; but, after all, can it be doubted that the disposition to say "No" has had an important place among the causes for the general steadiness of our bank legislation? To hold the banks to their obligation and to grant them few favors has been the rule, and the existence of any rule analogous to this in dealing with the legal tender issues would have given an entirely different cast to that unfortunate chapter of our history.

The nations already referred to as able to manage their currencies successfully and quietly have all done this by delegating the power of issue to banks. They have established their banks on different principles, but have agreed in the general policy of throwing upon them certain duties and restricting the field of probable legislation. That their systems have a remarkable steadiness and permanence has already been pointed out. These systems they also strengthen, as time goes on, not so much by legislation as by practice, by public opinion, and by the establishment of traditions of duty on the part of the banks themselves. Both in England and in France the legislative power takes distinctly the attitude of observation, towards an establishment which is conducted for private profit, but is intrusted with a *quasi* public function. In Germany the imperial control of the Reichsbank makes the relation somewhat different, and yet a note circulation of remarkable stability has been built up there on the basis of private capital invested in order to earn a profit.¹ In neither one of the three countries does the regulation of the currency present itself as a subject for ordinary legislation.

But it is not necessary for the present discussion to enter upon the general considerations for or against a paper currency consisting of bank-notes alone; and I shall only call attention here, in conclusion, to the often-repeated argument that a government issue, being a loan without interest, results in a saving to the Treasury

¹ There are still outstanding in Germany imperial treasury notes (not made a legal tender) to the amount of 120,000,000 marks, remaining from the larger issue made in 1875 to replace the notes of the several German states. But this exception to what is said above is not important.

which is lost when the right of circulation is delegated to banks. The experience of the United States in the last five years alone presents a complete answer to this penny-wise reasoning. In that space of time the people of the United States have lost by shaken confidence, discouraged enterprise, and the actual ruin of thousands of citizens, resulting from the mismanagement of their currency, an amount beyond all comparison with the annual saving of perhaps \$12,000,000 made by them at the Treasury. The thrill of alarm which runs through the country whenever the gold reserve dips too far below the line, or when there is delay or doubt in applying the costly remedy, means a loss to the people to be measured only by scores of millions. The monetary panic of 1893 alone, by its direct results and without reference to the stagnation which followed it, was enough to counterbalance all savings of interest made by the Treasury in the last twenty years.

But the question as to the means of securing the safest paper currency is one in which the consequences to the national industry and prosperity are on a scale so vast that any attempt at pecuniary measurement appears irrelevant, — as irrelevant as it would be to draw from the post-office deficit a conclusion as to the maintenance of the postal service by our people. No such calculations are needed to show that our people cannot afford to rest content with a system which their experience for a generation has shown to be radically unsafe. So long as such a system continues, its history must continue to repeat itself. Errors made in the past will be made also by the new men in the future ; and the possibility that, in any moment of popular discouragement or passing delusion, some fresh experiment or abandonment of wholesome limitation may be resolved upon in haste, but with irreparable results, must continue to be a standing menace to our credit, public and private.

THE NATIONAL BANKING SYSTEM¹

OF the constituents of our paper currency the government notes are amply shown by the history of the last thirty years to be the dangerous element. Experience has shown that we can rely upon no principle or policy as a safeguard against the caprice or the temptation, which at intervals must surely beset any legislative body having control of the direct issue of paper. The bank-notes, on the other hand, have been jealously guarded and strengthened by legislation, until they resemble a government issue resting upon a special fund of cash and securities rather than the promises of corporations. In their case the present need of reform is not the result of excess or of insecurity. Their increase is under heavy restraint, and they are as secure as the credit of the government can make them. Their grand defect is want of adaptation to the proper business of banking, which limits their usefulness in some parts of the country and makes them practically unavailable for issue in others.

The framers of the bank acts of 1863 and 1864, which have become Title LXII. of the Revised Statutes, had their attention fixed chiefly on the provision of a paper currency of uniform value throughout the United States, which should absorb by permanent investment a certain amount of United States bonds, and should become the sole paper currency of the future. Indeed, the title of each act, "An Act to provide a National Currency, secured by the pledge of United States stocks [or bonds], and to provide for the Circulation and Redemption thereof," sufficiently shows the point of view from which these measures were regarded. The provisions as to the general business of banking were, no doubt, greatly in advance of those existing in many states; but, after all, it was the issue of notes upon a secure basis which interested Congress and the public at the time, and has continued to be a leading con-

¹ *Quarterly Journal of Economics*, October, 1897.

sideration in national legislation on this subject ever since. Perhaps the failure of the national system to meet the wants of large sections of country might not, even now, have secured the attention which it deserves, had not the provision for the safety of the notes finally undermined the issue and threatened its extinction. The inability of the system as it stands to perform steadily and satisfactorily its chief duty of supplying the business of the country with a safe and adequate currency, has finally brought the whole subject of banking under discussion, and has raised the question as to the proper coördination of issue with the other functions of banks, in a more radical form than for thirty years before.

Although the purpose of this paper is to consider some of the points at which, in the judgment of the writer, the national banking system has proved to be badly adapted to the present needs of the country, the writer must premise that the national system appears to him to be the foundation on which any reform of our bank-note currency must necessarily stand. Experience under that system has shown plainly the gain secured by uniformity of regulation and unity of supervision. There is no question that the national banks find their credit in every form strengthened by the fact that all rest upon the same law, universally known, and are under the same recognized authority, whose mode of operation is universally understood. That the convenience of their notes for use is materially increased by this unity of regulation, and by the uniformity of design of the notes themselves, is perhaps the one point in the working of the national system as to which all are agreed. To replace such a system by any complex arrangement by which the right of issue should be extended to state banks would be a palpable sacrifice of advantages, from which the public as well as the stockholders of the banks are now gainers. It has been proposed that such state banks as may accede to proper regulations prescribed for safety and solvency should be allowed the right of issue. But it is difficult to see how such regulations could be enforced with certainty except by the authority of the United States, or by that authority without much risk of friction and possible conflict between national and state jurisdictions, or without such strictness of rule and superintendence as would destroy the reasons for preferring state organization to national. The

last-named consideration is the more serious when we consider the fact, not to be disguised, that in many states the local opinion as to what is safe regulation and what is not is too loose to be satisfactory beyond the state line. In short, practical as well as theoretical difficulties begin to multiply, as soon as we attempt to reconcile the conception of a really national currency with anything short of an absolutely uniform system of safeguards.

The banking history of the United States has been for the most part a succession of catastrophic changes rather than a process of steady growth. One expedient after another has been taken up, abruptly dismissed in its turn, like the two Banks of the United States, or suddenly revolutionized, like the currency provisions of the Independent Treasury Act. The national banking system has now had a longer term of active existence than any other national system adopted in this country, or any important state system of issue. Seriously as its defects have limited its usefulness, it has grown in strength and credit. In the course of a generation it has collected a mass of legislation, judicial precedents, and rules of official practice, which make up a body of administrative law of remarkable completeness and value, known from one end of the Union to the other, — a common possession, in which it is not impossible that all our people may yet come to appreciate their common interest. This is a foundation to build upon, not an experiment to be dismissed and superseded by some other. Never since the early part of this century has there been a like opportunity to improve our legislation upon banking and currency by the proper adjustment of an existing system, old enough and successful enough to have acquired an historical position and credit. We now enjoy an advantage analogous to that which England finds in making the ancient reputation and strength of the Bank of England the starting-point in any financial measure, or France in her careful adhesion, through every revolution in dynasty or politics, to the century-old Bank of France.

It is also a practical consideration of great weight that any change in the existing system would be made with the least disturbance of business relations and practices if it were made by the better regulation of the mass of banks which already have the right of issue; but upon this it is not necessary to dwell.

DISTRIBUTION OF BANKS, NATIONAL AND STATE

[Compiled from the *Report of the Comptroller of the Currency for 1896*: the national banks for October 31, 1896 (p. 513); the state banks for various dates, chiefly in 1896 (p. 696). Dollars are given in millions and tenths of millions.]

	NATIONAL BANKS				STATE BANKS			
	Number	Capital	Circulation	Deposits	Number	Capital	Deposits	Deposits
New England . . .	589	\$161.3	\$63.9	\$254.2	14	\$3.2	\$5.8	
Middle States . . .	950	198.3	86.4	719.6	332	42.9	242.9	
West and Northwest	995	151.4	45.	348.6	985	59.2	202.8	451.5
	2534	511.	195.3	1322.4	1331	105.3		
South and Southwest	557	70.5	21.7	123.4	625	49.4	82.8	
Missouri River . . .	357	44.3	9.4	75.9	1469	39.2	99.4	182.2
	914	114.8	31.1	199.4	2094	88.6		
Central and Mountain	126	15.8	4.1	45.7	203	4.2	6.9	
Pacific	105	16.6	4.	30.2	80	42.	55.1	62.
	231	32.4	8.1	75.9	283	46.2		
	3679	658.2	234.5	1597.6	3708	240.1		695.7

The defective adaptation of the national banking system to the needs of the different sections is amply shown by the reports of the Comptroller of the Currency. From the latest of these reports¹ it appears that in 1896 more than two-thirds in number of the national banks and more than three-fourths in capital were to be found in the belt of states lying north of the Potomac and Ohio on the east of the Mississippi, and including Iowa and Minnesota on the west of this river. The same states have more than one-third in number and two-fifths in capital of the state banks carrying on business without the right of issue; but the state banks, taking these states together, carry on an unequal contest with the national system. In the rich states of the North the vast preponderance, in number, capital, and business, is with the national banks, although, as we advance westward, the newer states, even in this belt, show a more equal division of the field. Coming to the South and Southwest, excluding Missouri, we find the national banks less numerous than the state banks, but holding about seven-twelfths of the capital and a slightly larger proportion of the deposits. The group made up of Missouri, Kansas, Nebraska, and the Dakotas shows a great preponderance of state banks in number and deposits and an approach to equality in capital.² The Central and Mountain states and territories, with their extraordinary differences of economic condition, have placed the greater part of their small banking capital under the national system; and, finally, the Pacific states show a great preponderance of state banking, which upon examination is found to be due to the little use made of national banks by California.

It is clear that the inequalities thus briefly recapitulated rest upon something more than mere differences in population, wealth,

¹ See table on page 230.

In this table the Middle states include Maryland and the District of Columbia; the West and Northwest, the states from Ohio to Iowa and Minnesota; the South and Southwest, the Atlantic and the Gulf states from Virginia to Texas, with West Virginia, Arkansas, Kentucky, and Tennessee; the Missouri River group is Missouri, Kansas, Nebraska, and the Dakotas; the Pacific states are Nevada, California, Oregon, and Washington; the Central and Mountain group is Colorado, Idaho, Montana, Wyoming, Utah, New Mexico, Arizona, Oklahoma, and the Indian Territory.

² It should be noted here that in the Comptroller's returns for Kentucky, Kansas, Nebraska, and Oklahoma, the figures for state banks include private as well as incorporated banks. Of the Kansas banks returned 109 were private, and of those in Nebraska 81, mostly of small capital in each case.

and general activity. Those differences would lead us to expect much disproportion in the use of banks in general; but it is plain that, in addition to this, the comparative attractions of national banking with the right of issue, and of state banking without it, are differently estimated in different states and sections. This appears still more clearly when a comparison is made between different parts of the same section. Thus, in the large Western group, the four newer states — Michigan, Wisconsin, Iowa, and Minnesota — have \$36,000,000 of state bank capital to \$52,000,000 of national, in this respect approximating the condition of sparsely settled agricultural states in other sections. In the South, of the most important banking states, the Virginias and Kentucky have \$32,000,000 of state bank capital to \$21,000,000 of national. In general, the rule holds that the older, richer, or more densely populated states, with varied industries, find it easier to use the national system than the more thinly settled communities, poor in capital and carrying on industries of slow return. Even such an apparent exception as that of Texas, where only the national system appears to be used, proves the rule; for Texas, since 1876, has forbidden by her constitution the establishment of state banks, and any competition with national banks must there be carried on by private bankers.

It is beyond dispute that one of the most serious difficulties in the use of the national system in the newer or poorer communities is the requirement of an investment in United States bonds, locking up banking capital in a non-banking security, returning less than three per cent to the holder. In the older states, with abundance of capital and low rates of profit, this requirement has less importance; but in states where the conditions are reversed it is a heavy block in the way of the national system and its possible usefulness. Especially does the bond deposit block the way in any section where there is a need of banks of relatively small capital; for, as the minimum holding of bonds is one-fourth of the capital for banks of \$150,000 or under, and \$50,000 for larger banks of whatever size, it bears most heavily in proportion upon the small capitals. The comparative pressure of this requirement in different sections, in October, 1896, is shown by the Comptroller of the Currency,¹ in a table from which the following statement is made up: —

¹ *Report for 1896*, p. 552.

	BONDS HELD FOR CIRCULATION	MINIMUM REQUIRED	PERCENTAGE OF EXCESS
New England	65.4	21.6	.67
Middle States	87.9	28.9	.67
West and Northwest	45.6	24.9	.45
South and Southwest	21.3	14.2	.33
Missouri River	9.2	7.1	.23
Central and Mountain	3.9	2.9	.29
Pacific	3.9	3.	.24
	<hr/> 237.2	<hr/> 102.6	

The reluctance with which the investment in bonds is made by small banks in the agricultural states is also shown with great distinctness by the case of Texas, where vigorous growth calls for extended banking, but only national banks can obtain charters. Of the 207 national banks in Texas, 88 are banks of \$50,000 capital, of which 86 have the exact minimum of bonds, 1 a nominal excess, and 1 a circulation equal to its capital. Of the 76 banks above \$50,000 and not over \$100,000, 63 have only the exact minimum, 7 only a nominal excess, and 6 have together \$182,250 above the minimum. Of the 43 banks having capitals above \$100,000, 36 have the exact minimum of bonds, 3 have only a nominal excess, and 4 have together \$208,000 in excess of the requirement. For the whole \$20,920,000 of national bank capital in Texas, the bonds held for circulation above the legally possible minimum is but \$434,700. The inference from these figures is irresistible that banks in Texas cannot afford to invest at the low rate of interest yielded by United States bonds, and the presumption is strong that the increase of small banks is hindered and that capital is forced into other channels by the bond requirement. Nebraska is also a strong case of the same kind, with the difference that Nebraska seeks her relief by means of incorporated state banks. The 113 national banks in Nebraska, having an aggregate capital of \$10,975,000, hold only \$368,650 of bonds in excess of the required amount; and \$333,000 of this excess is held by the large banks in the cities of Lincoln and Omaha. Out of 72 banks of \$50,000 capital, only 3 hold bonds exceeding the minimum by so much as \$1000, and 64 hold no excess whatever. Similar illustrations of the working of the bond requirement may be found in many other states.

Of the objects to be gained from the deposit of bonds,—

security for the notes and the creation of a market for bonds, — the former alone now has any value. Against the complete attainment of this object, which must be admitted, have to be set the facts that, as the government credit rises, the inducement to take out circulation weakens, so that the strength of the security tends to pinch the issue out of existence, and that the necessity of giving this particular kind of security produces the maximum of discouragement in sections where the need of banking facilities is strongly felt. The propositions to permit notes to be issued to the par of the bonds, instead of the ninety per cent so far allowed, and to moderate or withdraw the one per cent tax on circulation, are offered as palliatives for an acknowledged evil; but they do not strike at the cause, nor, as will be seen, can they have any effect upon some of the more serious difficulties of the system. The root of the trouble is, after all, the necessity for taking a relatively large part of the capital of a bank out of the proper business of banking, and investing it elsewhere, when all that the bank can do by means of its capital and credit combined is needed for the accommodation of its customers. A complete remedy would have to start therefore, as was proposed by the American Bankers' Association in 1894¹ in the well-known "Baltimore Plan," with the abolition of the bond deposit and the restoration of the note to its natural relation, as an exercise of credit in the business of banking. If to this were added provisions for the security of the note-holder by a first lien on the assets of the bank, and, as was also proposed in the Baltimore Plan, by a guarantee or safety fund supported by the contributions of the issuing banks, both reason and experience show that the strength of the note would be ample. Some other parts of the present system would no doubt need revision. Provision for more thorough inspection than is possible with the present staff, more frequent publication of accounts, and strengthening of the stockholder's liability, not in its nominal extent, but in its binding effect,² are changes already needed, which would then be seen to be imperative.

¹ For the details of the "Baltimore Plan" see White's "Money and Banking," p. 458; *Journal of Political Economy*, December, 1894, p. 101.

² Prior to 1880 only about thirty-five per cent of assessments upon stockholders of insolvent banks was actually collected; and in the finished cases since 1880, reported in the Comptroller's *Report* for 1896 (Table No. 76), it appears that the collections averaged only fifty-two per cent.

Amended by resting the issues of national banks upon their assets, where the business community are willing to let the \$1,600,000,000 of deposits rest, the system would be freed from one of the burdens which hinder its progress in the South and West. It would still find its growth seriously hampered in sparsely settled districts everywhere, by the inability of a small community either to provide the capital or to supply the business for banks of the size required by the present law. On this subject a flood of light is thrown by Mr. Thornton Cooke, in a paper¹ showing the distribution of small banks in Missouri, Kansas, Nebraska, and the Dakotas. In these states the minimum capital required for state banks is \$10,000 in Missouri and \$5000 in the four other states. Whatever this minuteness of capital may show as to the prudence of the legislation, it proves that in this important block of states the need of diffusion is keenly felt; and the same inference is to be drawn from the minimum of \$15,000 required in Michigan and \$10,000 in Minnesota. In the five states dealt with by Mr. Cooke an extraordinary development has taken place. Of 1247 state banks covered by the latest official returns, and excluding private banks, 1158 are not beyond the \$50,000 line of capital, 451 are not beyond the line of \$10,000, and 112 have capitals not exceeding \$5000. The tables make it plain that in these states, as a whole, there has been a strong movement to provide for needs not now covered by the national system. There is a long list of other states in which, upon examination, we should find proof of demands not satisfied by the national system, but met imperfectly by state banks and by the great number of private banks, of whose operations there is no record even approximately complete. In every other important banking country such a demonstrated need as this for diffused but sound banking would be answered by the establishment of branches or agencies of banks of larger capital. This method is not unknown in the United States, although for various reasons its application for many years past has been confined to a few states and has been on a limited scale. That it is less applicable or hopeful here than in all the other English-speaking countries, or that it needs anything more than proper encouragement for its wide introduction, at least in sections

¹ See Appendix, *Quarterly Journal of Economics*, October, 1897.

like the South and West, it is hard to believe. The change required in the present law would be slight. If no use were made of the liberty to establish branches, the national system would simply stand as at present, if not improved, at least not impaired; and, if use were made of the liberty, one of the two barriers which bar the access of national banks to an important field would have ceased to block the way.¹

It has also been proposed, as a partial remedy for the imperfect distribution of banking under the national system, to reduce the minimum required capital to \$25,000, as it stands in the law of New York and of several other states.² This proposition, however, is open to some serious objections. It plainly does not go far enough to reach the seat of a great part of the evil. Taking for illustration the case of the Missouri and Dakota group already referred to, it appears from Mr. Cooke's tables that little over one-third of the state banks in that group have capitals above \$20,000. The fact appears to be that banks of \$25,000 capital would be almost as completely beyond the means of a majority of the small village centres in sparsely settled districts as banks of \$50,000 are now. But, even if such a reduction of required capital were enough to lead to an important extension of the national system, it is also a serious question whether on other grounds this would not be a move in the wrong direction. As national banks multiply in number, the problem of insuring sound management by effective supervision becomes grave. With not far from thirty-seven hundred banks already in operation, the United States evidently have in hand a task such as no government ever before undertook; and the difficulties of this task would increase with the further pulverization of capital now suggested. The records of failures show that even in large banks the close attention of directors is not always easily had; but with banks of the smallest class in small villages, not only is there increased difficulty in making it worth the while of directors to give the requisite attention and thought to what is, after all, a matter of but trifling importance to any one individual, but there is also the often experienced embarrassment in finding

¹ The present Comptroller of Currency has urged the introduction of the branch system in his *Report for 1896*, p. 102; and the same ground was taken by Secretary Carlisle, *Finance Report, 1895*, p. lxxxiv.

² For this also see *Report of the Comptroller of the Currency, 1896*, p. 102.

among the business men of a village the material for making up a competent board. The best promise of good management is afforded by a bank with an immediate constituency large enough to supply an ample choice of men, and with a capital large enough to secure the pressure of a full sense of responsibility, and to demand a reasonable share of time and care from an unpaid body of men. In short, any change in capital should be in the direction of consolidation rather than subdivision. The smallest class of national banks now in existence should shrink, and the extension of the system should be effected by banks of more considerable capital, if we are to move towards the most efficient and safe organization. As for the suggestion that such a movement would mean diminished competition and the "concentration of the money power," a system of thirty-seven hundred members would afford ample scope for healthy consolidation long before the danger point could come into view. As for any risk of monopoly, if the power of establishing branches were restricted within state lines, every state would be likely to find within its borders sufficient competition among its own banks to give its people the full benefit of diffused accommodation, free from external control or internal combination.

So far our discussion has turned chiefly upon the present inability of the national banking system to develop banking in accordance with pressing needs of important sections of the country. The further objection that the system is not so constituted as to supply an elastic currency points to a defect in the working of the bank circulation in every section. This objection is indisputable, if we give to the word "elasticity" the meaning usually given to it in banking discussions. If by elasticity we are to understand nothing more than mere capacity for growth under favoring conditions, or variability, no doubt the bank circulation has varied and has had its periods of growth. It rose rapidly in its earlier period, when the investment in bonds yielded a high return; it ran down for a long series of years as the return upon bonds declined; and it rose again after the revulsion of 1893, when with the decline of bonds the return upon them advanced. But the elasticity of a currency is understood to mean something quite different from this tendency to vary over long periods. It means responsiveness to present increase or diminution of demand,—the power of

adaptation to the needs of the month, the week, or the day, whether rising or falling. A glance at the figures for any series of years, or for any period of marked change in affairs, shows that the national bank circulation has never had this quality. How should it be elastic? Elasticity implies the operation of counter forces, in a currency as well as in a steel spring. That a currency may be responsive to demand, it is necessary that the forces, tending respectively to expand or to restrict, should be forces at work in the daily business of the bank, where it is brought into contact with the community by the stream of loans, deposits, and payments. But under the national system at present the motives for extending issues are completely separated from real banking considerations, and such tendencies for the return of notes as exist are equally foreign to the relations between the issuing bank and that portion of the public which it serves.

The failure of the national system to provide for a return flow of notes by some effective plan of redemption is no doubt due to the circumstances under which the national bank acts were passed. Looking to a distant future, the acts contemplated an ultimate return to specie payment, and some of their provisions were shaped accordingly. But, after all, Congress was not greatly interested in any present requirement of redemption, when, so far as could be seen, the redemption of a note must for years mean no more than its exchange for another piece of paper, itself irredeemable. To tie the bank circulation to the public debt, and thus to secure for it as good a chance of ultimate solvency as a promise by the government could then have, and to give the bank paper universal credit, were immediately attainable results, beyond which there was not felt to be much necessity for looking. The act of 1863 accordingly made no provision for the ordinary redemption of bank-notes anywhere except at the counter of the bank itself; and the chance of presentation there was obviously so slight, that Mr. Sherman cheerfully assured the Senate that "these notes, all being the same," so far from having a pitiful life of thirty or sixty days, "may have an indefinite circulation, and the average may extend to years."¹ It was clearly the expectation that the notes, when once set afloat, would drift on the ocean of

¹ *Cong. Globe*, February 10, 1863, p. 843. Mr. Baker of New York, in the House, insisted upon the need of central redemption. *Ibid.*, February 20, p. 1141.

paper as long as their material could hold together. The amended act of 1864 added the requirement that every bank outside of the redemption cities should redeem its notes through some bank in one of those cities, and that all banks in other redemption cities should redeem their notes through banks in the city of New York; but, in the absence of any motive for demanding the redemption of notes which every holder, whether a bank or an individual, could use in his own payments, these provisions served only as a reason for allowing banks to reckon as a part of their reserve the funds deposited by them with banks acting as their redeeming agents.

This inadequate arrangement did not satisfy the conservative banking opinion of the country; and in 1865 and 1866 an important movement for establishing assorting houses in the chief financial centres, with central redemption, was organized in New York, Boston, and Philadelphia, with the approval of the Secretary of the Treasury and the Comptroller of the Currency.¹ The elements of opposition, however, were too strong. The project lost its strength, and died; and the opportunity was lost. The national bank system grew up with an apparatus of redemption which did everything but redeem; and no change was made until 1874, when the function of redemption was transferred to the Treasury, and banks were even forbidden by law to redeem anywhere else, except at their own counters. Thus we have to-day a system of so-called redemption, which no doubt removes from circulation notes which for sanitary reasons, or from wear and tear, are unfit for further use, and enables banks which are overloaded with bank-notes at any season to convert them into greenbacks; but, plainly, the redemption thus carried on has little more than an accidental connection with the financial condition of any issuing bank. A large amount of notes may be passing through the Redemption Bureau; but the National Bank of X has no reason to look for any unusual return of its notes, however extreme its expansion may be, for the holder of its notes, whatever the amount of its obligations, will sooner use them in pay-

¹ For the action of the banks engaged in this movement, and for Secretary McCulloch's part in it, see *Banker's Magazine*, 1865-1866, pp. 193, 401, 415. For the views of the Comptroller of the Currency, *Report*, 1865 (for Mr. Clarke's) and (for Mr. Hurlburd's) 1866 to 1870.

ments than waste time by sending them to the Treasury. This is not a kind of redemption which can possibly make the bank circulation responsive to the demands of business, whatever else it may accomplish.

The singular futility of all this part of our legislation is no doubt closely connected with the ideas as to the meaning of note redemption in general, which have grown up in connection with the greenbacks. Even before the act of 1878 ordered the reissue of the redeemed greenbacks, the original idea of redemption as the fulfilment and ending of a contract had been obscured. That, as a matter of legal interpretation, a note "retired and cancelled" had been paid, and that any new issue must be a new debt, requiring clear legal authority for incurring it, had been disputed for more than ten years,¹ until something more than the mere interpretation of a statute had come into the question. From 1866 to 1878 there is shown in the debates and the acts of Congress a progressive weakening of the force assigned to the term "redemption," and the growth of an opinion that everything needful is accomplished, if the opportunity for an exchange of one kind of currency for another is somewhere held open.

But is it enough that every holder of government or bank notes should understand that gold can always be had for the paper at the Treasury or the bank? Especially as regards bank-notes, can redemption do its work if it is merely a passive arrangement for possible payment, in case anybody thinks it worth while to call for it, and not an active system of prompt presentation? At the bottom of much that is said and written on this subject there would seem to be an impression that to give the public convincing assurance of convertibility is the only object to be provided for. But the redemption of a currency has a bearing much broader than this. The exchange of notes for specie on any large scale is called for in most cases because the trade relations of the country or the section concerned are such as to make specie for the time its cheapest export. This state of things may

¹ In January, 1868, Mr. Edmunds stated in the Senate his opinion that the notes "retired and cancelled" under the act of 1866 could be reissued, and moved an amendment to a pending bill to prevent this. Mr. Sherman objected that reissue was illegal and further legislation on the point needless, and Mr. Edmund's amendment was lost. *Cong. Globe*, January 10, 1868, pp. 435, 529. Six years later \$26,000,000 of notes once "retired and cancelled" were reissued.

be the result of deplorable misfortune or of equally deplorable folly; but in either case it is the misfortune or the folly that is to be deplored, and not the process by which we pay in the easiest way the debts which have been created. The payment is, after all, a curative process, by which our currency seeks the condition of equilibrium with our real ability to hold money, as the first step towards sound strength; and it is for the general interest that the movement of specie should be easy, and that the payment of our debts, in this form as well as any other, should be prompt.

Moreover, whether we look at the government issue or at that of the banks, it is important that the natural effect of a depletion of our currency by specie export should not, under ordinary circumstances, be thwarted or warded off. In the one case, for the government to undertake, by the reissue of its notes, to keep up the domestic currency in the face of a movement for redemption and specie export, is to make that currency, so far as may be possible, insensitive to the influences which tend to its final replenishment. Mr. Sherman perhaps had a vision of this truth when he recommended "that by law the resumption fund be specifically defined and set apart for the redemption of United States notes, and that the notes redeemed shall only be issued in exchange for or purchase of coin or bullion."¹ No doubt such an arrangement, so long as Congress permitted its existence, would at any rate have insured the close reciprocal relation which any effective redemption of greenbacks should have with the active currency, and would have made the position of the Treasury defensible without the alternation of panic and loan which has been witnessed since 1893. In the other case, it is almost equally important that, so far as an export movement of specie draws from the bank-note circulation, it should draw as directly as possible from the particular banks which are in a state of relative expansion. The drain of specie is presumably not the consequence of any equally distributed imprudence or any level stroke of misfortune; and its effect should fall, both by the rule of right and by that of expediency, upon some more heavily than upon others. This can only be secured by providing for an easy, automatic return of notes, so that expanded liability shall, so far as is humanly possible, be followed by increased demand for payment.

¹ *Finance Report, 1879, p. x.*

With the imperfect conception of redemption in general on which our law proceeds, it is not surprising that the national-bank note, when once issued, should be regarded as a liability of indefinite date, differing from other bank liabilities in this, that the issuing bank hardly need trouble itself as to its discharge. The fact that it has thus become something not far different from a permanent obligation, is no doubt one of the grounds for the idea of unjust privilege which so many of our people connect with the national bank system. It is also singularly at variance with the principle of having a wholesome restraint upon the operations of each bank by itself, which governs our treatment of other demand liabilities. Provision for the systematic return of notes by other banks, like the daily collection of checks, is so contrary to our present established habits of thought that it seems abnormal, inconsistent with full credit, and useless, if not hostile. But, not to dwell upon other considerations, it appears too plain to require demonstration that a regular return flow of notes is the necessary condition of the elasticity which is now commonly demanded for our bank currency. Elasticity cannot be secured without the operation of restrictive force upon an outstanding circulation: restrictive force cannot operate there, except through the agency of the holders of the notes; and it can only operate through them by virtue of some legal provision or of some convention or practice having equivalent force. Of legal provisions for this end a striking example is supplied by the law of Massachusetts, which from 1843 forbade any bank to pay out any notes except its own, and thus made it necessary that notes received on deposit or in payments should be sent to the issuing banks for redemption. Of a practice equivalent in effect to this, there is the equally striking case of the Canadian banks, which, without any requirement of law, but simply as competitors for business, "demand prompt and daily redemption of all the notes of other banks that have come in."¹ But our system presents nothing analogous to these devices for making the self-interest of the banks the restrictive force needed to secure elasticity of issue.² We appear to rely vaguely upon some sup-

¹ Breckinridge states that the average life of a bank-note in Canada is found to be about four weeks. "Canadian Banking System," p. 407.

² Breckinridge gives (*ibid.*, p. 408) a diagram showing the monthly variation of the issues of the Canadian banks for fifteen years. The minimum is usually reached in

posed slowly acting tendency of the public to free itself by some means of a currency, if felt to be excessive; but we set no machinery in motion for that purpose, and do not make it for the interest of anybody in particular to do that which on general grounds may be desirable for all. Even so radical a scheme of reform as the "Baltimore Plan" contents itself with the existing provisions for redemption.

It is obvious that the practical difficulties of redemption have multiplied with the growth of our system. Methods easily established at the start would be difficult of introduction into a mass of nearly thirty-seven hundred national banks. Still, unless we are prepared to surrender the idea of true elasticity, the means must finally be devised for making the bank-note as well as the check present itself systematically and promptly for payment; and it is highly improbable that this can be done without restricting the right of national banks to pay out other notes than their own. It is conceivable, although unlikely, that competition might set in among the banks of a single state, and prompt them to refuse of their own accord to circulate each other's notes, although a result like this—easy to understand in a system of only thirty-nine banks, like the Canadian—would be hard to reach in states which count their national banks by hundreds. But outside of its own state, and probably within it, the circulation of a bank-note would have to end by law with its receipt in payment or on deposit by a national bank, and its return for redemption would have to follow.

Probably the mere administrative difficulties in the way of an effective system of real general redemption would not be found to be so serious as they might appear at first blush. For the most part the reserve cities, formerly known as redemption cities, would be the natural centres of redemption, at which the banks would clear their notes with each other as they now clear their checks in a clearing-house; and the two operations would be likely to be

June, but sometimes in August, and one year in September; and the maximum is always near the beginning of November. From the lowest point to the highest, the average annual rise, which disappears in January, is about twenty per cent., varying in the last dozen years from under thirteen per cent in 1882 to twenty four per cent. in 1888. There is also a small rise in the spring, nearly always at the beginning of April, but occasionally a month earlier, trifling in amount, but singularly constant, and showing a remarkably close correspondence between the notes in circulation and some regularly recurring condition of business.

carried on under the same roof. The reserve cities would necessarily exchange with each other, possibly at a common centre; and thus, the country being districted, presumably with reference to the natural course of commercial payments, notes paid in or deposited at any point would find their way back to the issuing bank, through the same channels in which the streams of other liabilities flow back upon the debtor banks, and without more difficulty. No change in the present uniformity of design of the national-bank notes would be required. Distinctive marks to determine the redemption district in which a note belongs, and possibly its state also, could be as easily stamped upon it as the charter number of the bank is now, and would be all that is required for instant recognition. Moreover, the labor of assorting the notes, with a redemption system once fairly in operation, is not to be inferred from the present condition of the bank circulation. We now see a confused mass of notes on which no regularly acting agency of this sort has been at work; but, with an established compulsory return of notes, the bank circulation of every part of the country would tend to be that of the local banks. Notes might still stray widely, for uniformity of system and design would give them the same ease of movement among individuals as at present; but the proportion thus carried to a distance would not be great, and their wanderings would not be of long duration. The whole circulation would probably be so far localized that the chief labor in every redemption centre would be to assort the notes issued in its own district and cleared by the local banks; and this would simplify and lighten a task which, however formidable, would not be too great to be undertaken in view of the object to be secured.

Returning now to more general considerations, the limitation of the field of circulation to be expected from a system of actual redemption deserves a little further notice. Existing banks of relatively large circulation might naturally dislike exclusion from the wide area in which their issues now find their chance of long life. So far as their gain from circulation comes from the supply of currency for use in remote sections or those ill provided with banking facilities, they could not be expected to welcome a proposition to confine them in effect to their home districts. But, besides the general equity of an arrangement which would call upon any bank to find its chief field for note issue in the community with which it

has its closest relations, it is of special importance for the better distribution of banking in the United States that the opportunity as well as the legal right of note issue should be more widely extended. The sections which now find the national system insufficient are those in which the sparseness of population and other industrial conditions invite the use of bank-notes and limit the use of bank credit in other forms. The local banks require the support to be obtained from circulation, and it is desirable as well as equitable that they should be able to rely upon the support afforded in their own neighborhood. A sense that the home field belongs first to the home banks has shown itself in the demand for the relief of state banks by the repeal of the ten per cent tax; and this feeling is too well grounded to be disregarded with safety. Certainly, if the national system is to be extended and popularized, it will be necessary that in this respect the local banks should be made as far as possible the natural sources of supply for their own constituencies.

Whether the sections which are now deficient in banks of issue would find their currency in actual use greatly increased under the changed conditions here suggested may be doubted. They are, as a rule, in debt, — rich in possibilities, but poor in actual accumulation. National banking with general redemption might, at any rate, supply them as well as state banking, if the latter were to be on the specie basis; but could they under any system find their currency plentiful if it were kept at its specie value? It is hard to see how the regular course of payments, which now takes to the commercial centres such coin, legal tender, or bank-notes as they acquire, could fail to restrict their note circulation by drawing from their banks their cash for remittance.¹ This hardship is the

¹ At a hearing before the House Committee on Banking and Currency, December 19, 1896, Mr. W. L. Royall, of Richmond, Virginia, presented his views: —

“Mr. ROYALL. I say that, if you put out notes in a backwoods community that are good at par in New York, those notes will leave the backwoods community, and go to New York. . . .

“Mr. JOHNSON. Must not those notes suffer a discount when the holders of them want to go outside of their own community to make purchases with that money in their pockets?

“Mr. ROYALL. No, sir: those notes are payable in coin on demand. They go to the bank, and say, ‘Give me gold for these notes;’ and they get gold.”

And again, favoring the issue of notes by state banks, —

“Mr. ROYALL. If [a bank] issues currency at all, it is for the convenience of the

natural consequence of economic conditions which for the present keep their demands for certain commodities constantly in advance of their means of payment. Nevertheless, good policy and fair dealing alike require that whatever opportunity may in fact exist for affording either the present or an increased supply of currency should be enjoyed first by banks upon the spot. If the lack of active circulation remains as at present, the nature of the difficulty will at least be clearer than it is now, and will be obviously free from the present appearance of unjust discrimination. Moreover, to give to local banks all possible encouragement for natural development, by enabling them to use as far as safety will allow the power of issue, notoriously needed in immature communities more than in the mature, is the readiest way to promote the growth of industry and wealth, which will finally raise the people to the condition where their need of goods for use will no longer keep them bare of cash. At present the condition of portions of the South and West presents a kind of deadlock. Their people are poor in all but natural resources. They remain poor because there is little "money in circulation," and there is little "money in circulation" because they are poor. With a short succession of bad years they are in something like destitution. With a bountiful harvest they gain a little ground, and hope rises. To encourage the proper use of credit, and of credit in the form most natural to their condition, although a slow remedy, appears to be not only a hopeful one, but also the only one now within reach of the national government.

To recapitulate the points which appear to be of chief importance in the current discussion :—

The great objects to be secured are: to enable sections of country, now excluded from the advantages of the national banking system, altogether or in part, to make use of this system and of the right of issue under it, as their needs may require; and to make the issues of the national banks elastic as well as safe.

The natural means for securing these results are: to abandon

people who live around it. Yet, if a country bank issues currency backed by the government, that currency will leave it and the people who really need it, and go to a commercial centre, where there is no legitimate need for it."

Mr. Royall's cure for the difficulty appeared to be an issue of notes, not too good, but just good enough to be used at home, — a difficult medium to strike.

the present system of bond deposit as security for notes, to substitute a first lien in favor of note-holders upon all assets and upon the stockholders' liability, and to create a guarantee fund supported by levy upon all banks in proportion to their circulation; to strengthen the system, by provision for closer inspection and by more frequent publication of accounts; to authorize and encourage the introduction of the branch system, at the same time raising the line of minimum capital, say, to \$200,000; and to organize a system of central redemption, enforced by restriction upon the right of banks to pay out the notes of other banks.

The practical and political difficulties, at present hindering any reform, need no comment. Factions in Congress, apathy produced by a new period of prosperity, popular financial delusion, and differences of opinion among the friends of reform may raise formidable obstacles in the way even of partial measures, and still more in the way of any comprehensive plan, for the removal of generally acknowledged evils. But, whatever steps it may be possible to take, little will be gained if they do not turn plainly towards the objects above stated, and proceed courageously and unequivocally upon the general lines which the present writer, following many others, has reviewed in these pages.

CAN WE KEEP A GOLD CURRENCY?¹

No previous year in our history has seen such an increase of the stock of gold in the United States as that which marks 1898. Our product for the year is believed to have exceeded that of the richest period of the California discoveries, our imports surpassed by fifty per cent the highest sum ever before reported by our customs records, and these enormous receipts were offset only to an unimportant extent by exports. Looking at the influx from abroad, it is safe to say that no commercial nation has ever before received such a mass of gold in a single twelvemonth for the supply of its own requirements. Taking our mining product and imports together, our total receipts in 1898 exceeded even those of England, the great distributing reservoir of gold, which also then reached their highest point.

Although the course of trade which produced this remarkable result is sometimes spoken of as if it betokened some radical change in our commercial relations, careful examination will show it to have been the consequence of precisely the same influences as those previously at work in our foreign dealings. Allowing for changes wrought by eighteen years of rapid national growth, the course of our foreign trade from the fall of 1896 bears a strong resemblance to the wonderful tide ending in 1881, which established the permanence of the specie payments, undertaken with such doubtful prospect of success at the beginning of 1879. In both cases the United States were able to command gold until every reserve and depository was overflowing.

Still, at the bottom of much of the current discussion of financial questions, there is often found a doubt, express or implied, as to the ability of the people of the United States to maintain a currency on the gold standard. This doubt relates to something more than our present ability to hold gold, with our paper currency in the top-heavy condition to which it has been brought by thirty

¹ *Quarterly Journal of Economics*, April, 1899.

years of haphazard legislation. It involves the much broader question whether there is not something in the economic characteristics or relations of this country, as compared with the other great commercial nations, which makes it difficult, perhaps impossible, for us to retain permanently what might otherwise be regarded as our natural proportion of the world's stock of money.

It is hardly surprising that this doubt should sometimes spring up. As no part of our financial system now works according to expectation, we have nearly the whole of the export demand for gold concentrated upon the Treasury. Any cause which lowers the gold balance in the Treasury, whether it be an unusual demand for the redemption of notes or a deficiency of revenue, weakens the sometimes narrow foundation on which our paper currency stands; and, as there is no provision for systematic repair, the possibility of a suspension of gold payments by the government instantly comes to mind. For the greater part of the time, in the last eight or ten years, the attention of the public has been fixed upon the Treasury balance. Any movement in the wrong direction has been viewed with alarm, any demand for the redemption of legal tender notes has come to be described as a "raid," the export of gold has become an event of black significance. The line to be drawn between the embarrassments caused by remediable defects of system and those springing from some inherent financial incapacity of the nation, is not always made out with ease; and we can hardly wonder, therefore, that the doubt whether, under any arrangement of the currency, we can expect to hold our own in the competition of international exchanges should sometimes gain ground. It is on the fundamental question thus presented that I now propose to offer a few considerations.

The general advantages with which the United States enter the field of international trade are manifestly such as to raise a strong presumption in favor of our ability to maintain a gold currency, if we will, — a presumption to be controlled, if at all, only by showing the existence of some highly exceptional disqualifying condition. We have a territory of remarkable productive capacity, already developed to such a point as to place us in the first rank as a producing country. Our people have the qualities needed for the most effective use of this source of material wealth, and are practically free from the burdens of debt and armaments which

fetter the energies of most of our rivals. Our industries are varied and highly organized; our industrial outfit for the production, transportation, and exchange of goods is vast in extent, and in many branches of unprecedented excellence; and our accumulation of capital has been extraordinary in rapidity and amount, as is evidenced, significantly for the present purpose, by the supply of gold in our hands, which, by the mode of estimate followed by the Treasury, must now largely exceed \$900,000,000. To all this is to be added the fact that the United States have long been the first gold-producing country in the world, and that, if we now take the second place, this is not because our own annual supply has fallen off, but because that of South Africa has come into existence.

If now we seek for a possible disqualifying condition, tending to defeat the presumption created by these solid advantages, original and acquired, we must look for it either in the trade in merchandise carried on by this country with others, or in our strictly financial transactions with the rest of the world. It is only in dealings of these two kinds that we receive gold or part with it, on any great scale, and it is therefore in one or the other set of relations thus created that any such exceptional characteristic as is now sought for must exist.

Taking into consideration, first, the economic character of our exchange of merchandise with other countries, it is clear that, as regards the movement of gold, the position of the United States is one of singular advantage. This fact we recognize in our confident moods, but are inclined to overlook in the presence of any financial difficulty. Summarily stated, the advantage consists in this, — that our demand for the goods of other nations is, on the whole, far less intense than their demand for ours. This is, doubtless, at variance with much that is often said as to our tendency to over-importation; but the truth of the statement is demonstrated by well-recognized facts, of which the history of 1893 offers a convenient illustration.

The crisis of that year came on so late in the spring that the imports for the fiscal year ending with June show little trace of its effects; and their net amount, \$849,800,000, is one of the highest then recorded. Under the pressure of the revulsion our imports for the next fiscal year, 1893-1894, fell more than \$211,000,000. A sudden change of that magnitude necessarily implies some extraordinary alteration of economic conditions, and great individual

hardship as the result; but it also implies a wide range of adjustable demand, previously satisfied by imported goods. The nature of this demand is disclosed by the classification of imports in the Treasury returns. Under Class I., articles of food (of which seven-eighths were made up by sugar, tea, coffee, and fruits), there was an increase of imports in 1893-1894, amounting to over \$6,000,000; under Class II., crude materials for domestic industry, there was a drop of forty per cent, or nearly \$90,000,000; under Class III., partially manufactured materials imported for further manufacture, there was a fall of thirty-one per cent, or a little more than \$30,000,000; under Class IV., manufactured goods for consumption, there was a fall of thirty-five per cent, or \$51,000,000; and under Class V., luxuries, including silks, laces, tobacco, wines, and liquors, there was a fall of over thirty-six per cent., or \$46,000,000.

These figures tell a plain story of enforced economy, by which a great people, under the pressure of a revulsion, changed for the time the scale and the distribution of their demands for consumption, slackened the productive machinery which supplied some great classes of demand, and undertook to live within their present available means. So far as our foreign trade was concerned, this economy was practised, not, indeed, with ease, but chiefly by cutting off the superfluities and the dispensable comforts of life and the material for their production, without, however, sacrificing the articles of necessary consumption, or even "the free breakfast table." Under similar pressure in other years the shrinkage of our demand has followed a similar course, marking a high degree of control on our side of the international trade.

If we look at the other side of the trade, and examine the demands made upon the United States, we find that cotton, breadstuffs, cattle, and provisions made up two-thirds of our domestic exports in 1893 and nearly two-thirds in 1894, the total rising from \$831,000,000 in the former year to \$869,000,000 in the latter. In neither year were our exports of these leading articles at their highest. Our cotton crop fell off in 1893 by more than 2,000,000 bales, and our yield of wheat fell in 1894 by more than 100,000,000 bushels. But the foreign demand for these products is plainly not a controllable demand in the same sense in which our demand for manufactures is controllable. The demand for cotton is as continuous as that for any article of consumption can be. Although

our exports vary with the abundance of our crop, the purchases of Great Britain in a long series of years show great steadiness; and the United States still send to that chief customer as large a proportion of her annual supply as they did before the Civil War. Our cotton, in short, finds its market in bad years as well as in good. It supplies the indispensable material for a vast industry, which may indeed flag in bad times, but cannot stop. Our exports of food, which are now seldom below \$300,000,000, swell, of course, with any deficiency of crops in Europe. The demand for them is imperative within the limits set by other sources of supply, and, when strengthened by the deficiency of those sources, is neither to be satisfied by a substitute nor to be reduced by economy of consumption. It may be said, therefore, of our great exports, that the demand made upon us for cotton is constant and imperative, and that the demand for breadstuffs and provisions, though irregular, is always large and often of remarkable intensity.

The extraordinary movement of gold to this country beginning in 1896 is the latest proof of the importance of this characteristic of the relative demands of the United States and of the other leading commercial nations. Illustrations to the same effect, however, can easily be found in the statistics of our foreign trade, all going to show that, while, like any rapidly developing nation, we often by large imports strain our ability to pay, any severe pinch finds us able to forego a large amount of purchases, — which, after all, are not for the supply of imperative wants, — and thus to check the outflow of gold; and that, on the other hand, the urgent demands made upon us frequently turn the current of gold in our direction with amazing force. That these urgent demands are irregular is an undeniable drawback to the advantage which we enjoy. Our command of the situation, which is now intermittent, might no doubt be constant, and the change in the volume of our trade less serious, if the need for our products were always felt at its maximum by our chief customers. This irregularity, however, is the condition annexed to the enjoyment of a resource which has no parallel in the commerce of the world.¹ How far it can be thought to

¹ The extent of the irregularity may be seen by the following statement of the percentage ratio of the annual export of breadstuffs, provisions, and food animals compared with the mean for the last ten years: —

1889	1890	1891	1892	1893	1894	1895	1896	1897	1898
.69	.91	.84	1.34	1.03	.98	.76	.88	1.05	1.52

place us at a disadvantage compared with other countries as regards ability to retain a gold currency will be seen more plainly when we come to consider the actual movements of gold to and from the leading nations respectively. For the present it is enough to point out the strong probability that a trade in which we buy for the satisfaction of our own secondary wants and sell chiefly to supply the primary needs of others, whether the course of this trade be uniform or not, gives us a position of exceptional advantage. It is at any rate certain that it presents no reason for concluding that the United States have any particular incapacity for retaining gold.

Turning now to the other quarter in which any disqualifying condition for maintaining a gold currency must be sought, — the strictly financial relations of this country with others, — we have to deal with a state of things far more complex than that already considered, in which misconception is far easier. Extraordinary rapidity of development and the possession of resources which offer a vast field for investment have made the United States the greatest borrower in the modern world. In saying this of our people as a community, the word "borrow" is used in a wide sense, to include all the forms in which foreign capital is employed within our limits in uses to which domestic capital must otherwise have been applied. Whatever form the evidence of the transaction may assume, whether it be found in national, state, corporation, or individual indebtedness, in the bonds or in the stocks of railways or industrial enterprises, or in the private ownership of manufacturing establishments, — in all these cases and under many other disguises, the people of the United States as a whole are employing foreign capital in the support of their general system of industry. The interest, the dividends, or the current profits, if any, are the reward of the lender: the general gain, convenience, and stimulus coming from the development of a particular resource or industry, or from the more rapid and symmetrical development of our system as a whole, inures to the advantage of our own community. Borrowing in this sense we have carried on for a century upon an ever increasing scale, and shall doubtless long continue to carry on, unless we wantonly sacrifice our unexhausted ability for vigorous advance.

As great debtors, in this large sense, the United States have

necessarily great payments to be made to their creditors, — to be made according to the standard of the commercial world, and therefore called, conveniently enough, gold payments. This consequence of our position as a debtor nation is habitually spoken of as a perpetual drain upon our stock of gold and as a necessary hindrance to the maintenance of a gold currency. And yet nothing is more certain than the fact that the interest, dividends, and profits upon foreign capital employed in our industries are no more a drain upon our gold than any other debts to be paid in the markets of the world. They no more require the export of gold than a payment for goods or securities; and even if by their terms the payment is to be made, not, we will say, in pounds sterling, but specifically in gold coin, neither the obligation nor the mode of its execution differs from that of the payments habitually made in foreign trade. It is not, even in this case, the actual transportation of metal across the Atlantic that is called for, but the payment of metal in London, Paris, or Frankfort, the debtor providing the means of payment at that place as he finds easiest, — by selling American wheat or cattle, or perhaps by a fresh loan.¹ In fact, in the actual process of settlement, one international liability is like another. They all take their place among the conditions which regulate the barter of commodities between nations, stimulating sales here and discouraging them there, and thus by their action on the relative level of prices requiring habitually only the clearing of comparatively moderate balances. "Gold interest" and the like, in the settled course of trade, simply call for the regular export of a larger amount of salable commodities, the proceeds of which are finally converted, in the foreign market, into that medium which secures the execution of the contract for foreign interest payments.

Without further exposition of these familiar facts, it is enough for the present purpose to point out that, although a systematic course of foreign payments on a large scale may have much to do with the habitual level of prices in the country making the payments, it has no tendency to strip the country of the gold neces-

¹ Thus the Geneva award of 1872 required the payment of \$15,500,000 by England to the United States "in gold." The gold was paid to the Treasury, but the transfer across the Atlantic was made by a shipment of United States bonds which had been called for payment. F. W. Hackett, "The Geneva Award Acts," p. 176.

sary to carry on its home transactions upon what has become, for it, the normal level. It is only when we come to the return of borrowed capital, or to the transfer in either direction of securities which represent debts, that we find in the relations of the borrower anything that can be treated as a permanent disturbing element. Indeed, the return of borrowed capital, or, in other words, the payment of debt, can also be set aside as little likely in practice to be the cause of serious disturbance, so steadily is cancelled debt replaced by fresh borrowing. It is the transfer of securities as investments or for speculative purposes, sometimes in large masses, acting as an unseen import or export, and therefore calling for settlement in precisely the same way as a movement of merchandise, that is most important from the present point of view. It is this which, at all events, appears to be the cause of most frequent anxiety as to the drain of specie. The possibility that, at some moment of stress on one side of the water or the other, stocks and bonds to an unknown amount may be launched by London upon the New York market, creates a vague apprehension, all the more disturbing because the facts involved can never be measured with precision.

No doubt the great class of "international securities," which have so important a place in the operations of modern finance, while they facilitate settlements and make transactions easy which would otherwise be impossible, at the same time often make the movements of commerce unsteady, and increase the swiftness and intensity of their changes. This, again, is a drawback suffered for the sake of great benefits enjoyed, the world being, on the whole, immeasurably the gainer. In the use of these securities the United States have a leading share, not only because of the extent of their general dealings, but because so large an amount of the securities are issued and domiciled in this country, and so find a natural market here. It is not probable, however, that, either in the general trade of the world, or in our particular trade, the movements of gold have been increased by the dealings in this kind of property. On the contrary, it is more probable that, like any other improvement which introduces new varieties of desirable exports, the increased movement of securities has, on the whole, tended to diminish the transfers of gold relatively to the value of goods exchanged, and that this relative diminution has been felt in the

trade of the United States,¹ although with our growth the absolute amount both of goods and of gold has vastly increased.

But our present inquiry is whether the dealings in international securities make the hold of the United States upon a specie currency weaker than that of other countries which successfully maintain such a currency. It would be strange if this were the case; for, as they sell what we buy and buy what we sell, any disturbing tendency felt by us must also be felt by them at some stage in the series of operations. London, for example, is a buyer when New York sells and a seller when New York buys, having the same sensitiveness to an outflow of gold and even greater anxiety as to the sufficiency of the export trade to counteract any serious drain. If, on the whole, New York is weakened by this class of operations, often no doubt highly speculative, is not London also weakened by a similar process? Do we, in fact, lose anything in the comparison of our position and its advantages with those of the country which for nearly eighty years has maintained a sound specie currency without interruption? The truth is that on each side of the water international securities, when imported, are an import of the class not necessary for the satisfaction of any imperative want, and are bought therefore because the purchase is likely to be profitable, and when exported, are sold, if at all, for such price as the purchaser judges to be for his advantage. The disadvantage of having them crowded for sale upon the home market, so often dwelt upon in discussion in this country, is, at all events, slight in comparison with the disadvantage suffered by the country which finds itself compelled to make unusual purchases of food or of any great staple for manufacture.

It is convenient, at this point in our discussion, to consider briefly the special advantage, as compared with the United States,

¹ In the last five decades the aggregate imports and exports of merchandise by the United States, compared with their aggregate import and export of gold, have been as follows:—

	MERCHANDISE	GOLD	PERCENTAGE OF GOLD TO MERCHANDISE
1849-1858	\$4,621,000,000	\$389,000,000	.0842
1859-1868	5,641,000,000	704,000,000	.1248
1869-1878	10,118,000,000	530,000,000	.0524 -
1879-1888	14,098,000,000	571,000,000	.0405
1889-1898	16,848,000,000	1,094,000,000	.0649 +

The exceptional conditions of the second and fifth decades require no comment.

which England is often said to derive from her peculiar position as a commercial nation. "England," it is said, "being the great creditor country of the world, can draw gold as she pleases from any quarter, whereas this is a debtor country, never secure against demands from abroad." This idea of the practical command of the gold of the world lying in the hands of the great creditor, perhaps owes its origin partly to the fact that the commercial relations of England make her the agency through which a large part of the gold produced by the United States, Australasia, and South Africa finds its way into the currency of the world at large, and partly to the visible movements of that great financial barometer, the Bank of England rate. It is true that her function as the distributor of gold does not enable England to retain more than a rather small proportion of what comes into her hands. It is also true that the sliding scale of discount, by which the Bank of England protects its own reserve and is apt to give the signal for the London market generally, is a means of defence in no way peculiar to that institution. It is used systematically and quite as effectively by the German Reichsbank. The apparent neglect of it by the Bank of France is due, partly to the fact that the enormous stock of metal in the bank enables it to yield up gold, if need be, to a great amount with no sensible inconvenience, and partly to the fact that, by charging a premium upon gold, the bank is able to mask its defensive policy, and to preserve a generally uniform rate of discount with little regard to an outflow of money. The English method may in fact be seen at work in our own country, in a less definite form, but with similar effect, in the changing rates of interest prevailing in the great money centres.¹ Nevertheless, the facts that the great streams of gold converge in England and

¹ The following extract is from the hearing before the House Committee on Banking and Currency, 1897-1898, Hon. C. S. Fairchild being under examination : —

"Mr. FAIRCHILD [referring to the raising of its rate by the Bank of England]. Now in this country the same thing takes place when a man borrows a million dollars to pay a debt abroad. It makes a diminution of the loanable funds, and that of itself works an increase in the rate of interest ; and, when that rate of interest becomes large enough, the seller of exchange, instead of meeting his remittances by the actual shipment of gold, finds a cheaper way to meet his bill of exchange. We do not have to have any specific measures to clothe banks with specific power to do that. It does itself. It is one of the natural laws which works itself out ; and, if we do not put any impediment in the way, it will take care of itself. That is my judgment about it.

"Secretary GAGE. I agree with what Mr. Fairchild has said." *Report*, p. 135.

diverge from her, and that the Bank of England conspicuously acts with reference to them, are enough to account for the general impression that the controlling power is to be found there.

But, besides these crude conceptions of the practical working of English commerce, there is something more implied in the common idea of England as "a creditor country." A creditor can call for the payment of debts due to him, and can require payment in money. Cannot England, then, call in her dues in gold, the world's money? Of the fallacies involved in this argumentative question, let us consider the fallacy of personifying England, — of saying "England" when we really mean "some Englishmen." By a figure of speech the country is presented to the mind as a community having a single directing will, a single interest and determining purpose, extending credit or collecting debts from definitely formed policy, and capable of saying to itself upon occasion that gold, and not commodities, must now be secured in payment. This might be true, in a degree, if the English polity were communistic, and if a committee directed the operations of the banks, the commerce, and the manufactures of England, and made provision for her daily consumption. But the real case to be kept in mind is that in which, instead of a single conscious will governing her action, there are some millions of individual wills, each determining within its own sphere; and, instead of a single clear line of chosen policy, there is only the confused outcome of the varying interests and needs of vast numbers of men.

In this, the actual state of things, the demand of one class of the population for cotton to spin, and the demand of others for wheat or for beef, are not and cannot be subordinated to the desire which any set of men or of institutions may feel to see gold flow in. On the contrary, the requirements for consumption, determined by the occupations and relations of a great people, are fundamental conditions, to which financial interests and policies, under whatever name, must of necessity conform their action. For illustration we need not go farther back than the great export movement of 1896, which between August 1 and December 1 brought into the United States \$74,000,000 of gold, \$40,000,000 of it coming from England. Although the Bank of England in seven weeks raised its rate from two per cent to four, it could not stop the outflow which in four months drained one-fourth of its specie from its vaults,

so uncontrollable are the currents which take their rise in the needs and habits of a whole people. The great trade movements of a country like England can never be concerted or calculated movements, as the language used about them often seems to imply. They are the result of forces quite independent of each other in origin and often in strong conflict, which the small fraction of men known as the financial world cannot withstand or govern, but which they can often turn to account.¹

These considerations — no doubt sufficiently obvious, but often neglected — apply to the action of England as a purchaser of merchandise from other countries. They also have a close application to her action as a holder of the securities of other countries. The class of Englishmen who hold foreign bonds or stocks as an investment will, no doubt, act at times under a common impulse of confidence or distrust, as investors do in our own country. This action may seriously disturb the financial relations of their own country with others and affect the movement of gold for a time, between England and this country, for example, as it has been seen to do. This is, of course, to be noted as an element of instability in our international finance, which must be recognized, although there may be a question whether a set of trade relations, which already include many unstable elements, is, in fact, made any more unstable by the introduction of another class of variables, with its chances of compensatory action. But it concerns us to notice that this action of English investors, although the result of a common impulse, is no more a concerted action than the movement in which English mill-owners buy cotton, eagerly or sparingly, as the case may be. It is the action of a great body of individuals, seeking advantageous employment each for his own capital, encouraged or disheartened by current opinion as to American securities, and neither bidding against each other nor selling at a loss in order to affect the general money market or turn the stream of gold. Even the class of bankers and other temporary holders of securities for speculative profit — a class of men as little disposed

¹ How impossible it is even for a syndicate comprising "every banking house and every bank in New York City, with important European connections," to control, beyond certain limits of time and favoring circumstances, the course of foreign exchange, is well shown by Mr. Noyes in his account of the gold movement in 1895. "Thirty Years of American Finance," ch. x.

as any to sell their property at a sacrifice — act in the same manner, according to the dictate of individual interest, and under no leadership or control which could justify the conception of concert and dangerous singleness of aim, which we have been considering.

It is perhaps hardly necessary to point out that, when we thus take into account the complex influences which must at any given time determine the course of dealing between England and other countries, gold loses a part of the quality as a *quasi*-legal tender for international trade, sometimes ascribed to it in current discussion. As a commodity, in universal demand at some rate or other, it can always be used in payment by the debtor nation, if offered on terms satisfactory to the creditor nation. But payment in gold cannot be required by the latter so long as there is, among the millions of its population, any sufficiently large class of wants demanding for their satisfaction the merchandise exports or the securities of the debtor in preference to money. The legal tender law of the place necessarily regulates the mode of payment in London, to be observed by each individual debtor; but, as has already been pointed out, it is no part of that law, nor is it a necessity of the case, that the debtor should have transported his means of payment across the Atlantic.

The conclusions reached by these general considerations are greatly strengthened, when we apply to them the test of observed facts. England, France, and Germany are the countries upon which the United States chiefly draw for gold, and by which the United States are most heavily drawn upon, all three successfully maintaining their currencies upon the gold standard. How, then, do the actual movements of gold into and out of the United States, for a series of years together, compare with similar movements as reported by the three countries named? For the purpose of this inquiry the nine calendar years from 1882 to 1890 are first taken, as making up what can be called a fairly normal period. They begin after the close of the great influx of gold which insured the success of specie resumption by the United States, and they end before the subsequent saturation of our currency with paper and silver had caused serious disturbance. They include years of great prosperity, and they cover the period of depression following the financial crisis of 1884. Both the products and the imports of gold by the United States are given, to show our total receipts from

year to year; and against them are set our annual gold exports. Annual imports and exports of gold are also given for each of the other countries, all being stated in dollars for convenient comparison.

[In dollars, 00,000 omitted.]

	UNITED STATES			ENGLAND		FRANCE		GERMANY	
	Prod't	Imp.	Exp.	Imp.	Exp.	Imp.	Exp.	Imp.	Exp.
1882 . . .	32,5	13,4	38,7	70,	58,5	54,7	39,1	6,8	9,3 ¹
1883 . . .	30,	22,1	6,	37,7	34,5	12,5	26, ¹	4,9	10, ¹
1884 . . .	30,8	28,	40,9	52,3	58,5 ¹	24,6	15,8	4,4	7,9 ¹
1885 . . .	31,8	23,6	11,4	61,3	58,1	47,	38,8	10,1	6,4
1886 . . .	35,	41,3	41,3	63,	67,1 ¹	50,4	38,2	11,2	5,5
1887 . . .	33,	44,9	9,1	48,5	45,4	18,	49,8 ¹	13,2	4,
1888 . . .	33,2	11,	34,5	76,9	72,8	19,5	37,1 ¹	39,9	23,9
1889 . . .	32,8	12,	50,9 ¹	87,2	70,4	65,2	25,	15,7	12,5
1890 . . .	32,8	20,2	24,1	114,8	69,6	22,6	48,3 ¹	24,2	9,9
Totals . .	291,9	216,5	256,9	611,7	534,9	314,5	318,1	130,4	89,4
Average. .	32,4	24,	28,5	68,	59,4	34,9	35,4 ¹	14,5	9,9

It appears that during these nine years the United States parted, on the average, with about one-half of the gold received by them from the mines or from abroad, and that England parted with seven-eighths of the gold received by her. These two countries, the United States as a mining country and England as the great commercial centre, acted as the distributors of an immense addition annually made to the world's stock of money, each retaining its own proportionate share. In this operation, each country was, to a great extent, a natural exporter of gold. Neither, in fact, could avoid exporting heavily, so long as its trade or its mines brought in a supply obviously so far beyond its power of healthy absorption. Of the two, it is important to observe, the United States had the firmer hold upon gold, so that this country was able to carry on an accumulation which it had begun to make in the later years of the long suspension, and thus to strengthen steadily the specie basis of its paper currency. The annual supply of the United States was also the more constant, its minimum being .78 of its average and its

¹ Export exceeds receipt.

maximum 1.38, whereas the annual supply of England ranged more widely, from .55 to 1.69 of its average. In the year of strongest export by the United States, their ratio of export to supply was scarcely higher than that of England in her strongest exporting year; and there were two years of the nine in which the United States exported less than .12 of their supply, whereas in no year did England export less than .60 of hers. Finally, England shows two years with an excess of exports over receipts of gold, and only one is shown by the United States.

As for France, her imports and exports of gold during these nine years are remarkable for their great amount, for their extreme irregularity from year to year, and for their close approach to equality, taking the whole period together. Germany also exhibits great irregularity of movement, with a constant accumulation in progress for all but the earlier years, the amounts actually moved being, for the most part, of but moderate importance.

Without pursuing further the comparisons suggested by this table, it is clear that during this period the United States were not only relatively, but absolutely, strong in gold, and gave full proof of ability to maintain their currency upon this standard, and this notwithstanding an infusion of nearly \$300,000,000 of legal tender silver. But the turning-point was reached by 1890. The accumulated mass of silver coin, the issue of more legal tender paper for the purchase of a vast weight of silver bullion,¹ the gradual conversion of that bullion into standard dollars, contemplated by the law and set in operation, the loss of confidence in the stability of gold payments by our government, and our increasing discredit abroad, — all combined thenceforward for several years to loosen the hold of the United States upon gold. Violent financial revulsion was the

¹ The Secretary of the Treasury said to a committee of the House of Representatives, December 16, 1897: "I have asked a gentleman in New York, . . . who has been Treasurer of the United States, and who has been Assistant Treasurer in New York for many years, Mr. Conrad N. Jordan, about this. He is in a position where he watches pretty closely the movements of foreign exchange. . . . He says it is the last \$200,000,000 which has put us to the blush all the time, that has been our trouble. If we get rid of \$200,000,000, and get a sufficient gold reserve, we will not be troubled; and the country will not fear that we are going to break." "Hearings and Arguments before the House Committee on Banking and Currency," 1897-1898, p. 23.

Mr. Jordan's \$200,000,000 apparently represented the treasury notes of 1890, \$114,000,000, and an increase of silver certificates from July, 1890, amounting to about \$86,000,000 more.

inevitable result; and, in the eight calendar years from 1891 to 1898 inclusive, gold moved between this country and Europe in heavy surges, as shown in the following table, compiled on the same plan as that already given for the years 1882-1890:—

[In dollars, 00,000 omitted.]

	UNITED STATES			ENGLAND		FRANCE		GERMANY	
	Prod't	Imp.	Exp.	Imp.	Exp.	Imp.	Exp.	Imp.	Exp.
1891	33,2	45,	79,1 ¹	147,4	117,7	69,9	45,4	52,6	28,9
1892	33,	17,5	76,5 ¹	105,1	72,2	74,8	21,5	42,5	35,6
1893	36,	72,8	79,8	120,9	94,9	58,9	22,6	33,3	24,2
1894	39,5	20,6	101,8 ¹	134,3	76,2	89,1	20,8	72,5	12,7
1895	46,6	32,5	104,6 ¹	175,4	104,1	49,	47,2	23,2	19,6
1896	53,1	104,7	58,3	119,2	146,7 ¹	58,1	60, ¹	52,4	47,
1897	57,4	34,	34,3	146,7	150, ¹	56,6	25,4	36,8	28,2
1898	[67,5]	158,2	16,2	212,8	178,1	38,4	60,4 ¹		
Totals . . .	366,3	485,3	550,6	1,161,8	939,9	494,8	303,3		
Average. . .	45,8	60,7	68,8	145,2	117,5	61,8	37,9		

In this table the change wrought in every column by the exceptional year 1898 is so marked that it is worth while to consider the facts as they stood at the close of 1897, when the footings were as follows:—

	UNITED STATES			ENGLAND		FRANCE		GERMANY	
	Prod't	Imp.	Exp.	Imp.	Exp.	Imp.	Exp.	Imp.	Exp.
7 years . . .	298.8	327.1	534.4	949	761.8	456.4	242.9	313.3	196.2
Average . . .	42.7	46.7	76.3	135.6	108.8	65.2	34.7	44.8	28

The relation of the United States to the three other commercial countries then showed a remarkable change since the period closing with 1890. Instead of being the greatest accumulator of gold, this country had become the least, and France held the first place. Instead of our supply from all sources being the most constant of all, the range between its minimum and maximum was the greatest; and, in years of greatest export, our ratio of export to supply was the highest. And yet, taken by itself, the exhibit for the United

¹ Export exceeds receipt.

States indicated a far greater power of resistance to a continued drain than might be inferred from this comparison with other countries. Omitting 1896 and 1897, when the tide had turned again in our favor, the five years, 1891–1895, showed a total net loss by the United States of scarcely more than \$65,000,000; and, even if we add to this the estimated amount of gold used in the industrial arts, we have an aggregate loss from our stock not exceeding \$142,000,000 in five years of unexampled disturbance,—a loss more than made up by the returning current of the next two years.¹ After all, in the series of seven years in which our legislation might almost be thought to be expressly designed to expel gold from the United States, our exports were not quite seven-eighths of our receipts from imports and mines. In the same years taken together, England also exported nearly in the same proportion, parting with four-fifths of all her receipts.

Violent as the changes were in these years, the years of recovery came with singular promptness. In 1891 and 1892 our exports of gold were greater than our receipts; and yet in 1893 the returning current gave us a favorable balance for the three years. Both 1894 and 1895 carried out a balance of gold, but 1896 turned the scale in our favor for another three-year period. 1897 practically left us in possession of our own product, and then came 1898, with such a tide in our favor as to completely distort the comparative results of the first seven years of the period. Taking the average for the eight years, 1891 to 1898, the United States again appear as the greatest accumulator of gold, parting with less than two-thirds of their gold receipts, whereas England in the same years parted with more than four-fifths of hers.

How large the accumulated stock of gold in the Treasury, in the banks, and in the hands of the public, has become in the twenty years since specie payment was resumed, is a question as to which the Treasury estimates may at least give us an approximation. Starting with an estimate of about \$213,000,000 in June, 1878,

¹ The Treasury estimate of the stock of gold coin and bullion in the United States gives the following sums :—

December 31, 1890	\$704,100,811
December 31, 1895	597,927,254
December 31, 1897	752,316,476

and following month by month, with great minuteness, the coinage and the movements of American coin in and out, the statisticians of the Treasury gave us in the latter part of 1881 a stock of over \$500,000,000, and, with occasional relapses, brought the estimates to \$700,000,000 by 1888, and to \$900,000,000 by October, 1898. The sums are vast, and it has never been easy to account for the great amounts which must be supposed to exist outside of the visible depositories. Still, the figures, when checked by the operations of the mint and by the annual product and movement in foreign trade, conform sufficiently well to the rough probabilities of the case. They give a solid assurance that, as a support for our monetary system, we have a stock of gold sufficient, and sufficiently nourished by the resources of mining and commerce, to meet the needs of a great and growing nation. Actual or probable inadequacy of supply cannot be alleged as a condition operating to our injury.

This, then, is the state of the facts. Our gold is at times drawn from us in considerable amounts, which, however, bear but a low ratio to our total stock, and are drawn away in no small measure by the aid of our own improvident legislation. The recovery comes with no great delay, and with extraordinary completeness, as the result of economic advantages of which imprudent policy may impair, but cannot destroy, the value. No reverse is strong enough to wrest our gold currency from us. And yet, judging from the past, two or three years may be enough to carry us from our present extreme of confidence to the same dread that the foundation is slipping from under us, that mastered the public mind in 1893 and 1896. We have the material to build a system as solid and as calmly enduring as that of England, but our failure for twenty years to bring into order our piecemeal legislation on this subject has cost hundreds of millions in shattered enterprises and stagnant industry. The foolish boast which some of our public men were fond of making a few years ago, that our currency system is the best ever known, and indeed perhaps perfect, is not current at present. In fact, there are not many who do not condemn the system for one reason or another. Still there is a perilous delay in the work of reform.

THE CRISIS OF 1857¹

CONTEMPORARY explanation of the revulsion of 1857 assigned a leading place to the course of our foreign trade and directed attention to the rapid increase of our importations and to the heavy exports of coin and bullion, made, it was said, to pay for imported luxuries purchased under the stimulus of habitual extravagance. A more careful examination of the facts, however, does not support the conclusion that during the years from 1850, when the marked increase of foreign trade began, to the summer of 1857, the people of the United States had purchased beyond their means. It is true that in the seven years, 1850-1856, imports for domestic consumption had doubled, the average at the beginning of the period being about \$150,000,000, and the amount for one of its last years rising to nearly \$300,000,000. But leaving out of view the effect produced upon the valuation by the depreciation of gold then in progress, owing to the immense product then coming forward from California and Australia, this increase of foreign purchases was the natural result of a rapidly increasing ability to pay, caused by an unexampled development of domestic resources and domestic industry and by the growth of the country in population. This was reflected in a greater volume of exports of merchandise, which increased from an average of about \$132,000,000 at the beginning to \$217,000,000 in the year 1854. In the year 1856 net imports, *i.e.* for home consumption, rose to \$295,000,000, but in the same year exports of merchandise increased in a much higher ratio in consequence of an unprecedented export of bread-stuffs; and even in the year ending with June, 1857, when net im-

¹ This and the following paper on the crisis of 1860 were clearly not intended by the author for publication. With some omissions they are the substance of a series of lectures prepared about 1875, which, though it was not his custom, were completely written out. They present so clear and comprehensive a narrative of an important period in our economic history that it has seemed fitting to include them in the present volume.

ports rose to \$333,000,000, the highest point they had ever reached, exports of merchandise in like manner rose to over \$278,000,000.

This enormous increase in the ability of the country to satisfy its demand for foreign productions by the sale of its own great staples of trade still left an annual balance, small at the beginning of the period, but rising at the close in some years to the neighborhood of \$70,000,000, to be liquidated in some other way. The sum of these annual balances for the period 1850-1855 amounted to nearly \$221,000,000, and to cover this amount there was an additional export of coin and bullion amounting to nearly \$205,000,000. It is no doubt this visible flow of the precious metals which, at the time and since, gave the impression of a vastly overdone foreign trade, draining our resources and leading us to some inevitable catastrophe. But there is plainly nothing in the export of the precious metals which should confirm this impression if fairly considered. The productive mines of California had made gold one of our regular staples of commerce, for which we must seek an outlet, as for cotton or for corn, and which would as certainly depreciate if it were entirely retained in the country. From the year 1849, then, gold became one of our ordinary articles of export, and formed a large part in the immense increase of purchasing power which led to the rapid growth of our imports. Nor had this steady sale of a constantly accruing surplus stock of gold left the people of the United States scantily supplied, since it appears that there was a steady increase of the stock held in this country, roughly estimated for the entire period at \$140,000,000.

1849-1857.	American gold received at the mint of the United States	\$402,000,000
1849-1857.	Specie and bullion imported	50,000,000
		<u>\$452,000,000</u>
1849-1857.	Deduct amount exported	312,000,000
	Added to the stock	<u>\$140,000,000</u>

Reckoning gold then as a domestic product and a legitimate and profitable subject of exchange with other nations for their products, our total exports for the years 1850-1855 fell short of our imports by only \$77,000,000; in the year 1856 there was a balance of over \$12,000,000 in our favor, and in the year ending with June,

1857, a balance of but \$2,000,000 against us ; so that from 1850 down to the beginning of the crisis there was an unfavorable balance, according to the usual way of estimating the balance of trade for the whole period, of only \$67,000,000.

In connection with this comparatively moderate sum, we must take into account some things which enter into the real balance of trade, which do not appear in the custom-house returns. The tonnage of the United States increased by forty per cent during the years 1850-1855, and of the immense foreign trade which had grown up, by far the larger part was carried on by American ships and with American capital. In some years the trade in foreign ships was not much above one-fifth ; even in our trade with England two-thirds of the freight was earned by American ships, and it was only in our trade with Canada that any considerable amount of freighting was so divided as to give to foreign tonnage an approach to equality of employment. The freights earned by American ships, therefore, and the profit on a large share of foreign trade carried on with American capital, must be included as an important addition to the purchasing power of the country. It must also be remembered that considerable amounts of capital had been borrowed from abroad for purposes of internal improvements, especially for the building of railroads, and that this capital, passing through the usual channels of exchange, would tend to produce a temporary preponderance of imports. Making allowance, on the other hand, for the probable undervaluation of imports under the purely ad valorem system of the tariff of 1846, which would make the real balance against the United States larger than that shown by the custom-house returns, it seems certain that the apparent balance against the United States for the period 1850-1857 is fully offset by freights and profits, and that therefore the foreign trade of that period, although large, was not beyond the means of the country. Its rapidity of increase, which was also thought by many to be alarming, was due to the addition of gold to our list of exports, to the immense extension of cotton growing with an ever widening market, to the fresh impulse lately given to industrial interests in all parts of the world by the gold discoveries, and, more than all, to the rapid increase of the United States in population, and hence in productive power.

In conclusion it may be observed that the increase of our for-

eign trade was compatible with either safe or unsound development of the country, and in itself affords no clear indication of the condition of affairs. If the countries which purchased the bulk of our exports were advancing along unhealthy lines, then our producers for those markets were engaged in occupations subject to serious check at any moment. Similarly, if our own domestic development was in large measure unsound, the increased purchasing power of the people, which was reflected in greater imports, was certain sooner or later to be seriously diminished.

While for these reasons we may fairly doubt the commonly received statement that in the years from 1850 to 1857 the foreign imports of the country had risen to a dangerous point, it is beyond question that in other respects business affairs exhibited an unhealthy expansion, which fully accounts for the state of things which followed. Aside from all stimulating influences of a special and local character, the people of the United States felt the impulse given both to production and to speculation in all parts of the world by the progressive depreciation of gold. The general rise in prices was a new spur to enterprise and a new incentive to the anticipation of gains likely to accrue in the future. In spite of the partial revulsion of 1854 and 1855, nearly every branch of domestic business was driven to the extreme point to which the competition of a singularly active and pushing class of men could force it, and this process was accompanied by an extension of mercantile credits in length as well as in amount. For more than a generation the temptation to this kind of expansion had been almost constantly present in the United States, especially in all branches of business connected, even remotely, with the supply of commodities in the South and West, — regions poorly supplied with capital, in which, either from the prevailing habits of the people or from the necessities of a rapid development, the crop of the year was apt to be heavily mortgaged for the expenses of its production. The credits given to Southern and Western buyers were necessarily long at any time, and there is ample evidence that in the few years before 1857 they had seriously increased, and that the lengthening of the credit given to the consumer had brought in its train a longer credit given to the merchant who supplied him, a longer credit by the jobber to the merchant, and by the manufacturer or commission merchant to the jobber, and so on through the whole chain of intermediate dealers

from the consumer to the producer or importer. The terms of credit given varied with the branch of trade, but in all the tendency to longer time was strong.

This vast mass of credit was managed by means of upwards of fourteen hundred banks, with an aggregate capital of \$371,000,000, established under the laws of the several states and therefore acting under no general superintendence or control. The systems of legislation on this subject, adopted by the states, often differed from each other radically, and were in many cases inadequate and even of questionable soundness; but nevertheless, the entire paper currency of the country for many years had been furnished by these banks. Gold was the only legal tender (except for sums under \$5), and was also the currency of the government, since the Treasury of the United States, under the Independent Treasury law of 1846, was not permitted either to receive or to pay except in coin. For the purpose of everyday life gold was little used by the people except in the Southwest and on the Pacific coast; the silver coinage, debased and limited in amount under the act of 1853, supplied the small change, and bank-notes were the ordinary currency throughout the greater part of the country. The safety and currency of these notes varied as materially as the systems on which the banks were established. The New England banks had entered into a voluntary combination to secure the daily redemption of their circulation, and this, together with the general soundness of their assets, maintained their notes in good credit. The greater number of the New York banks were established under a general law which required a deposit of public stocks with the state government as security for the redemption of their circulation. But this provision for ultimate payment did not answer the same purpose as the New England system of securing the immediate convertibility of the circulation, and it was accordingly only by the voluntary adoption of a similar system that the New York banks secured for their currency full confidence. In some of the Middle states, and in a large part of the West, the New York system of a secured circulation had been adopted, but with great looseness of detail, and currency had been poured out based upon stocks of uncertain value and without provision for its prompt redemption. In the South, three states, Florida, Arkansas, and Texas, forbade the establishment of banks within their limits, others had

followed the New York system, while Louisiana, availing herself of the peculiar course of Southwestern trade which then made New Orleans a natural *entrepôt* for specie, had established her banks on a more solid foundation of coin than any others in the United States.

The loans of these banks had been rapidly extended during the years 1855 and 1856, except in the Eastern states, where the increase had been moderate, and in the aggregate had risen at the beginning of 1857 to \$684,000,000, an increase of nearly twenty per cent. Their deposits had increased in similar ratio, and amounted to \$230,000,000; while their circulation, increasing more slowly, amounted to \$214,000,000. Against this immediate liability for deposits and circulation, amounting to \$445,000,000, the banks held an aggregate of \$58,000,000 in specie, divided very unequally between the different sections.¹ Specie holdings were but thirteen per cent of demand liabilities, contrasting with nineteen per cent in 1855. The proportion of specie, however, was not the measure of the confidence which the public felt in the banks of the several sections, for the notes of the Eastern banks which were most poorly provided with coin enjoyed a wide circulation in the other sections, while those of a large part of the banks of the Middle and Western states had only a local circulation. And of the whole mass of paper currency, we may fairly say that it was for the time, and so long as no reverse occurred, practically convertible, and really at a par with specie when not too far removed from the place of issue, but that the banks were nowhere, except in Louisiana, in a condition to resist a long-continued demand for specie. The paper currency was then eminently a currency resting upon credit and represented,

¹ The following table, from data collected by the Treasury Department, shows approximately the condition of the banks in January, 1857:—

STATES	SPECIE	CIRCULATION	DEPOSITS	PERCENTAGE OF LIABILITIES IN SPECIE
Eastern	\$7,000,000	\$53,000,000	\$35,000,000	.08 $\frac{1}{4}$
Middle	23,000,000	62,000,000	140,000,000	.11 $\frac{1}{2}$
Southern	7,000,000	39,000,000	15,000,000	.13
Southwestern	16,000,000	38,000,000	26,000,000	.24 $\frac{4}{10}$
Western	5,000,000	22,000,000	14,000,000	.13
	<hr/> \$58,000,000	<hr/> \$214,000,000	<hr/> \$230,000,000	<hr/> .13 $\frac{1}{10}$

not so much money, as the believed ability of the banks to ultimately pay money if required.¹

• The general tendency to expansion by means of credit had shown itself also in a marked degree in the development of the railway system of the United States. At the beginning of the year 1850 the number of miles of railway in the United States was but 7355. Under the pressure of urgent need of improved means of transportation and the general stimulus to all enterprises already referred to, the extension of the roads into districts not yet provided and not even settled, was undertaken on a great scale, and in January, 1857, the mileage had increased to 24,476 miles. That a large part of this increase was in anticipation of the actual wants of the country, and to a considerable degree of a speculative character, might be inferred from the fact that of the 3400 miles built in the year 1856, nearly one-half were in the seven sparsely inhabited Northwestern states, even if the notorious embarrassments of many of the newer roads had not made the fact certain. To this rapid investment of capital in a form in which its returns must be slow and uncertain, the policy of Congress in making liberal grants of public lands in aid of new railways had given no small encouragement. It is estimated that by acts of Congress from 1850 to August, 1856, upwards of 20,000,000 acres of lands were granted as subsidies for the opening of new lines in the West and South. That the assistance thus given to the extension of railways in advance of population has quickened the growth of the states interested and has caused an immense and general increase of wealth, is beyond any serious question; but its immediate effect was to encourage hazardous undertakings, to lead to the projection and opening of many lines of which the chief purpose was to secure the land grants for the projector, and to foster speculation in lands. To what a height this last form of speculation had run is apparent from the sudden increase in the receipts of

¹ We have then the following elements entering into the composition of the currency of the United States at the beginning of 1857:—

Bank-notes	\$214,778,822
Bank deposits	230,351,352
Specie in the Treasury	22,751,476
Specie in the banks	58,349,838
Specie in circulation (estimated)	160,000,000

the Treasury from the sale of lands, from an average of little over \$2,000,000 a year to nearly \$11,500,000 in the year 1854-1855, and nearly \$9,000,000 in 1855-1856. The railroads had been built, moreover, and lands bought, to a great extent, not by the use of funds belonging to the projectors and speculators, but by a lavish use of credit in the shape of mortgage bonds which offered a form of investment attractive in all respects save in security for regular returns. A chill came over these enterprises several months before the close of 1856, and declining prices marked the general diminution of public confidence. Some companies hitherto in good credit found their returns insufficient for the payment of their interest, the impression gained ground that the calculations on which most of the new railroad enterprises were founded were extravagant; and finally, when, under a domestic pressure for money, and a sudden rise of the rate of discount at the Bank of England, the prices of stocks underwent a sharp decline in September and October, 1856, the markets in New York exhibited some of the symptoms of panic. Returning ease in affairs partially restored confidence for the time, but the buoyancy of railroad securities and land operations was lost, and to engage capital for any fresh enterprise had become a matter of serious difficulty. The consequences, however, had still to be met of the investment of an average of \$60,000,000 a year in fixed capital in railroads, and of vast additional amounts required to complete construction already entered upon and to fund floating indebtedness. No small part of the bonds by which these debts were represented now depended largely upon the credit of individuals, and not upon their own real solidity, for the estimation which they still enjoyed in the markets, and thus added in no small degree to the increase of that general system of mutually dependent credit, in which the fall of a part may cause the fall of the whole fabric.

This, then, was in general the condition of the United States at the beginning of the year 1857 : — the foreign trade of the country, which for some years had rapidly increased, but, as is probable, without being overdone, was stimulated to a high degree of activity. Internal trade had been pushed forward with a great expansion and lengthening of credits; the railroad system in its rapid growth had absorbed much circulating capital and had also contributed a large share toward the increase of the vast system of credit on which

our domestic affairs rested. And finally, this mass of credit was managed by the aid of a great number of banks established upon unlike and often insecure systems, acting upon no common principle, and with no important guaranty for the faithful and prudent discharge of their functions.

In Europe the state of things was in few respects different from that seen here, and it may be said that throughout the commercial world the materials for a crisis were prepared and the consummation fast approaching. It is too much to say that in such a state of affairs an explosion is inevitable, for a crisis may be reached and passed without panic, and be followed by stagnation instead of revulsion. But it is important to observe that the circumstances were such that whatever should produce an explosion in one country might easily lead to a general crash. Speculations may be local in their character, but the credit of merchants and bankers is a complicated bond uniting nations too closely to allow any one to escape from its share of the burden which disaster brings upon any other.

At the beginning of the year 1857 the tone of general business in the United States was much less animated than it had been some months before. The year opened with but a moderately good domestic trade, some pressure for money being felt in all parts of the country, and it seems probable that some reaction had even then begun to be felt among consumers. The mercantile community, however, still had great confidence in the future, based on the knowledge that the crop of cotton then gathered, though smaller than that of the preceding year, was in quick demand abroad at advancing rates; that the foreign demand for breadstuffs and provisions was large, and that in spite of an immense harvest, prices were firmly maintained; while tobacco, then one of our chief articles of export, was higher than it had been for several years, and in strong demand. The importations made near the close of the preceding year had shown some falling off, and under these circumstances foreign exchange had suffered a little decline, showing that the real balance of trade at the opening of the year was on the whole inclining in favor of the United States. Shipments of gold continued, as was inevitable after the extraordinary importation for the fall trade of 1856, but not at any unusual rate. In

this state of things importers felt encouraged to increase their imports for the spring trade beyond any previous example.

The spring trade, however, did not meet the expectation which had been formed. The money market remained close in all parts of the country, and merchants everywhere found their collections slow. Especially was this the case in the West, where the chronic deficiency of floating capital felt in that swiftly developing region had been aggravated by the collapse of land speculation and by the absorption of capital in railroad enterprises. The sales of the spring, therefore, were unsatisfactory, and importers found it necessary to force off their merchandise by auction to an unusual extent, and with heavy loss. Large stocks were also held over in bond by those who deemed themselves in position to do so, in the hope of an improved demand for the fall trade. It should be observed also that the heavy importations which were pressing upon the market at this time were largely swollen by a speculative movement in sugar, caused by the almost complete failure of the crop in Louisiana in 1856. This cause led to an immense increase of imports of sugar from an average of about \$13,000,000 per annum, to nearly \$42,000,000 in the year ending with June, 1857, so that on the latter date it was estimated that nearly 70,000 tons were held in New York alone, and at high prices, in the expectation of a still further advance. The effort required to carry this enormous stock in a market where existing business conditions were tending to lock up a large amount of capital in unsalable imports, was evidently a considerable aggravation of the situation.

The state of affairs which can be so clearly traced in the movements of the import trade, also made itself felt in most departments of domestic business. There was everywhere what may be called a premonitory chill, and some exhibition of uncertainty, if not of doubt, respecting the future,—the unfailling symptoms that although prices might often be maintained in many branches of business, speculation had reached its limit. It appears from the periodicals of the day that early in the year fears began to be expressed here and there that a crisis was approaching. Predictions of this sort, however, are unpopular, and are apt to be timidly expressed, except by those whose habitual fondness for the dark side of things deprives their foresight of all current value, and the mercantile world, in its calculations as to possible

disaster, is generally ready to give more weight to the chances of escape than to the chances of failure. It would seem, however, that the banks of the city of New York were sensible, as early as February, that the condition of affairs was unsafe, and that the expansion of their liabilities had gone too far, for in three weeks after the 7th of February, when their loans stood at \$112,876,000, the highest point then known, they contracted them to \$111,137,000 at the season when an increase instead of a contraction was usual. Deposits which had for some time been irregular fell off by about \$4,000,000, but in the first week in March the contraction was abandoned, and the expansion resumed. With the exception of a short reaction in April, the increase of loans then went on with tolerable regularity until the 8th of August, when they reached the extreme point for the year, and stood at \$122,077,000. Although a large part of this expansion was offset by the creation of new bank capital, its effect in encouraging dependence on an already over-stimulated credit is manifest. It is important to observe, however, that so far as their own position was concerned, the banks of New York had gained a little in strength since the beginning of the year. Comparing their returns in January with those for the last half of July and the first half of August, it appears that in the former month they held an average of eleven and one-half per cent of their liabilities in specie, and in the latter an average of twelve and one-half. This was a narrow basis for a business so vast as that indicated by the point reached by their loans, and shows that whatever caution their position in August required was equally needed in January.

The banks of the city of New York began at this point to feel severely the effects of a practice which has more than once led them into difficulty. They had for a long time been in the habit of inviting the deposit of large balances, especially by the country banks, by paying interest for such deposits. Such transactions enabled the country banks to earn an interest of perhaps four per cent on sums which might otherwise be unemployed, while the city banks, obtaining funds at this moderate rate, were able to increase their loans to several times the amount of the cash thus secured. But as the country banks were subject to demands from their own depositors, it was necessary for them to reserve

the right of calling upon the city banks for their balances at any moment, and there was thus an amount of liabilities, variously estimated at from \$8,000,000 to \$15,000,000, which an unfavorable turn of affairs might at any time cause to be drawn from the city. In order to be in a position to meet such withdrawals, the city banks had fallen into the habit of making large loans upon call with collateral security. Early in August, when the bank loans had reached their height, the dangers of this part of the system had begun to develop themselves. The serious fall which had already occurred in the prices of railroad securities, which it would seem were a favorite form of collateral, had made it necessary to insist upon a larger margin of security above the amount lent, and it began to be felt that the curtailment of loans of this kind would be attended with some difficulty. It needed then only a strong demand by the country banks to cause a pressure by the city banks upon those who had borrowed from them upon call, and in the necessary tightening of the money market a similar pressure upon the regular borrowers on commercial paper.

Reviewing the condition of affairs at the beginning of August, we find that although the money market in the cities had even shown some temporary ease from the large payments of dividends and interest on public and corporate securities in July, it had some disquieting symptoms. There was as usual at this season a distinct rise in the rates for foreign exchange, not caused, however, by any special demand for money abroad, for the Bank of England was able even to lower its rate of discount in July, but the effect of the heavy importations made in the past few months, which had added nearly \$30,000,000 to the amount of goods ordinarily in the government warehouses. Under this rise in exchange the exportation of specie began to increase, with the prospect of a serious drain, from which little relief was to be expected in an increase of domestic exports, since the favorable harvests in Western Europe promised but a light demand for breadstuffs, while it was still early for the exports of cotton and tobacco. This unfavorable state of affairs was aggravated by the increasing difficulty in making collections, especially in the West, and by the heavy demand for capital which began to be made by that section where the absorption of floating capital in unproductive enterprises was now felt in its full intensity. The interior banks of the Eastern and

Middle states had for some time found their deposits declining and an increasing difficulty in keeping out their circulation, and in this state of things it could not be long before the country banks must make a serious call for their balances in New York to protect themselves against this demand.

That from one or both of these causes a drain had set in upon the New York banks at the beginning of August, is evident from the fact that although they increased their loans in the first week of this month by \$1,500,000, their deposits, so far from rising, showed a slight decline, while their specie reserve fell off by more than \$1,000,000. Feeling their condition to be one of some danger, the New York banks in the second week of August began a contraction of their loans. Although this contraction was at first moderate, it was instantly followed by a large falling off in deposits, and this in turn led the banks to protect themselves by a still more rapid reduction of loans. On the 22d of August the banks had reduced their loans by a little less than \$2,000,000 in two weeks, but the increasing stringency had caused their deposits to fall off by more than \$5,000,000, a difference which is accounted for by a loss of nearly \$1,500,000 in specie reserve, and for the remainder by an increase of banking capital. Of this loss in reserve a considerable part was occasioned by the withdrawal of balances by distant banks, which found that the demand upon them for loans was increasing, and which no doubt were often called upon more or less directly to lend their funds for use in New York itself. Thus the banks of Boston, the money centre next in importance to New York, slightly increased their loans during this period, but were shortly after compelled to begin a sharp contraction to protect themselves from an increasing drain toward New York. Prices in the stock markets had lately shown some improvement, but the general uneasiness and drain and the increasing stringency now made themselves felt, particularly in a general decline of railroad securities, exhibited in an average loss of nearly eleven per cent on thirteen leading railroad stocks on the New York Exchange, between the 7th and the 21st of August.

Thus at the beginning of the last week of August the condition of affairs had become such that it needed only some unusually startling and alarming event to convert the general tension of feel-

ing into panic. Such an event occurred on Monday the 24th, when the Ohio Life Insurance and Trust Company suspended payments and closed its doors. This was a company with a capital of \$2,500,000, engaged solely in the business of receiving deposits and making loans. Its principal office was in Cincinnati, but its agency in New York City had gradually absorbed a large share of its business, and by a course of management which had been at least imprudent, was found to have reduced the company to insolvency. Whether without this occurrence the money market could still have recovered its tone may be matter of doubt; but its happening was the signal for uncontrollable panic, the disastrous course of which was inevitable in the absence of any real unity of counsel among the banks and of any important dominating influence like that of the Bank of England. The Trust Company was itself a large borrower from the banks and from private bankers, and had among its creditors small banks and depositors both in New York and in Ohio, so that the shock and distress caused by its suspension were immediate and widespread. One of the smaller banks of New York City failed on the same day; several heavy failures among bankers and merchants in New York and Boston followed in quick succession, and a week later came the failure of an important banking firm having connections at several points in the West. Failures among country banks of the Middle and Western states now began to follow each other rapidly, and in the general alarm the notes of solvent banks began to come in for redemption in large amounts. The banks of New York City continued to contract their loans as the alarm and stringency increased, and with such severity as compelled those in the other banking cities to adopt the same course. In three weeks following the failure of the Trust Company they had reduced their loans by more than \$10,000,000, and deposit liabilities were diminished nearly \$13,000,000. They had begun, however, at this point to gain in specie, their reserve, which had fallen on August 29 to \$9,000,000, having advanced to \$12,000,000 on September 12. Under the heavy pressure of the panic exchange was difficult of sale, and rates had fallen, so that although this caused a temporary difficulty in the exportation of domestic produce, still the export of gold had nearly ceased, and it promised soon to become profitable to import gold from Europe. It was accordingly the opinion of some financiers,

and of some of the bank managers, that the banks should avail themselves of this turn in the exchanges and their own increasing strength, for the purpose of at once enlarging their loans, relieving the mercantile community, and so possibly allaying the panic. But if this could still have been done by a combined movement, it proved to be impossible to convince a large part of the banks, and among these some of the largest and strongest, that they were required to consult anything except their own safety, or that this could be found in any other course than that of contraction.

The reduction of loans still went on, therefore, and in parallel course the reduction of deposits. Mercantile firms of high standing began to give way in all parts of the country, and failures became more frequent and heightened the panic which prevailed among the depositors and note-holders of the interior banks. Productive industry was now seriously affected by the disorder in the money market and the consequent derangement of distribution. As early as the 20th of September many factories and other manufacturing establishments in the Middle and Eastern states were slackening production, or in many cases were either closed or preparing to close until such time as the abatement of the financial storm might enable them to dispose safely of their stock of goods, then large for the season. Many establishments, and some of the first magnitude, found themselves embarrassed by the failure of commission houses or of their agents with large liabilities for goods already delivered. The extreme pressure for money, moreover, and the consequent difficulty of selling exchange drawn against shipments of produce combined with the disorganization of internal exchanges to discourage the movement of the crops, and the arrival of flour and grain at tide-water began to fall seriously behind the receipts of the preceding year, with a corresponding loss of traffic by the railroads. On the 17th of the month the prevailing gloom was deepened by intelligence of the loss of the steamship *Central America* on her way from the Isthmus to New York with nearly \$2,000,000 in gold. On the 24th and 25th of September the banks of Philadelphia and Baltimore were compelled to suspend payments in specie, in consequence of the drain upon their gold caused by the general panic in the community; a large part of the banks in Pennsylvania, Virginia, and Maryland followed their example upon its announcement by

telegraph, and the banks of Rhode Island also suspended on the 28th. The New York banks at once called a meeting to consider this event and issued a circular declaring that "the banks of the city of New York are in a safe and secure position" and that they could "not only sustain themselves as specie-paying banks," but would soon be able to assist the mercantile community. At that moment they had succeeded in raising their reserve of specie so far that it amounted to sixteen per cent of their liabilities, the latter being reduced by the cancelling of \$20,000,000 of deposits, chiefly in the payment of loans. But at how great a cost to the public this strengthening of the banks had been accomplished—if indeed it were a real gain of strength—was too plainly shown by returns of the Clearing-house, from which it appeared that exchanges amounting in July to \$728,000,000 had fallen in August to \$668,000,000 and in September to \$482,000,000—a reduction which in a great commercial centre like New York could mean little less than the near approach of complete paralysis of affairs.

At this time the Treasury of the United States had on hand an unemployed balance of nearly \$12,000,000; and on the 23d of September the Secretary of the Treasury attempted to administer some relief to the money market from this source by announcing his readiness to buy the bonds of the United States at the current premium. Purchases were made in this way to the extent of nearly \$4,000,000, but without producing any sensible relief, and were finally discontinued in consequence of a threatening decline of revenue and the rapid sinking of the Treasury balance.

That hoarding was going on at this time to some extent appears to be beyond question. With the increasing demands upon the banks both in the cities and in the country there was a steady disappearance of specie, which could not longer be accounted for by exportation, since the turn of exchange. If we consider the specie movements of New York, by far the most important and significant, it appears that during the month of September the banks and the Treasury together lost \$2,900,000 of specie, to which we must add \$1,600,000 received during the month from California. The net specie exports of the month were less than \$200,000, so that we have a balance of \$4,300,000 which disappeared during the month from a market which was

then attracting to itself specie from all parts of the country and which therefore received much that does not find its place in any record.

From the date of the suspension of the Philadelphia and Baltimore banks, the course of the panic was marked every day by fresh mercantile failures and bank suspensions. Confidence had entirely disappeared and with it the chief bond of society in the commercial world, and nothing was now seen but a desperate struggle for self-preservation. The banks continued their harsh measures of curtailment, — measures which were declared by them to be defensive merely and by their half-ruined customers to be oppressive and certain to overwhelm all in a common ruin. Early in October another attempt was made by some of the bank managers to secure a general agreement to increase loans both in New York and in Boston, and resolutions were finally passed favoring an immediate expansion of three millions, which it was hoped might give sufficient relief to turn the current. But it proved to be easier to resolve than to act. Forty or fifty banks, each of which was compelled to consult its own safety, could not move forward simultaneously in such a line of policy, without some machinery which would insure each against the possibility of finding itself abandoned by the others; and the concerted movement was accordingly a *fiasco*. Instead of the promised expansion of \$3,000,000, the bank returns for the week ending October 10 showed a reduction of \$4,000,000 in loans and of more than that amount in deposits. It was alleged and was believed by many that the attempt to enlarge discounts had been defeated by a few of the stronger banks which were not unwilling to drive their weaker neighbors into liquidation and to confine the business of banking to fewer establishments. Whatever basis of truth this allegation may have had, the mercantile community was now appalled at the prospect before it of a continuance of the struggle between the banks and itself. Every day brought some fresh disaster. On the 9th notes of the Reading Railroad Company went to protest; on the 10th it was announced that the Erie had suspended payment, the Illinois Central had made an assignment of its property for the benefit of its creditors, and the Michigan Central had asked for an extension of time on its floating debt. No corporation or commercial house appeared to be strong enough

to resist the pressure of this suddenly enforced liquidation. To the list of bank suspensions was now added the Bowery Bank, which suspended on the 9th, the East River Bank on the 10th, and the Grocers' Bank on the 12th, all banks of the smaller class, which had been left to go down without an attempt to relieve them by their stronger neighbors. On Tuesday, the 13th, the run, of which there had been decided premonitions on Monday, set in with violence. The banks were all besieged from the opening of business by an excited crowd of depositors and note holders demanding specie. At the close of business it was found that eighteen banks had been obliged to suspend payment in specie, and it had become certain that none could long resist the demands of their depositors. At a meeting of the managers late in the afternoon it was resolved, in view of the prevailing excitement, that all should suspend on the next day. The Chemical Bank held out for three days, but was forced to follow the example of the others on the 16th. The banks of Boston suspended on the 15th and with them all the New England banks, and the suspension in a few days became general throughout the North and West. The only exceptions to it in the South were the banks of Kentucky and some of those of New Orleans. In both cases the sections upon which the banks relied were in a peculiarly strong position. Kentucky had enjoyed the benefit of high prices for tobacco and of large crops, and her banks had therefore felt less pressure from their customers than those of almost any other state; their specie resources were comparatively large, their deposits small, and their circulation in excellent credit. The banks of New Orleans also were in a community which found its great products in good demand and with the exception of sugar in fair supply, and at that season of the year had large credits both at the North and in Europe. They had for some years been strong in specie as a matter of habitual policy, and being, moreover, few in number, were able when the crisis came to act in concert upon a liberal plan. Their deposits showed a moderate decline and their circulation contracted to some extent, but still they kept up their loans and even made a slight increase of them during the panic. Four of the New Orleans banks suspended at the same time with those of New York, but the remaining five, being about three-fifths of the bank capital of the city, continued

to pay all demands in specie ; and with those of Kentucky were the only banks in the United States which continued the full discharge of their obligations.¹

It should be noticed here that the banks of Canada, which were also subjected to heavy pressure by the crisis in consequence of the close commercial connection between Canada and the United States, were able, nevertheless, to maintain specie payments. The directors of the more important banks were able by concert to establish a common policy ; considerable credits in London strengthened their resources, and by avoiding any unnecessary curtailment of loans they prevented any panic among their customers and depositors, and passed through the crisis safely. It was stated that in their efforts to prevent any embarrassment in the export of Canadian produce they bought bills of exchange drawn against shipments early in October at rates three or four per cent higher than those at which they could then have bought exchange in New York. Their efforts to sustain the community depending on them were well rewarded, for the Commercial Bank of Canada, one of the largest, was able to say in its next annual report that not one of its customers who were doing a sound business had suspended payments.

In the United States, on the other hand, it is not too much to say that before the general suspension of specie payments business had been reduced to complete paralysis. Exchange on England found so few buyers that few bills could then be sold above one hundred, the real par being about one hundred and nine and one-half. Breadstuffs and provisions therefore could not be moved from the West, and this section had nothing on which to draw domestic exchange for the payment of its debts to the East. The receipts of breadstuffs at tide-water in the six weeks before the suspension had suddenly fallen below those of 1856 by the equivalent of one million barrels of flour. One-half of the imports arriving at New York went at once into the public warehouse to avoid the payment of duties on articles which for the time were not salable, and the withdrawals from warehouse fell to half their usual amount. Merchandise of every kind was for the moment a drug, and an active exportation of imported goods began as soon as the con-

¹ Individual banks elsewhere are said to have maintained themselves on a specie basis. See *Bankers' Magazine*, 1857-1858, pp. 505, 507, 658.

dition of the exchanges would permit. The loss in prices in the wholesale market and upon the great staple necessities of life was immense; but it was observed that in sales by retail, consumers were late in obtaining any corresponding concession, time being necessary as usual to determine whether the reduction in prices was transient or likely to continue, before the retail dealers could be forced to make their own prices conform.

In stocks the fall of prices was still heavier, for in the course of the panic some corporations had justly lost their credit, and others suffered from bad associations in the mind of an indiscriminating public. Taking the thirteen leading stocks before referred to as a test, the quotations show a loss in price of forty-three per cent in the two months ending October 9th. State bonds showed an average decline of ten per cent in the same time. United States six per cents alone held their old quotations, being sustained by the purchases for the Treasury; but after the middle of October, when purchases were discontinued for lack of funds, these securities also fell from one hundred and seventeen and one-half to one hundred and eleven. To what extent the fall in stocks was increased by the return of stocks held abroad under the influence of the panic cannot well be determined, but it is quite probable the influence thus exerted on the market was less than has been supposed. Indeed, at the height of the crisis, it was stated in New York that orders for the purchase of stocks to a considerable amount had been received from abroad, but could not be executed on account of the difficulty in selling the exchange which was to be drawn.

For the banks and their customers the effect of suspension was to give immediate relief from the heavy pressure, and to enable them to carry through in a less ruinous fashion the liquidation and the disengagement of capital, which the revulsion rendered inevitable. Individual banks could now enter upon a more liberal policy, quite regardless of the action of other banks, since an unfavorable balance at the Clearing-house involved no longer loss of reserve, and by refusing to lend a bank could not strengthen itself at the expense of its neighbors. The removal of this check, however, was not followed by increased loans, but further contraction ceased virtually with suspension.¹

¹ The bank statements of the 17th and the 24th of October show some further reduction of loans, which is probably accounted for through the elimination of failed

The movements of specie at the height of the crisis promptly responded to the fall and rise of foreign exchange. The turn of exchanges "in favor of the country," as it is called, was effected by the news carried out by the *Baltic* on the 28th of September, four days after the suspension of the Philadelphia and Baltimore banks, when the difficulty in selling bills drawn against shipments had forced sterling exchange down to about one hundred and five. The *Baltic* reached Liverpool on the 6th of October; the Bank of England at once raised its rate, but the *Europa* on the 10th sailed with £63,000 in specie, which reached Boston on the 22d. This was the real beginning of the stream, some small shipments earlier in date being made upon uncertain grounds and as a speculation. The stream was strongest from the 10th to the 29th of October, but continued to flow until about the middle of November, when it was stopped by the extraordinary pressure in London and by the news that exchange had risen in New York to a point which made the shipment of specie to Liverpool profitable. Indeed, the *Asia*, which left Boston October 28th, carried \$100,000 a little in advance of the general returning current of specie toward Europe, and some of the later shipments from Liverpool crossed on their way the early returning shipments from New York, and more than one English steamer took back a part of the gold which it had brought on its outward passage. The actual amount of specie sent from England to the United States in these operations was stated by the Governor of the Bank of England to be £1,134,000.

Specie was heaped up beyond all precedent in the banking history of New York; with the diminished wants of business, deposit liabilities were increased by the receipts of specie and not as before the crisis by the increase of loans, and the circulation of the banks was sensibly lessened. The Clearing-house returns show that the weekly exchanges of the banks had fallen by the 1st of November to \$57,600,000, an amount scarcely equal to one-third of the weekly exchanges in the latter part of the summer. In the other banking centres the course of things was the same as in New York, and even such country banks as were disposed to maintain their business on an unsound basis, found themselves

banks. From that time to the end of the year changes in loans, from week to week, were insignificant in amount, clearly reflecting the condition of general business depression, which continued for many months after the acute panic of October.

compelled, by the terms on which their circulation was redeemed in the cities, to restrict their issues and strengthen their position preparatory to a return to specie payment. Specie continued, however, for some weeks after the suspension to be sold at a small premium, sometimes ranging as high as three per cent, when required in quantities for the payment of duties on imports or in preparing for foreign voyages, until the banks found themselves strong enough to supply the specie wanted for such purposes, in advance of formal resumption; whereupon the premium on specie disappeared. But with some restriction in the terms on which the notes of country banks were received on deposit in the cities, general business was carried on with the same paper currency as before the suspension, and with the same system of deposits and checks, and it was only in the comparatively infrequent case of a desire to exchange bank-notes for specie for some particular transaction that the change to an inconvertible currency was observed. In preserving this condition of affairs during the time in which the city banks were strengthening themselves for resumption, important relief was obtained from the regular semi-monthly receipts of bullion from California, from the small amount of gold required for the payment of duties on the diminished imports, and for a time from the state of exchanges with Europe.

From this statement of the success with which the credit of an inconvertible bank currency was kept up during the two months of suspension must be excepted a large number of banks in the interior and particularly in the West. Early in the crisis the decline of the securities on which the circulation of some of the Western states was based had brought their banks into difficulty and discredit. Others were weakened or carried down by the failures of individuals or of railroad corporations. There was, therefore, throughout the crisis a rapid forced contraction even of such part of the Western currency as was not withdrawn in consequence of the insolvency of the issuing banks, and this increased the difficulty of making collections in the country and added to the general embarrassment of exchanges. After the suspension the process of contraction still went on; bank-notes in circulation in other states were returned to the state where they were issued, and in the Eastern cities a heavy discount upon Western bank paper drove it home. The process of calling in this paper was

painful, but it was also salutary. It withdrew a part of the circulation which had little real strength and much of which ought never to have been issued, and, leaving only such part of the currency as was comparatively sound, it enabled the West to follow the East, though somewhat tardily, in the resumption of specie payment.

At the beginning of December, 1857, the banks of New York found that their stock of gold had risen to \$26,058,000, or nearly one-third of their liabilities, and was increasing from week to week, while the demand for money was small and the news from every quarter indicated the restoration of quiet. They accordingly voted to resume specie payments on the 14th, in which step they were at once followed by the banks of Boston and of a large part of New England, together with those of the state of New York. The banks of Providence resumed on the 13th of January, those of Philadelphia and Baltimore on the 3d and 5th of February, the Virginia banks on the 1st of May, and the resumption was general by midsummer. The returns published by the Treasury Department show that at the beginning of 1858 the banks of the United States had diminished their loans by \$100,000,000; their deposits had fallen off \$44,000,000; their circulation nearly \$60,000,000; while their specie had gained about \$16,000,000; of which nearly the whole was by the banks of New York City. The diminution in the circulation of bank-notes, caused chiefly by the diminished requirements of business, was nearly thirty per cent, taking the country as a whole, while in the manufacturing centres it was even greater. Thus the country banks of Massachusetts, issuing a circulation used by an active industrial population and sent in the course of business into distant states where it was received with favor, found their notes reduced from above \$16,000,000 to \$9,600,000. This state of things, sometimes called a plethora of capital, but in fact mere stagnation, continued for the most part until midsummer. The loans of the banks were slowly increased after January 1, but there was no general revival of business to counteract the tendency of capital to accumulate in the financial centres. Nor did it seek an outlet by the exportation of specie beyond the receipts from the mines, for there was no demand for money abroad, and there was no disposition, and indeed little ability, on the part of consumers, to renew importations of foreign goods on any large scale. The fiscal year closing with June, 1858,

showed a falling off in imports of foreign merchandise of \$85,000,000, nearly half of which was in the imports of manufactures of cotton, wool, silk, flax, and iron, besides which the reëxportation of foreign goods increased by nearly \$6,000,000. On the other hand, domestic exports suffered a decline of only about \$27,000,000, chiefly caused by the reduced demand for breadstuffs, while the cotton crop, notwithstanding the shock which the manufacturers suffered from the revulsion, maintained its price so well in consequence of the moderate supply for the two cotton years ending with August, 1858, that the value of the export did not fall off. The result of this general state of trade was that the net exportation of specie from the United States for the year ending with June, 1858, was only \$33,000,000, being considerably less than the product of the mines.

The land speculation which has already been adverted to as a characteristic of the period preceding the crisis was for the time crushed by the revulsion. The receipts by the government for sales of public lands, which had already suffered from the chill experienced in advance of the crisis, fell off somewhat in the fiscal year 1858 and still more in 1859. How great the diminution in such transactions was in some parts of the West is evident from the fact recorded by the Commissioner of Statistics for Ohio, that the mortgages of real estate given in that state, amounting in 1857 to \$38,000,000, fell off to \$25,000,000 in 1858. And the number of emigrants arriving in the United States, which is an important factor in the demand for land, especially in the newer states, fell from 251,000 in the year ending with June, 1857, to 123,000 in the year ending with June, 1858. Railroad enterprises also suffered a severe check from the revulsion; the owners of many railroad securities found that their capital had been invested in advance of the real wants of the country, and as a natural result the number of miles built in the next three years, 1858, 1859, and 1860, fell considerably below that of the number built in the two years 1856 and 1857.

The heaviest pressure from the revulsion was felt, however, by the laboring classes. The destruction of credit stopped at once a large part of the machinery of productive industry. Even had the stocks of goods generally been small, it would have been necessary for many manufacturers to stop for the time, owing to the difficulty

both of making sales and of procuring the capital with which to go on. But stocks were large in most branches of trade, the high prices of the year before the crisis having stimulated production into great activity, and it was therefore a considerable time before the old supply of goods was so far sold as to make it necessary to resume operations for the supply of the current wants of the country. During this period, in which the country was on the whole simply consuming the accumulated products of its previous industry, thousands of workmen were unemployed and thousands of families were reduced to extreme privation. Many corporations and individual manufacturers attempted to carry on their works and to keep their operatives in at least partial employment, but not a few found that even on these terms it was impossible to continue to pile up goods for which there was no sale except at a sacrifice, and were finally obliged like the others to suspend their operations until better times. *

How many persons were thus thrown out of employment at the beginning of the cold weather it is impossible to say; but they must have been numbered by hundreds of thousands. As early as the 1st of October it was reported that all the cotton and woollen mills near Philadelphia had stopped, and that the Rhode Island mills were either closed or working on short time. And from that time on the papers of the day were full of the reports of closing in the cotton and woollen manufactures, the iron trade, the manufacture of boots and shoes, and of clothing. No branch of industry seemed to escape unscathed. The real extent of the calamity may be better realized from a few significant facts. It was said by a leading cotton manufacturer that "in January (1858), there were 502,000 spindles stopped in Rhode Island and 216,000 running, and these represented pretty fairly the condition of the mills in other states." To stop 500,000 spindles implied the idleness of more than 15,000 men and women, and of the spindles then existing in the Northern states Rhode Island had a little less than one-fifth. The iron interest of Pennsylvania was notably slow in reviving, and its product in 1858 was estimated at only one-half that of the previous year, while it would appear that from October, 1857, until the following spring, the large majority of the iron works were idle. The great New England manufacture of boots and shoes, which then employed 80,000 operatives, began to slacken its operations

as early as September, 1857, and remained inactive until the next spring.

For the country in general the actual recovery from the revulsion appears to have begun in the latter part of the winter of 1857-1858. In several branches of production, demand began to spring up from the actual exhaustion of stocks by consumption, and capital then seeking employment at low rates, manufacturing began, in some cases cautiously and on a small scale, in others, as in the cotton manufacture, boldly and even prematurely. By midsummer there was tolerably active employment in most important branches, except in the production of iron, which was slow in its recovery from the depression of railroad enterprise and from the moderate demands made upon it by the other industries on which it is dependent. The resumption of operations on their former scale, however, was everywhere retarded by the efforts made to effect a general shortening of the terms of credit. This change, which was essential for the soundness of trade, checked buyers for a time and bore with especial severity upon the West. That region had suffered from the revulsion more severely than the rest of the country, owing to the collapse of its real estate and railroad speculations, and the breaking down of the prices of its leading staples at a moment when its purchases had for some time been on a liberal scale. Entering upon the new year of resumption under these difficulties, it had received a further blow, for the crops of the year 1858 were at best moderate, while the continued abundance of crops in Europe diminished our exports of breadstuffs and lowered prices, so that the West, in settling her indebtedness in that year, neither had so much to sell nor could sell it at so high rates as in the previous years. The South, on the other hand, was in far better condition to accept shorter credits. The favorable cotton crop of the fall of 1857 has already been noticed as one of the circumstances which strengthened that section at the critical moment. The crop for 1859 was still larger and prices firmer, so that there was an increase of \$30,000,000 in the value of the cotton exported. Moreover, the sugar plantations, which had yielded only a quarter of a crop in 1856, had given a fair product in 1857, and in 1858 the largest but one that had ever been known. If we except Virginia, which in 1858 had a short crop of tobacco, the South was, in general, in a good condition for

the establishment of a healthier condition of trade, and had no serious obstacle to overcome except its own lavish and improvident habits.

The course of recovery throughout the country can be traced tolerably well in returns from the banks. Bank loans, from their low point at the beginning of 1858, increased steadily through the year, though they did not reach their former heights, taking the country as a whole, until late in 1859. In New York and Massachusetts, however, there was a more rapid expansion, and as early as August, 1858, the loans in these two states had passed the highest point reached before the crisis in 1857. The circulation of the banks, however, did not again reach the point which it touched in that year. This was due in a measure to the smaller requirements of the country in a period of moderate business activity, and in part to the adoption of more stringent systems of redemption, which compelled the interior banks of some states to meet their notes with a promptness to which they were not used and thus restricted their circulation. And it is to be noticed that the severe lessons of the revulsion led to some special efforts toward placing the banking system on a broader basis. The New York Clearing-house adopted a rule requiring the banks belonging to it to keep in hand coin amounting to twenty per cent of their liabilities; and the legislature of Massachusetts passed an act requiring the banks of the state to keep a minimum of fifteen per cent of their liabilities in specie. A majority of the banks of the city of New York also declared in favor of abandoning the practice of paying interest on deposits, but as this virtuous restriction did not take the form of a positive rule binding upon all, it had no permanent influence. On the whole, however, it is probable that the condition of the banking system of the country after the revulsion, many as were its defects, was considerably better than it had been before.

Notwithstanding the tending to a gradual return of activity and confidence, however, the year 1858 was a hard period of straitened enterprise and small returns. Prices were low, demand was sluggish, and a cold caution had followed the fever of speculation. The aspect of affairs brightened as the year went on, but even in 1859 it could not be said that the effects of the revulsion had ceased to be felt. Some of its traces were indeed indelible. The ruin of great mercantile houses, the blighted hopes

and fortunes of individuals, mark the year 1857 as one of the most memorable in the annals of commerce. But in a country like the United States, which is still in the fresh vigor of its youth, its natural growth gives it a seeming elasticity which enables it to surmount all disasters quickly and soon repairs all losses and even disguises the consequences of the most serious errors. Three years had not passed, therefore, before the pursuit of wealth was as eager and confident and the prosperity of the country apparently as great as ever. The lessons learned in the bitter months of 1857 were passing out of mind, and the country was once more well advanced in that inevitable cycle, "quiescence, — next, improvement, — growing confidence, — prosperity, — excitement, — overtrading, — convulsion, — pressure, — stagnation, — distress, — ending again in quiescence." ¹

¹ Lord Overstone's Tracts, p. 31.

THE CRISIS OF 1860¹

THE financial condition of the United States in the earlier part of the year 1860, although not disquieting, was far from satisfactory. The recovery from the disasters of 1857 had been considerable, but had not been so uniformly distributed as to restore ease and a sound state of business in all sections. The South had had the benefit of large exports of cotton for five years in succession, with prices which were sufficiently well sustained by the increase in the cotton manufacture in all parts of the world to raise the worth of the crops in money beyond all precedent. Thus the cotton crop of 1855-1856, the largest which had then been made, was a little more than 3,600,000 bales, of which the nearly 3,000,000 bales exported were valued at \$128,000,000; but the crop sent to market in the winter of 1859-1860 was 4,670,000 bales and the export value was \$192,000,000, while the purchases for consumption in the United States were also larger than ever before. The export value of the tobacco crop also, although variable, had for four years been much above any previous figures, although there had been a moderate decline in price from the beginning of 1858, and of course a considerable reduction from the inflated prices of the summer of 1857. Sugar had also become once more an important, though an unsteady, product, the value of which was now upon a much higher level than before. During the years succeeding the great revulsion of 1857 then, the South had been prosperous, and its prosperity was the more marked because it had fewer losses to be repaired than the other sections. True to its traditional habits, however, the South had availed itself of its opportunity to buy freely, and to this end had used not only its large means, but also its ample credit.

The West in the meantime had recovered only by slow degrees and painfully from the depression caused by the revulsion. Its crops had been moderate, the foreign demand for its great staples

¹ See note, p. 266, above.

had fallen off, and prices had been low. In the years succeeding 1856, England, the most important single customer for those products, had continued to be a large buyer, but had drawn a smaller proportion of her supplies from the United States than formerly, in consequence of the renewal of her trade with the Baltic and Black seas and her large purchases from Germany and France. Thus our exports of breadstuffs, which for each of the fiscal years 1856 and 1857 had been more than \$50,000,000, had fallen to \$32,500,000 in 1858 and \$22,800,000 for the fiscal year 1860. The foreign demand for provisions had been sustained better, but still prices had been moderate and had not been sufficient to restore to the West its full measure of prosperity in any year.

The manufacturing and commercial sections of the country had been more fortunate in their recovery. The great abundance of capital seeking employment after the revulsion led to some premature efforts, and the haste with which the banks expanded their loans conduced to the same result. Business strengthened, however, by degrees, and the demand for labor became active; and although dealers experienced difficulty in procuring settlements among their Western customers, a fairly profitable trade had sprung up as early as 1859. Manufacturing became brisk, and in many branches was extended by the introduction of new capital and additional machinery. In some branches indeed there was a considerable over-production, caused by the abundance of capital and undue confidence in the increase of demand, and followed by a reaction in prices.

The foreign trade of the country during these years is highly significant. The fiscal year ending with June, 1858, was of course wholly abnormal in this respect, since it covered the period of the revulsion and of the severest depression. In this year the imports of merchandise fell off by \$85,000,000 and the re-exports increased by \$6,000,000, so that the foreign merchandise introduced for consumption was diminished by \$91,000,000. On the other hand, the revulsion having been general, the same causes, which in the United States checked the desire to buy, operated also to check purchases from us by foreign nations, although in a less degree, owing to the indispensable character of our great staple export. The export of merchandise from the United States declined, therefore, in this year, but only to the extent of \$27,000,000, and thus

the imports and exports of merchandise were for once nearly equal, while the balance of specie exported was reduced to \$33,000,000. This was in short a year of enforced economy in which the people of the United States bought as little and sold as much as possible; and that a commercial nation whose tonnage earned heavy freights had in the balance of the year to pay more than it received was, unquestionably, due to the debt which remained to be settled from the year 1857 and to the interest, estimated at not less than \$20,000,000, payable on state and corporation bonds owned in Europe. The year 1859 showed a great increase of confidence, the net imports of foreign merchandise increasing by \$74,000,000 and falling only \$17,000,000 short of the point reached in the fiscal year 1857. If indeed the imports for the whole of the fiscal year ending with June, 1859, had shown the same increase as was shown by the last half-year, the aggregate of 1857 would have been far exceeded. This heavy increase of imports in the last half of the year was no doubt based on the knowledge that the cotton crop of the year was larger than ever and on the state of exchange caused by the enormous exports of this product. On the whole, the fiscal year closed with an apparent excess of exports over imports of only \$18,000,000, the exportation of bullion having once more become equal to our product. In the year 1858, indeed, the discredit or disappearance of so large a part of the bank currency no doubt created some domestic demand for specie beyond what was used; but this did not extend so far as to require the retention of much, if of any, of our product for the next two years. Of the latter half of the calendar year 1859, making the first half of the fiscal year ending with June, 1860, it is enough to say at present that it was marked by a still further increase in imports and by the gradually increasing certainty that the United States had in hand the largest crop of cotton ever raised on its soil.

During the years 1858 and 1859, the banking interest had been extended in every section, and in some with little regard to its safety. In the Western states particularly, in spite of the banks swept out of existence in 1857, the bank capital at the beginning of 1860 showed a nominal increase of more than twenty per cent. Numbers of banks had been established in several states on systems bearing a general resemblance to the free banking system of New York. But the New York system,

which had given great satisfaction, secured the note-holder from loss by limiting the securities on which the notes were issued to certain classes of sound stocks; whereas in the Northwest and in Missouri a wide range was permitted and the issues were in fact based to a great extent upon stocks which as the event proved were of unstable value. The circulation issued in this manner was also excessive, even as compared with the standard of the United States, and the arrangements for its redemption were little more than evasions of this duty, so that the whole West and Northwest was overrun with a practically inconvertible currency often circulating at a discount which made itself painfully apparent when the holder sought to buy exchange for remittance to the East. The banks of the South and Southwest, even omitting the exceptionally strong ones of Louisiana, were on a firmer basis. Indeed, in specie reserves, the South and Southwest was stronger in proportion to its bank capital and liabilities than the North and West, notwithstanding the large accumulation of specie at New York. This, however, was a point of management as to which neither section had much to boast of, outside of one or two leading cities. In New Orleans the law required the banks to have a reserve of specie amounting to one-third of their cash liabilities, and they usually had more. In New York the banks by custom since the suspension in 1857 kept on hand an amount of specie seldom much less than one-fifth of their cash liabilities; and these two cities held generally about forty per cent of the bank specie of the United States. In both the amount of specie had declined considerably during the year 1859. In New York, where the specie in the banks had at one time in 1858 exceeded \$35,000,000, it had fallen to an average of about \$20,000,000, as was to be expected from the increased exports of gold and the fuller employment of capital in business.

The course which the banks had pursued in extending their loans from the beginning of 1858 to the beginning of 1860 was the object of much unfavorable criticism. During the period of the low money market, bank loans were increased to a degree which exceeded the highest inflation of 1857, and while their abundant specie made the position of the banks strong, it was clear that their eagerness to employ their resources was stimulating adventurous enterprise in advance of the real recovery of

the country, and was exposing the community to violent fluctuations in the money market, and to the chance of some dangerous relapse. Indeed, in the fall of 1859 there had been a period of considerable stringency, which had passed off, without, however, inspiring much additional steadiness in the management of the banks. The managers of the banks were stimulated to take this course by the great accumulation of capital in their hands, a large part of which must have been idle but for their efforts to extend its employment in loans; but in thus pursuing their own interests they excited speculation, at a time when the tendency of the public was toward caution, and gave a powerful impulse toward a fresh expansion of credit. As the year 1860 advanced there was a disposition in some branches of trade to lengthen the terms of credit, which had wisely been shortened after the disasters of 1857, and to return to the old system of high pressure.

At the close of the fiscal year ending with June, 1860, it appeared that while there had been in many quarters complaints of irregularity and occasional dulness in affairs, foreign imports had exceeded those of any year, not excepting 1857. The merchandise imported had been beyond all precedent; but there was some diminution of imports and an increasing disposition to send goods into warehouses in the closing months of the spring. The immense crop of cotton had carried the exports also beyond any previous figures; but the deficient demand for breadstuffs had left a large balance to be settled by the exportation of specie, exceeding in amount the gold product of the year. This remarkable recovery in the demand for foreign goods at a time when productive enterprises were not receiving any general development could hardly be deemed a healthy symptom. Indeed there were plain indications of reaction to be found in the slackening of importations already referred to, and in a considerable decline in the call for money since the beginning of the year 1860. But, as the summer passed on, all this was changed by the appearance of a new set of conditions in our commerce, both domestic and foreign. The year had been favorable in the West, and it was found that that section was sending to market the largest crop which she had then ever raised. Her granaries were full of corn and wheat, every means of transportation was taxed to its utmost, and in the midst of this plenty there was an increasing probability that Europe would once

more be a large buyer of Western wheat and flour. The West, after its two years of ill-requited effort, had a prospect of such prosperity as she had never yet seen. There was a strong advance in railroad stocks, amounting to nearly forty per cent on an average of twelve important lines of transportation. Merchants in New York and the East began to look with increasing favor on Western trade, while the owners of shipping advanced their rates of freight in expectation of a year of large business and high profits. At the same time, while the reports as to the probable magnitude of the cotton crop were conflicting, there was hardly any limit to the general confidence in the elasticity of that export, and its capacity to make good in price any shortcoming in quantity.

The horizon was obscured, however, by one cloud which became more and more portentous as the season advanced. This was the increasing gloom in the political situation of the country. The canvass for the presidency then in progress had assumed a distinctly sectional character, and there was a prevailing consciousness that it was based on irreconcilable differences of principle and of interest. So far as the platforms of parties were concerned it involved only the old question, more than once laid to rest as it was supposed by our statesmen, of the extension of slavery, and had an intensely legal and unpractical aspect. Behind this formal discussion, however, there was deep aversion to the system of slavery itself on the one hand and devotion to it on the other. Indifference to the moral bearings of the subject had indeed become impossible, long before the country in general recognized its impossibility. Of the two great divisions, the South was the first to comprehend this and to realize all that was implied in the success of the party opposed to the extension of slavery; and thus while even after the election in November, only a minority of the Southern people were prepared for disunion, the community in general of those states had long been in a state of alarm at the prospect before it. Without any distinct perception of the form which the danger might take, the people of those states felt the increasing probability of some violent convulsion at a time when the public in the Northern states were for the most part inclined to regard all predictions of trouble as merely a part of the electioneering tactics by which conviction was to be overcome by fear. It is certain that credit was affected in the South some weeks before

it showed signs of disturbance in the North. Exchange in the North began to be difficult of sale in the Southern cities before the end of the summer. The banks of New Orleans, as appears from their returns, had begun as early as the beginning of August to diminish their purchases of exchange below the usual point and to call in their distant balances, using their funds in short loans on the spot apparently as a precautionary measure.

We must now observe the position in which the New York banks found themselves when the storm finally burst upon the country. During the summer these banks had carried their loans above \$130,000,000, with a specie reserve amounting to nearly twenty-five per cent of their liabilities. At this time stock speculation, especially in Western securities, was active, prices were buoyant, and it is probable that a large part of the increased facilities then afforded by the banks was employed in this direction. The steady decline of their specie, however, in the last few weeks of this advance and the approach of the season when the wants of legitimate business increase, led the banks to retrace their steps. They contracted their loans, from the highest point for the summer on the 25th of August, for eight weeks at the rate of \$1,000,000 per week, with a corresponding decline in deposits while their specie reserve underwent little change. During this time the loans of the Boston and Philadelphia banks remained almost stationary, and in New York it was a matter of remark that the business community felt the contraction but little and that the current rates for money were not greatly affected. The stock market felt some reaction, however, at the beginning of October, partly by reason of the reduction of loans and partly also from the fact that speculation had no doubt carried prices beyond the point which a single year of good business on the great lines would justify. The market was weakened, therefore, and became a little irregular early in the month from natural causes, quite distinct from any political apprehension; but prices rallied in a few days, the general money market becoming easier, notwithstanding the progressive contraction of bank loans. The state election in Pennsylvania, which was always justly regarded as an important index of the probable result in the national election in the following month, occurred on the 9th of October, and the Republican party was the victor. The chances of political disturbance now became

the argument most insisted upon by those who were operating for a fall in stocks; but still no such real alarm was felt as to affect prices until some days later. By the middle of the month, however, a tendency to decline was fairly visible, notwithstanding the ease in money, the advancing prices for cotton and breadstuffs in consequence of an active foreign demand, and the downward turn of exchange, which had fallen below the point at which specie could be profitably shipped. The state of feeling now became more uneasy every day. The stock market became unsettled and dull, neither buyers nor sellers being as yet disposed to act decidedly. On the 22d of October the bids for a five per cent loan of \$10,000,000, advertised by the United States government, were opened and were found to amount in the aggregate to \$10,500,000 at an average premium of about one-half of one per cent. The rate was fair, but still the transaction did not strengthen confidence, the limited amount of the proposals causing much remark. The threatening reports from the Southern commercial cities now attracted attention, and a sharp decline in stocks began, which for a few days had almost the character of a panic. In this movement the bonds of Southern states were of course seriously affected, the fall in those of Virginia, North Carolina, and Tennessee being on the average about eight per cent for the month of October. The fall for the month in the securities of the Western railroads was even more serious; but a part of it was regained by a temporary recovery in the last few days.

At this time and down to the presidential election, the pressure in the money market of New York and the other Eastern cities was not serious. Such tendency as might have been felt in this direction was no doubt in part counteracted by an increase of nearly \$4,000,000 in loans made by the banks between the 20th of October and the election, in view of the steadiness of their deposits and their gain in specie. In the Southern cities, however, the pressure was becoming intense, political apprehension having there become universal, while the grounds for it were still the subject of debate at the North. For similar reasons the stringency in Baltimore was early and extreme. In the Western cities also distress began to be felt, owing to the vicious character of the local currency at a moment when the abundance of most forms of material wealth had filled the public with confidence. Especially

in Illinois and Wisconsin the evils of too free banking began to be cruelly felt. Of ninety-four banks of Illinois issuing a circulation amounting to over \$12,000,000, one-half were at that time banks of circulation only, engaged in no business except that of issuing notes based upon stocks and state bonds, and of their securities nearly two-thirds were bonds of Missouri, Virginia, North Carolina, and Tennessee, all of which were then rapidly declining. In Wisconsin, where the circulation of bank-notes was \$4,500,000, the state of things was equally bad. The local currency of Indiana was also infected with the same disorder. To the evils of the practical inconvertibility of this currency of the West and Northwest, which had long since caused some depreciation, was now added the misfortune of thorough loss of confidence in the basis of credit on which the currency depended.

The election of Lincoln as President on the 6th of November was followed by a slight movement of relief in the market, as if the country breathed more freely now that the decision was made; but this was followed by depression, which was deepened by early news from the South. Not only did the resignation of United States officers in the South and the tone of the political press and the politicians portend a quick development of the movement for secession, but there was a sudden fall in the Southern cities of the rates of exchange on New York. As this fall occurred at a time when not only the shipments of cotton to Europe were large, but the Northern manufacturers were laying in unusually large stocks, it was necessarily followed by an active shipment of gold to Charleston, Mobile, and New Orleans. This movement in ten days carried off by the known channels more than \$3,500,000 in specie. The banks of course lost the greater part of this, and felt compelled to contract their loans. Capital at once became scarce and high, stocks fell rapidly, exchange was slow of sale and low, merchandise waiting to be exported was nearly immovable, and these results followed each other so quickly that by the 12th the panic was complete. Business was everywhere at a stand. Collections had become difficult at the East, and almost impossible at the West, where there was now an actual deficiency of currency having any tolerable degree of credit. The movement of produce slackened at the time when it should be at its height in anticipation of the closing of navigation. Although existing stocks of

merchandise were not excessive in most branches, the impossibility of moving them stopped the orders for fresh supplies, and production diminished, thousands of workmen being thrown out of work every day.

The terrors of this revulsion were heightened by the recognized dangers of the political situation. The possibility of some great convulsion in our civil order oppressed the public mind and made the future something portentous and incalculable. Actual dissolution of the Union was not believed to be possible, nor was the approach of Civil War yet credited; but what scenes of agitation might be before us, what changes might impend, and what loss of the great guarantees of liberty and property, what interruption of national growth and sundering of the bonds of sectional intercourse,—these were questions which filled every mind with foreboding. This general condition of alarm was in itself enough to cut down every enterprise and to wither credit. But to this was added the direct influence of the absolute destruction of a large body of credit distributed through all branches of production and of internal trade. Great numbers of jobbing houses in the Northern cities had their entire capital at stake in the debts which were due to them from customers in the South. Many Southern jobbing houses were branches of firms established in the North whose solvency depended on receiving the collections from consumers at the South. Many Northern manufacturers, in different branches of industry, sent their entire product to the Southern market. Indeed, when it is remembered that the occupations of the South were chiefly agricultural, that its supplies of hardware, dry goods, clothing, and boots and shoes were drawn chiefly from the Northern centres of trade, and that it habitually required and obtained long credit for what it bought, depending on the coming crop for the means of payment, it is clear that the mass of debts due to the North, and all made of doubtful value by the possibility of a political overturn, was enormous. The rapid disorganization of the South had made it certain that payment of a large part of their debts must be delayed, if not finally lost; and in the modern use of credit delay is fatal. Houses in the Southern trade, therefore, found their credit suddenly impaired. All paper resting in any degree upon Southern trade had upon it the taint of a rapidly increasing suspicion. The panic grew in intensity from this cause day by day.

Relief which might have been possible in an ordinary crisis became hopeless, for lenders were now not merely doubtful as to their security, but had the certainty that a large part of the paper offered them had become weak and perhaps worthless from a real cause. The lending of money by private bankers and discount houses came nearly to a stop from the unwillingness of lenders to venture upon long paper of any description, while at the same time call loans were to be had on tolerably easy terms. The banks restricted their discounts within the narrowest possible limits, and as they contracted their loans their deposits fell off and their specie melted away, leaving them to press still more heavily upon borrowers and to restrict their loans still farther. In short, they were once more in the false position in which they found themselves in October, 1857, when they could neither discount nor refuse to discount.

By the 17th of November the drain of specie to the South had stopped, exchange on New York in the Southern cities having taken an upward turn, partly under the influence of the shipments of specie which had been going on and which had given some ease to the Southern money market. But the panic in New York was no longer to be relieved by any single circumstance of this kind. Foreign bills fell to a lower point than ever, and the *Atlantic*, which sailed on Saturday the 17th, carried to England the news that bankers' bills on London sold with difficulty at 1.05 (the real par being 109½) and commercial bills at 1.00, with few buyers even at those rates. In this state of things the prices of merchandise were beginning to fall rapidly.

This disastrous state of things was perhaps felt more severely at Chicago than at any other place in the West. The block in foreign exchange at New York prevented the possibility of realizing on the immense crop which the West had been pouring toward the seaboard, and thus destroyed the means of payment, but did not remove the pressure of debt, while with the fall in prices the wealth of the West seemed to vanish. Exchange on New York had risen in Chicago to five to ten per cent premium with little demand, and the local currency had so depreciated that gold was sold at five to seven per cent premium. In Cincinnati, exchange was scarce, but lower, the local currency being more sound; money was little demanded, said the papers of the day, because it was of no use to ask for it.

The business of the country was, in fine, at a dead-lock: the panic in the money market prevented the importers from buying bills for remittance abroad; the impossibility of selling bills drawn against it stopped the sales of produce; this destroyed the basis on which the West drew its exchange on the East; the Western merchants being unable to sell their produce were unable to remit; and the falling off in collections from the West intensified the pressure in New York. The machinery of internal circulation had stopped, and no one wheel could move until the others started. The case seemed hopeless unless some strong external force could give the desired impulse. This impulse some of the banks of New York determined to give, if possible, by making large purchases of exchange on their own account, in the hope that the movement of trade might thus be revived and some relief given to the general market, while they should themselves be able to secure the returns for the exchange in specie with only a few weeks' delay. Accordingly, on the 19th it was announced that several of the largest banks were ready to buy sterling bills to the amount altogether of £500,000. The relief obtained from this measure, however, was not immediate. The banks found it difficult to secure the amount of first-class bills, and at the rates which they had expected, and were reported to have finally bought only to the extent of £60,000. Their action caused some movement by private parties, and thus helped the exchange market for the time, and caused a more cheerful feeling on the 20th. On the next day, however, there was a relapse, and the tone of affairs became more alarming than ever. It became plain that without immediate relief in the way of loans a large part of the customers of the banks must soon become insolvent, for it was impossible for even the most prudent merchant, after selling his goods upon credit, to repay at short notice his borrowed capital. And it was further urged by the merchants that even if the banks were at any time justified in saving themselves by breaking their customers, there was now no occasion requiring them to do so, for with the fall in exchange upon England and the cessation of the Southern drain of specie there was not only no demand which exposed them to any danger in case of an enlargement of their liabilities for the benefit of their customers, but there was every reason to look for an early and considerable flow of specie from Europe. The bank managers had, perhaps,

learned something from the experience of 1857 as to the effects of an unrelenting contraction at such a moment. At any rate, they were not, as then, insensible to the appeals of their customers. Their resolution to buy exchange was an acknowledgment of a duty toward the community and evidence of a desire to perform it, and if they were slow in taking any more decided action, it was rather from the difficulty of devising any course to be pursued by fifty banks, each acting for itself, than from any indisposition on the part of the leading managers to meet their proper responsibility.

The expedient to which the banks finally resorted for the relief of the community and for their own protection at this frightful juncture deserves careful attention. They now held in the aggregate an amount of specie which was equal to about twenty-two per cent of their cash liabilities. This was a scanty reserve, but still the amount was large enough to make it probable that if credit, and especially the credit of the banks, suffered no further shock, it might be possible to tide over the emergency. But for this purpose it was necessary that the reserve should be treated as a genuine reserve, that is, as something to be used in pressing necessity, and not merely to be guarded, and that assistance should be freely extended to the public. In short, it was necessary that loans should be liberally increased, although this increase might be attended with the risk of a still further exhaustion of resources, in case depositors or note-holders should be led to demand specie. In the opinion of the more sagacious managers this risk was not great. The heavy fall of exchange had stopped the export of specie and made it certain that the flow of gold must set in from abroad, as was seen in 1857. The circulation of the banks was under no suspicion, and their general credit was secure, provided the credit of the mercantile community could be saved. There was reason, indeed, to expect that additional loans, being used in payments falling due at the banks, would be in substance and to a great extent a mere exchange of obligations and postponement of the time for payment. That this relief might be given, however, freely enough to quell the panic which existed and by sustaining the credit of individuals to sustain that of the banks themselves, it was necessary that it should be given by concerted action. Experience had shown that no mere general understanding was sufficient for this purpose. Among upwards of fifty banks, it was certain that, if expansion

should be undertaken without some practically binding arrangement, some would be found to adopt the selfish policy of leaving the burden of expansion upon their neighbors and using the opportunity to strengthen themselves; and that others would hesitate to go forward from fear of not being supported by their neighbors. In short, the banks felt the same necessity for some sort of discipline, which should hold in check the individual instinct of self-preservation, which a regiment feels when it is about to charge in battle.

The existence of the Clearing-house Association offered the means of establishing this unanimity of action which should make the banks one for the time and enable each to act in full confidence of support. The vast amount of exchanges made by the banks through the Clearing-house, and the immense advantage of making these exchanges by the mere offset of mutual accounts and settlement of balances, instead of doing it by the laborious process of collection by each bank from every other, made the possibility of exclusion from the Clearing-house a severe penalty which few would care to brave. A plan of operation was therefore settled upon which should become binding upon all the banks in the Association when adopted by three-fourths of them. By this plan, to which all the banks in the Association save one finally gave their adhesion, the banks agreed that for the purpose of enabling them to expand their loans, the specie held by them should be treated as a common fund, and if necessary should be equalized among the banks by assessments upon the stronger for the benefit of the weaker, and that for the purpose of settling balances between the banks, a committee should be appointed with power to issue certificates of deposit to any bank depositing with them adequate security in the shape of stocks, bonds, or bills receivable, and that these certificates should be received in payment by creditor banks. The effect of this arrangement was that any bank which experienced an unusual demand for specie was supported in meeting it by the whole of the common stock, and that the debt which it thus incurred it could meet by a pledge of its securities. Whatever course might be taken, each bank was as strong as the rest in specie, nor could any bank, by holding back its loans, strengthen itself at the expense of the others, since the specie which it might thus collect must by the agreement be held for the general benefit.

And finally it was provided that after the 1st of February, 1861, any bank whose specie fell below one-fourth of its liabilities should cease discounting until that proportion was recovered, under the penalty of expulsion from the Clearing-house.

Although this arrangement was favorably received by the public, and was indeed rightly regarded as the turning-point in the panic, it was the subject of much criticism. It was declared by many to be equivalent to the suspension of specie payments, since the debts of the banks to each other were not to be settled by the payments of specie but by the pledge of securities. But it was answered triumphantly by the bank managers that the power of the public to obtain payment of deposits or redemption of notes in specie remained unimpaired. So long as the convertibility of the bank-note was maintained, how could it be said that specie payments were ever virtually suspended, although the banks should mutually forbear to demand specie from each other? The arrangement was in fact a temporary fusion of the fifty banks of the city in their relations with each other, but without prejudice to the rights of the public. If an analogy for it were sought, it might be found in the suspension of the act of 1844 for the relief of the Bank of England, and the consequent substitution of government securities for bullion in the dealings between the two departments of the bank, the bank-note remaining convertible as before.

All of the New York banks entered into this arrangement, except the Chemical Bank, an institution with remarkably large and steady deposits and small circulation, which preferred to be cut off from the privileges of the Clearing-house, rather than throw its large reserve of specie into the common stock. The effects of the combination were instantaneous. In the next week the banks increased their loans so rapidly that the average for the week rose by \$7,000,000, and the panic, strictly speaking, came to an end. Nearly the whole of the additional loans went to swell the mass of deposits, with only an inconsiderable loss of specie. The expansion continued at a more moderate rate for four weeks longer until on the 22d of December the average of loans for the week stood at \$132,000,000, with rapidly increasing deposits and specie. From that point, under the natural influence of the revulsion, the demand for loans diminished

and specie accumulated rapidly, this movement going on far into the year 1861. The Boston banks on the 24th of November followed the example of the banks in New York so far as to agree in general terms to discount as freely as possible and to provide that banks owing balances in settlement at the Clearing-house might pay in their own bills to the extent of fifty per cent of the balances due, provided the bills paid did not exceed a certain amount, fixed in proportion to the capital of each bank, varying from one-tenth for the smallest banks to one-twentieth for the largest. The expedient of throwing their specie into a common fund was rejected by them, and they therefore failed in securing the unanimity of action which distinguished the conduct of the New York banks; some of the Boston banks attempted to expand, but others contracted, and the result was a slow diminution of loans for some weeks, which bore with great severity on the mercantile public. With some loss of specie, however, and with the aid, it was said, of some forbearance by New York creditor banks in calling for balances due to them from Boston, the banks of Boston went through the panic without suspending specie payment.

It was too late, however, or was for other reasons impossible, for banks in other sections to adopt the same course. On the 21st of November the Farmers' Bank of Virginia, a large institution with numerous branches, suspended specie payment and was followed by its neighbors on the next day. The Baltimore banks, which had been severely pressed for some days and had felt the symptoms of a run by their note-holders, suspended on the 22d, and the Philadelphia banks on the same afternoon resolved to take the same course. The St. Louis banks suspended with one exception on the 28th, the South Carolina banks on the 29th, and the Georgia banks on the 30th. Of these suspensions those of the Southern banks were in part the result of political calculation, it being desired to retain within control the specie which they held, and in part the result of the absorption of specie by individuals which had been going on through the South for some weeks. The Baltimore banks were driven to the same course by the action of the banks of Virginia which cut off a large share of the specie collections of the Baltimore merchants. Whether the Philadelphia banks could have held out longer or not may be a question, but it seems that their suspension, when it occurred, was more the result

of a want of concert than of special weakness at that moment. The banks of Kentucky continued specie payments throughout this period of difficulty; those of New Orleans did not suspend until September 1861, and then only, it was said, at the request of the Confederate government.¹

The free banks of the Northwest suffered instant discredit from the development of the secession movement and the consequent decline of the securities upon which their circulation was founded. From July to December, 1860, the bonds of several of the Southern states showed a loss of twenty to twenty-five per cent; Missouri bonds in particular dropped from eighty to sixty-one; and the whole range of these securities, after a reaction in the early part of 1861, continued to fall without hope of recovery. The Auditor of Illinois refused in November, 1860, to receive any more Missouri bonds as security for notes, the Chicago bankers began to throw out the notes of country banks known to have large deposits of Southern bonds, and the Bank Commissioners called upon thirty-three banks to deposit additional security — a demand which could not be complied with. Exchange upon New York rose in Chicago to eight or ten per cent, declining to five or six in the early part of 1861. In May of that year the notes of nearly half of the Illinois country banks had been thrown out in Chicago and the discount on their notes ranged from twelve to twenty per cent. The legislature had already voted to receive only Illinois stocks on deposit from free banks in the future; but this change came too late to save the people of Illinois from what Governor Yates, two years after, described as immense loss. The Wisconsin banks were also thrown into indescribable confusion by the collapse of a large part of their securities. In May, 1861, the Bank Comptroller of Wisconsin sold in New York for redemption purposes Missouri bonds at thirty-seven and one-half, Tennessee at forty-five and one-eighth, and North Carolina at fifty-six. Banks were closed in quick succession, leaving their notes outstanding, and in 1863 the comptroller was redeeming — at rates under par and ranging as low as fifty — the notes of thirty-seven Wisconsin banks. Neither in Ohio nor in Indiana did the banks with secured circulation suffer as in Illinois and Wisconsin, although of the Indiana free banks many had to increase their securities to make good the loss on

¹ *Bankers' Magazine*, 1861-62, p. 393.

Missouri and Louisiana stocks, which were largely held by them, and as many as sixteen proceeded to withdraw their notes, a small number suspending altogether. In Missouri also, notwithstanding the loss of credit by the state and the depreciated local currency already noticed, the banks were able to meet the strain of the revulsion with a good face. They held a relatively strong coin reserve, and although their suspended debt was of serious amount, they were able to reduce their circulation and thus to bring their business into a condition in which they could await the issue of the war.

The specie movement occasioned by the crisis in this country was larger in amount, but less serious in its consequences than that of 1857. It has already been remarked that so early as the middle of October exchange had fallen below the point at which specie could be profitably exported. Although there was a rally in the last part of the month, exchange was still heavy and shipments finally came entirely to a stand. The gold exported from New York, the chief point of specie shipments and imports, was only \$740,000 for the months of November and December, 1860, and \$23,000 in January, 1861, against \$7,190,000 in the same three months of the previous year. The decisive turn was given to the exchanges by the news carried to Europe by the *Atlantic*, which sailed on the 17th of November, when five days of panic had completely paralyzed the market for exchange in New York. The *Atlantic* reached England on the 30th, and on the next day the *Europa* sailing from Liverpool took as freight to New York \$540,000 in specie. The tide soon began to flow with great strength, the *Persia* which sailed a few days later bringing over \$3,000,000. In the three months after the flow of specie began the receipts of gold in New York from Europe amounted to \$12,725,000, and the importation continued until the fall of 1861. The aggregate of specie imported in the fiscal year ending with June, 1861, was over \$40,300,000, so that deducting the \$23,800,000, exported chiefly in the earlier part of the year, the United States on the whole drew from abroad in this year \$16,500,000 of gold. In no other year since the product of California became important had this happened.

The first effect produced in New York by the measures taken by the banks of that city was to cause a general sense of relief

and of returning hope, manifesting itself in greater ease in the money market and improved prices for stocks. Had the crisis been of the ordinary type, recovery would no doubt have dated from this point as in 1857. The period of revulsion must of course have been gone through, but, with the accumulation of capital, prices of good securities must have begun to rise at once and credit to regain its healthy condition. But the crisis of 1860 was not of the ordinary type, and this fact the public were every day learning to comprehend more fully. The confidence imparted by the action of the banks was then but temporary. It was soon felt that the losses already experienced from the secession movement in the South, and the greater ones yet to be expected, were not to be cured or averted by the mere expansion of loans. They involved a real loss of capital, and how far this might go could not be guessed. It was only certain that the movement was gaining ground, and that a revolution in the business of the country as well as its government became daily more imminent. After a few days, therefore, the advance in stocks which followed the union of the banks was lost under the increasing pressure in the money market, and prices then continued to decline until the early part of December, when they "touched bottom." Merchandise also suffered the same fall in the few weeks after the action of the banks.

This continuous fall of prices after the 21st of November, it is to be observed, was not accompanied by any panic. Though the demand for loans was great, and private lenders were extremely reluctant to act, the banks were lending freely, and the apprehension now felt was not that the means of payment should be unavailable, but that they should not exist. Assets of real value could now be used, though at some sacrifice; but what assets were of real value was a matter of doubt. Settled gloom, therefore, took the place of that peculiar tension of feeling which is known as panic, and the country entered upon a revulsion in both domestic and foreign commerce, of distinctly different character from that which would have followed the panic under ordinary circumstances. This difference was owing to the steadily increasing mass of Southern indebtedness, either repudiated or suspended in consequence of the movement for secession. The panic, although

short, had been of frightful severity, and recovery from its paralyzing effects must have been slow. It had not been caused, however, by any general unsoundness of business, the commercial and manufacturing interests had withstood the strain with some success, the demoralizing effects of specie suspension had been averted in the great financial centres, and if nothing more had happened, the return to a prosperous, although a reduced business, would have followed early and naturally. And there is evidence in the publications of the day that the observers of financial affairs were slow to admit that such a course of affairs was no longer possible. As winter advanced, however, the unwelcome truth forced conviction upon every mind that the business of one whole section must be struck out from all calculations of payment for the past and of production for the future. This was not the mere "shrinkage" in transactions caused by revulsion of the usual type, but the annihilation of resources belonging to merchants and manufacturers to the extent, as has been estimated, of more than \$200,000,000. The pacification of political troubles might have checked and cut short this destruction; their progress made it inevitable. The causes now at work, therefore, although connected with these from which the panic had sprung, were political and not financial.

It is useless then to attempt to trace farther the course of recovery from the panic of 1860. The steadily increasing effect of new and extraneous influences after the early part of December disguised the operation of the ordinary laws of finance and distorts their results.

STATE BANKS IN 1860¹

THE fifteen years which preceded the Civil War saw the currency of the United States established completely, and to all appearance firmly, upon the theories involved in the Independent Treasury system. A long period of fierce debate and struggle had ended with a declaration by the federal government, in the act of August 6, 1846, that in all its transactions specie alone should be received or paid out by its officers after April 1, 1847, and that no public moneys should thenceforward be deposited in banks. This absolute prohibition of all use of banks or of bank currency, following the repeated and decisive defeat of projects for establishing a Bank of the United States, implied the renunciation of all responsibility for the banking system, on which the mercantile community continued to depend. The theory of the Whig leaders "that there are duties, devolving on Congress, in relation to currency, beyond the mere regulation of the gold and silver coins,"² was rejected, and all except gold and silver was left to be regulated by the states at their discretion. It had become the established order of things, then, that the government should use coin, leaving the people to use either coin or such substitutes as they might prefer, and that the government should rely upon its own strong box, leaving the people to set in operation such local institutions of credit as necessity or ingenuity might suggest. The gold of California and the rush of industrial growth stimulated by it came in good time to support this crude arrangement, and in 1860 it appeared, like many other things in our system, if not beyond criticism, at least safe from attack.

¹ The last three essays included in this volume are a fragment of a larger whole designed to present a history of the national banks. The survey of state banks in 1860 would probably have been somewhat expanded, if we may judge from the absence of reference to the banking system of Louisiana. In scope as well as in other respects the essays on "The Establishment" and on "The Circulation of the National Banks" were left by Professor Dunbar in a state more nearly approaching completion.

² Webster, "Works," iv. 328.

Under such circumstances the legislation of the states with respect to banks lost none of the variety which had characterized it from the first. From 1846 to 1860 the state legislatures continued to act upon this important subject without concert and upon no common principle, but simply as they happened to be moved by the traditions, habits, or supposed needs of any particular community, sometimes under the stimulus of party prejudice and sometimes in obedience to the local craze of the moment. In some sections groups of states finally adopted tolerably similar systems, showing progress toward the formation of a consistent policy over considerable areas; in other sections no such crystallization was visible. The history of the state bank systems, therefore, is a mass of disconnected details, from which a movement of some importance within narrow geographical limits is evolved here or there, but with no important general trend. For the purpose of making a general survey of the state bank systems, then, it is convenient to confine ourselves to a survey of those banks at some given epoch. The beginning of the year 1860 is selected as the best date for such a survey, because a costly experience had then brought state banking on the whole to its best condition prior to the Civil War. The wreckage of the revulsion of 1857 had then been cleared away, the business of the country had resumed its activity, and the sinister influence of the impending political crisis was not yet felt.

It is probably impossible to obtain at this date precise information from all of the states as to the number and condition of the banks then existing. Some states maintained a careful supervision over their banks, requiring the collection and publication of accounts at stated times, but others made no such requirements, and in others still the publication was made too negligently to be satisfactory. The Secretary of the Treasury had been required ever since 1832 to lay before the House of Representatives annually such returns of state banks "as may have been communicated" to the state governments during the year, and in default of such statements to present "other authentic information"; but the returns thus compiled, although exact for some of the states, do not command confidence as regards others. The returns published by the Treasury may, however, be corrected and completed in some cases by the figures collected and periodically revised for the *Bankers' Maga-*

zine, that publication having special reasons for securing absolute accuracy if possible.¹ From these sources it appears that in January, 1860, there were at least 1590 banks in twenty-nine states and the District of Columbia, besides seven in the territories of Kansas and Nebraska. No banks then existed in Arkansas; and the constitutions of Texas, California, and Oregon forbade the establishment of any bank of issue. The distribution of these banks among the states points plainly to differences of legislative policy, as well as to differences in population, wealth, and economic conditions; but the most striking facts in this respect are the concentration of more than half of the banks, both in number and in capital, in New England and New York, the small number of banks in the planting states, and the great irregularity of their distribution in the West and Northwest.²

When we examine the laws under which the several states had organized their banks, it is difficult to find any basis for systematic arrangement and review. Not only did the legislation of one state differ from that of another in its general effect, but, taking the states individually, there were in some states banks established under several different systems, and in others, where the legislation permitted a like diversity, the banks had, in fact, organized wholly or chiefly under some one preferred system. The tedium of an examination of the laws, state by state, may, however, be avoided in part, if we begin by noting the fundamental distinction between

¹ See table in *Bankers' Magazine*, April, 1860, p. 764, giving figures for all the states for January, 1860; observe also the remarks on page 763. Page 975 gives also, for June, 1860, a list of all the banks by name, the names of their officers, and the amount of their capital, showing the precision of the information collected.

	NO. OF BANKS	CAPITAL 000,000 omitted
² New England	507	\$123
New York	301	111
Middle and District of Columbia	180	48
South Atlantic	153	48
North Central	287	25
South Central and Missouri	162	55
Total	1590	\$410

Wisconsin had 104 banks, Illinois 72, Ohio 53, Indiana 37, Iowa 13, and Michigan 4. Of the banks in the South Central states, those of Kentucky and Louisiana represented \$33,000,000 of capital. — *Bankers' Magazine*, 1859-1860, p. 764.

the banks organized under special charters and those which were generally known as free banks.

In the earlier part of the century the only method of incorporation practised by any legislature was incorporation by special charter. This method implied the exercise of legislative judgment as to the need for the establishment of a bank in the particular locality and as to the fitness of the persons applying, and in many states it continued to commend itself to public approval down to the Civil War. The state, thus incorporating its banks singly and after inquiring as to the merits of each one, in many cases established general regulations applicable to all its charter banks, prescribing the limits within which the business of each should be confined and the measures to be taken for supervision or public information, and strengthening its system by such other safeguards as the particular constituency demanded or would bear. To this method of incorporation by special charter was added the method of incorporation by general act, partly as the result of a desire to systematize banking and partly under the influence of a growing preference for general legislation rather than special in all possible cases. New York had undertaken in 1829 the doubtful experiment of establishing a safety fund, to be fed by annual contributions from all banks organized under the system, and to be used for the payment of the debts of any such bank becoming insolvent. Without waiting for the catastrophe which ultimately disclosed the weakness of this system, the legislature in 1838 adopted the expedient of requiring any bank subsequently established to deposit with the State Comptroller securities of specified kinds, in amount sufficient to cover the notes to be issued by the bank. Making this provision for the safety of the circulation, it was easy to provide also by general law that any body of applicants, upon complying with the terms of the act, should be organized with banking powers; and thus New York set on foot what became known in many states as the free banking system, as distinguished from the system of special charters. The plan for a secured currency might easily have been grafted upon the regulations for banks under special charters; but in fact this seldom took place, and the line of demarcation between the free banks and the charter banks was in most states maintained to the last as it had been first drawn. The free banks were organized

under a general law, with some plan for a uniform secured circulation, while the charter banks, organized by special acts, presented no such uniformity of security.

It was in New England that the chartered banks were strongest in 1860. Having a comparatively dense population, active manufacturing and commercial interests, and large accumulations of capital, several of those states had provided themselves with banks early and rapidly. The legislatures had for the most part granted charters with great freedom, but had surrounded the banks by rather elaborate general regulations, which on the whole conformed to a common type. The New England chartered bank was an incorporated company, having tolerably ample banking powers, using its funds chiefly and often exclusively in the purchase of commercial paper, and depending for its strength on the solidity of this investment. In Maine and Massachusetts the expansion of its credit by any bank was limited by the prohibition of loans in excess of double the capital, and by a limit upon the debts due by the bank. In most of the New England states, however, the chief effort of legislation was to restrict circulation, this form of liability still continuing, down to 1860, in all these states except Massachusetts, to be more important in amount than the deposits. In pursuance of this policy New Hampshire, Massachusetts, and Rhode Island limited the circulation of the bank to the amount of its capital, and Rhode Island in 1859 limited it to sixty-five per cent of the capital; Vermont limited all debts except for deposits to twice the capital; and Maine limited the circulation to the amount of capital and also required that all circulation in excess of one-half of the capital should be protected by a reserve of one-third its amount in specie. In addition, New Hampshire and Massachusetts gave to the notes of any bank a first lien on its assets, and Maine made the stockholders individually liable in proportion to their stock for unpaid notes.

In every New England state the legislature had placed the banks under the supervision of one or more Commissioners, armed with certain powers of inspection and investigation, and had provided for returns of the condition of every bank to be made to the state authorities. As to the frequency of such returns, however, there was no uniformity, and the requirements varied from the moderate demand of Vermont for a full exhibit of affairs to the Commis-

sioner at his annual visit, to the requirement of Massachusetts for sworn returns to be given in weekly by Boston banks and monthly by all others, and then to be published in abstract by the Secretary of the Commonwealth. The great concentration of the business interests of much of New England in the city of Boston, however, made up in part for the laxity of the provisions for publicity made by some of the states. The great majority of the New England banks were under some pressure from Boston correspondents, prompt to require payment and keen to discern signs of weakness. There had grown up, moreover, the system of the Suffolk Bank, so often described, under which the New England banks found themselves compelled to provide for the daily par redemption of their notes in Boston.¹ This system, originally introduced in order to free the city circulation from the excessive issues of country banks, and maintained for nearly forty years, had finally become more efficient than any legislative provision in keeping the currency of New England sound and uniform.² Country banks were often made uneasy by the strict requirements of an extra-legal arrangement, forced upon them by an irresistible power; but the result was that their issues, being kept within legitimate limits, had unquestioned credit throughout New England, were at no greater discount in New York than the secured notes of the country banks of that state, and were even taken to the West to be used in making purchases of produce in the fall of the year.

It cannot be said that the New England system was at any time strong in specie. In the years 1859 and 1860 the specie in

¹ An account of the Suffolk Bank system is given by Knox, "History of Banking in the United States," published in 1900. D. R. Whitney, "The Suffolk Bank" (1878), is a full account, from official sources, by the president of the bank. Nathan Appleton, "Remarks on Currency and Banking" (1841), compendiously describes the method followed: "The country banks are invited to keep a fund in deposit at the Suffolk bank for the redemption of their bills. If they decline, the bills are sent home for payment, in which case nothing but a legal payment in coin will be received. The trouble attending this mode of payment soon induces the bank to yield to its true interest and keep up the deposit. . . ." The deposit required over \$2000 for banks with capital not exceeding \$100,000, with an increase for larger capital. At its height the daily redemption by the Suffolk Bank averaged not far from \$1,300,000. The establishment of the Bank of Mutual Redemption in 1858, having country banks among its stockholders, compelled a division of the business, which finally came to an end with the disappearance of notes issued under state legislation.

² The Massachusetts law of 1843, which forbade any bank to pay out notes not its own, no doubt strengthened materially the system already established.

New England banks amounted to less than one-eighth of their liabilities, and the holdings of single banks were often pitiful in amount. And yet the system was strong in credit. Excessive issues were quickly and rigidly checked; the commercial relations of the region did not subject it to sudden or intense demand from outside; and the community felt confidence in the value of assets which were made up of the paper created in a regular and prosperous business. The use of specie was economized almost to the last degree, a smoothly working credit, produced in response to the regular demands of business, was substituted for coin, and yet the whole was kept at the specie standard by the influence exerted at the central point. The system was not strong enough to stand by itself when the credit system in other parts of the country gave way, and still less to give any effective support to others under such conditions, as was shown by the suspension of the New England banks immediately following the suspension of those in New York City, both in 1857 and in 1861. But leaving out of view the failure on these two occasions, of which one was a world-wide financial catastrophe and the other was the crisis of a nation's history, the people of New England found themselves in general well served by their banks, and felt little disposition for change. The free banking movement, to which New York gave so strong an impulse, had never made any strong impression in the New England states. Vermont and Massachusetts had passed general banking laws providing for secured notes in 1851, and Connecticut in 1852, but their example was not followed by their neighbors. Moreover, in each of these states the legislature continued to grant special charters upon application, and no free bank was established in Vermont or Connecticut. Massachusetts established none until 1860, when seven banks under the general law went into operation, six of which were placed in Boston and one in Cambridge. Whatever this sudden movement may have betokened, it was speedily lost sight of in the greater changes brought by the war, and the fact remains that the chartered banks of New England retained almost exclusive possession of the field of banking in those states, until they were replaced by national banks under the acts of Congress.

Most important of all the states, as regards the number and capital of its banks, was New York. The Manhattan Company

and the New York Dry Dock Company, incorporated near the beginning of the century with perpetual charters, continued their business in 1860, under the general regulations imposed upon all banks by the statutes; banks incorporated before 1829 with charters for limited terms were still in existence; banks incorporated between 1829 and 1838 issued notes under the Safety Fund system, imposed in the former year upon banks thereafter chartered. This system, requiring of every bank a contribution equal to three per cent of its capital for the establishment of a common fund, to be made good by renewed contributions if impaired, was intended to secure the notes of the contributing banks by giving them a lien on the fund. It was found in 1841, however, that by a singular oversight the law had been drawn so as to charge the fund with all the debts of an insolvent bank, and not with the notes only, and before the legislature was ready to apply a remedy, ten banks had failed and had left to their creditors claims upon the Safety Fund. The legislature, in 1842, changed the liability of the fund so as to give the note-holders a preferred claim upon it; the state undertook, moreover, to meet the claims left behind by the insolvent banks, providing for its own reimbursements out of the future contributions of the banks; but the Safety Fund system had lost its vitality, and in 1860 was little more than a name. A few banks remained, holding charters which were to expire not later than 1866, but the larger number had taken refuge under the free banking system.

The "free banks," or banks organized under the general banking law of 1838, and its amendments, had come to hold in 1860 by far the most important place in New York. Of the banking capital of the state, amounting to nearly \$112,000,000, more than ninety per cent was organized under the general law; and of the \$70,000,000 of this capital, belonging to the banks in New York City, more than ninety-two per cent. As the limited charters of the incorporated banks expired free banks filled the place, and thus, omitting the two cases of perpetual charters, the banking system of the state promised in a few years to pass under the general law.

The details of the New York free banking system require little description or comment, except in two or three particulars. The fundamental idea of the law, as has already been seen, was to insure the solvency of all bank-notes issued under its provisions, by compelling the deposit of sufficient security in the hands of a

public officer. For this purpose the law, in 1860, after some singular changes of policy, admitted stocks of the United States and of New York, and also mortgages upon real estate to the extent of one-half of the amount to be secured. Uniformity of security naturally carried with it the idea of unrestricted circulation within the limits of the state, and the law therefore contemplated the indiscriminate use of each other's notes by the free banks, allowing any bank to pay out the notes of any other which it was willing to receive at par. A safeguard against the risks involved in these arrangements was provided, however, by the early requirement of the redemption of notes in the principal cities, and by the final establishment in New York City of a system similar to that of the Suffolk Bank.¹

In its earlier years this system passed through some trying periods. In 1844, out of ninety-three banks organized under it, twenty-six had failed, and their circulation had been redeemed at an average discount of about twenty-five per cent. But as early as 1850 the law of New York had become a model for other states, and in 1860 the banks organized under it had a credit which carried their notes easily into adjoining states, and often in the course of trade into the Northwest. This credit was probably due, not so much to the terms of the law, which (as in the admission of mortgage security) sometimes passed the bounds of prudence, as to the reënforcement of the law by a generally strict and vigilant administration, and to the influence exerted by the city banks. As early as 1851 the banks of New York City found it for their interest to organize thoroughly the system of central par redemption of country bank-notes; and in 1853 they established the Clearing-house and thus brought every one of their own number to a strict daily account.

The free banking system, with provision for a bond-secured note issue, was followed in other states in such rapid succession in the later fifties as to suggest the probability that had not the normal course of development been interrupted, the system might soon have become general.² At its best in New York, the system

¹ A similar step was taken by the Philadelphia banks in 1858, but it was given up after a short trial. *Bankers' Magazine*, 1859-1860, pp. 13, 149.

² The following states had passed free banking laws down to 1860: Vermont, Massachusetts, Connecticut, New Jersey, Pennsylvania, Virginia, Tennessee, Florida, Louisiana, Ohio, Indiana, Illinois, Wisconsin, and Iowa.

was from its nature defective, since under its provisions real elasticity of note issue was nearly if not quite impossible. In many of the states, moreover, and particularly in the Northwest, it did not even secure that safety which is the sole virtue of a bond-secured circulation. It is not possible to determine how many of the seventy-four banks of Illinois and the one hundred and nine banks of Wisconsin were really at the beginning of 1860 anything more than establishments for the issue of notes upon speculative securities.¹ In each case the law of the state allowed the issue of notes upon the bonds of any state paying its annual interest, and in each the banks had convinced the state officers as to the soundness of a great variety of bonds. The favorite security for this purpose was for the time the six per cent bond of Missouri. That state was issuing its bonds in payment for railway construction, and the rates in the market, which early in 1860 were not far above eighty, indicated that the supply was not easily absorbed. To make a deposit of the bonds under the Wisconsin law and to take out an amount of notes equal to their average value in New York for the preceding six months, appears to have been an easy method of obtaining an advance, which might be left to throw the burden on the note-holder in case the bonds fell still further. Other issues of Southern and Western bonds appear to have been used in the same manner, bringing into existence a mass of currency protected by no real redemption by the issuing bank, and with doubtful security in the hands of the state. Public indignation found its vent in epithets of great freshness and vigor applied to the notes, but the notes continued to circulate. It was generally recognized that Illinois and Wisconsin did not use a currency of specie value; it was hard even in Chicago to buy gold; and the propositions made at intervals for some scheme of redemption were generally limited to redemption in exchange upon some more fortunate state at "reasonable rates." The free banks in Indiana were apparently disposed to follow the example of those

¹ It was stated in a circular of Chicago bankers in 1860 that more than half of the Illinois banks were banks of circulation only, doing no business in their nominal location. *Bankers' Magazine*, January, 1861, p. 585. The Comptroller of Wisconsin, in January, 1860, named 15 banks in that state as irresponsible, 13 having no place of business and the other 2 being apparently mere places of issue. That these were the only Wisconsin banks having little or no foundation in legitimate business is highly improbable.

in Wisconsin and Illinois. They, too, held Missouri and Southern bonds freely, and sought to devise some plan for preventing the frequent return of circulation for redemption, but could agree upon nothing except common hatred for the Bank of the State of Indiana, which pushed them hard by the regular return of their notes.¹ As for Missouri itself, the currency there was freely recognized as inconvertible. The bank commissioner of the state early in 1860 reported that bank-notes were at a discount of one or one and one-half per cent compared with gold, and one per cent below the notes of the state banks of Indiana and Ohio and the banks of Kentucky, Tennessee, and Louisiana. The state itself had paid one and one-half per cent for exchange in order to remit money for its annual interest due in New York; and in March the Chamber of Commerce of St. Louis resolved that it was necessary to return to the specie basis.²

The difference in the value of local currencies, which thus culminated in the West, necessarily showed itself in published rates of discount on "foreign" notes in most of the principal cities. In some cases notes were sent in large sums to be put into circulation at a distance from home; in other cases they found their way to distant places, in small amounts in the pockets of individuals. In either case they often fell into the hands of the dealers in "uncurrent money," who carried on a profitable business in buying such notes, often at low rates, and either selling them for remittance, or sending them home, to be redeemed or to be put into circulation anew, as the case might be. But notwithstanding the discount upon "foreign" notes when bought or sold, they made their way into circulation, and sometimes to a serious extent, whenever the local banks failed to enforce a rigid exclusion. Complaint was made that Missouri notes accumulated in Cincinnati,³ the banks there preferring to pay them out rather than incur the expense of sending them home, and Illinois and Wisconsin notes overran the whole Northwest.⁴ That all this confusion implied great inconvenience and certain loss for the unwary, even in dealing with genuine notes, is clear. But there was also an added danger arising from the multitude of counterfeited notes. The art

¹ *Bankers' Magazine*, 1859-1860, p. 913.

² *Ibid.*, pp. 811-817.

³ *Ibid.*, p. 152.

⁴ "Iowa State Bank and Western Banking," in *Bankers' Magazine*, 1859-1860, p. 609.

of bank-note engraving was then well advanced, as the natural result of the needs of a multitude of banks having different plates. The business of engraving had been concentrated in a few hands, and much highly creditable work was produced. The counterfeiter found his opportunity, however, in the vast variety of the notes in use, and in the probability that no person would be familiar with the appearance of many issues. Only the expert could know the characteristics of a multitude of plates, and detect at sight the variation from the original, which might be as difficult of precise definition, and yet as real, as the difference in the features of two brothers. A pamphlet bank-note detector was a part of the outfit of every well-provided counting-room. The published detectors rivalled each other in the completeness of their information, and the test of latest counterfeits was a valuable contribution regularly made by the financial publications. The New England banks had an efficient Association for the Suppression of Counterfeiting, and another went into operation in 1860 in Philadelphia.¹ But no small part of the people found themselves frequent losers by imitations of a currency to which they could apply no certain test and for which they could obtain no substitute.

The free banking system, in some of the Western states, found a formidable rival in the state banks organized on the model adopted by Indiana in 1834. After some unsatisfactory adventures in banking, Indiana, in that year, in view of the probable disappearance of the Bank of the United States, instituted a system under which local banks established in different parts of the state, as branches of an organization to be known collectively as the State Bank of Indiana, were to be placed under the supervision of a central Board of Control. The capital of any board was to be subscribed in equal parts by the state and by individuals, the state also lending its credit to enable individuals to make full payment for their shares in cash. Prudent management of an essentially sound institution brought the State Bank safely through the revulsion of 1837, though, like banks throughout the country generally, it was obliged to suspend specie payments, and it carried

¹ The New England Association for the suppressing of counterfeiting "paid for sentencing" two hundred and twenty-eight persons during the four years 1858 to 1861. It received an annual subsidy from the state of \$1500. For its report for 1859, see *Bankers' Magazine*, 1859-1860, p. 705.

on a profitable business, enjoying high credit and performing valuable public service until the expiration of its charter in 1857.

To take its place a new bank was chartered in 1855, organized upon a similar plan, but having all its capital supplied by individuals, and went into operation at the beginning of 1857, under the name of the Bank of the State of Indiana. The act of incorporation provided for opening fifteen to twenty branches¹ in different parts of the state, every branch to have a capital of at least \$100,000 and the aggregate being limited to \$6,000,000. Every branch had its own board of directors and its own stockholders, among whom its profits were to be divided; but although distinct from each other the branches were not independent. Over them all was the bank, supported by proportional assessments upon the branches, represented by a board of directors, of whom four were elected by the legislature and one by every branch, and existing for the purpose of inspecting and controlling the branches. The directors of the bank fixed the number of directors for every branch and appointed two among them. They could also restrict the discounts of any branch to one and a quarter times its capital; and although they could not compel the transfer of capital from one branch to another, they had authority to close any branch after the first year, if it did not earn six per cent. In addition to these guarantees against mismanagement and to the further security afforded by ample provision for reports from all and for both stated and discretionary examinations by the central board, the branches were made liable for each other's debts, and the stockholders were also made personally liable to an amount equal to their stock. Notes for circulation were supplied to the branches by the parent bank, the issue being limited to twice the capital of the issuing branch; and the suspension of specie payments was forbidden under a penalty of heavy interest to the holder of notes on which payment should be refused or delayed. The average discounts of any bank were limited to the amount of its deposits, and two and a half times its capital and some strict regulations were prescribed as to the kind of loans to be made.

The Bank of the State of Indiana was therefore a cluster of banks submitting to mutual inspection and control,—for the

¹ The law provided for the division of the state into "not less than fifteen nor more than twenty districts," and the larger number was in fact taken.

parent bank was in fact the representative of all, — and accepting mutual responsibility for debts. The organization, then, was essentially conservative, and its cautious movement lost nothing in steadiness under the firm hand of Hugh McCulloch, its first president. It passed through the crisis of 1857 without discredit, and in 1860 was recognized as a sound and valuable system, under which healthy business and prudent management supplied all needful guarantees for every class of creditors.

Ohio followed the example of Indiana in 1855, by incorporating the State Bank of Ohio, also a group of closely allied banks, with a maximum capital of \$6,150,000. In its general characteristics the Ohio State Bank differed but little from the Indiana model, except that instead of making the branches liable for each other's obligations, the Ohio system instituted a Safety Fund, to be held by the central Board of Control and supported by a contribution required from every branch to an amount equal to ten per cent of its circulation. The branches were required to receive each other's notes at par; the issue of each branch was limited to twice its capital if this did not exceed \$100,000, and in a descending ratio for any additional \$100,000; and the Board of Control could require any branch to reduce its circulation within safe limits. The liability of stockholders was limited to an amount equal to one-third of the capital paid in. To these regulations and to some restriction upon the indebtedness of any branch beyond its circulation and deposits, the Ohio system added the requirement of a reserve of thirty per cent of the amount of notes outstanding. Of this reserve at least one-half was required to be in coin and for the remainder the branch was allowed to count cash deposits in New York, Boston, Philadelphia, or Baltimore as the equivalent of coin. Organized upon this plan the State Bank of Ohio had in 1860 thirty-six branches. The system was in strong condition and good credit, and well able to resist the approaching convulsion.

Iowa began its life as a state in 1846 under a constitution which in one section forbade the creation of any corporation with the privilege of issuing notes "to circulate as money," and in another forbade the creation of any "corporations with banking privileges." The necessities of modern life, however, and the example of Indiana and Ohio wrought so powerfully upon Iowa, that in the revised constitution of 1857, after providing for the sub-

mission of all acts relating to banking corporations to popular vote, express authority was given to establish a state bank with branches, to be founded on a specie-paying basis and with a mutual responsibility among the branches for each other's circulating notes. Under this authority the legislature in 1858 incorporated the State Bank of Iowa, with a possible aggregate capital of \$6,000,000, with the capital of each branch limited to \$50,000 as its minimum and \$300,000 as its maximum, and with the same concentration of supervisory power in a central board of directors as in the State Banks of Indiana and Ohio. A Safety Fund, amounting to one-eighth of the circulation, was established in the hands of the parent bank, and the circulation of every branch was limited in proportion to its capital,—on the first \$100,000 to double the amount, and so with a descending scale for additional amounts of capital. A reserve of coin equal to one-fourth of the circulation was required, and also a similar reserve in current funds for the deposits. Any branch refusing to pay its notes in coin on demand was to be declared insolvent, and the State Bank was at once to take possession of its effects, in order to apply the Safety Fund, or enforce the mutual responsibility of the branches. Behind this responsibility lay the personal liability of all stockholders to an amount equal to their stock. As a security for general soundness the law limited the indebtedness of any branch beyond its circulation and deposits, and forbade loans upon paper having more than four months to run. It forbade any branch to issue the notes of any other, and required all to take each other's notes at par; but it permitted the circulation of notes received in payment of debts, if redeemable in gold and silver and received in the regular course of business, although issued by banks out of the state. In many particulars the Iowa law followed closely provisions of the laws of Indiana and Ohio, and, as in those cases, the result was the establishment of a solid institution maintaining its own credit and strengthening that of the community in which it was established.

So strong was the impression made by the group of state banks on what we may call the Indiana model, that in 1861 the legislature of a fourth state, Illinois, prepared to adopt the system, having apparently lost all hope of a thorough reform of the free banks. The act for the establishment of the Union Bank of

Illinois, passed February 20, 1861, proposed a group of banks collected around a central board with mutual responsibility and with strict provision for specie payment. Many of its sections were taken from the Indiana statutes with little change, and in general promised the same rigorous and prudent management. It failed, however, to secure a majority when submitted to popular vote in November. The people of Illinois at that juncture felt a reluctance, perhaps reasonable under the circumstances, to commit themselves further on the subject of banking.

THE ESTABLISHMENT OF THE NATIONAL BANK- ING SYSTEM¹

THE plan of establishing a system of national banks, whose notes should take the place of those issued by the state banks, was first presented in definite shape in the report of the Secretary of the Treasury, at the beginning of December, 1861. Mr. Chase started in his discussion of the subject from the consideration that by some process the advantage of issuing a paper circulation, amounting to not far from \$150,000,000 in the loyal states, ought to be transferred from the issuing banks to the government, and that the moment was opportune for such a change. He referred to the lack of system in the existing circulation, the insecurity of the bank-notes, the heavy losses suffered by the public, and especially to the recent misfortunes of banks in the Mississippi Valley,² to enforce upon Congress the duty of protecting the public from such evils in the future. Two methods were suggested by him, in which all the objects aimed at in the proposed reform might be attained,—first, the issue of United States notes in place of bank-notes; and second, a national system for the issue of bank-notes, to be redeemed by the issuing banks, but secured by the pledge of United States bonds. The plan of issuing United States notes Mr. Chase rejected, believing that its possible disasters far outweighed its probable benefits. It is interesting to observe, in view of what soon followed, that the possible disasters which so powerfully affected his judgment were, the issue of notes under great temptation without adequate provision for redemption, the risk of “a depreciated, depreciating, and finally worthless paper money,” and “the immeasurable evils of dishonored public faith and national bankruptcy,” all then being “possible consequences of the adoption of a system of government circulation.”³ Mr. Chase turned, therefore, in accordance no doubt with some

¹ See note, p. 314, above.

² *Ibid.*, p. 310.

³ *Finance Report*, 1861, p. 18.

predilections as well as with logic, to the second plan, a secured national bank currency, and recommended this for adoption by Congress.

A bank currency thus secured, Mr. Chase was careful to point out, besides its advantages of uniformity and security, would also offer the further advantage of a large demand for government securities and of facilities for obtaining the loans required by the war. In addition it would strengthen and diffuse the interest in preserving the Union, by making the government stocks the basis for the circulation in general use, and would also secure equality of value for the paper currency in every part of the Union. The device of securing bank-notes by a pledge of public stocks had been shown to be practicable and useful by the experience of New York and of some other states, and notes issued upon this system would now have a solid basis, in the large amount of specie retained in the United States by the requirement that duties on imports should be paid in coin. To these considerations it was wisely added that by offering inducements to existing solvent institutions to adopt the national system, the transition from a heterogeneous and unsafe currency to one which should be uniform and sound could be effected almost imperceptibly and the evils of a great and sudden change could be avoided.

But although Mr. Chase believed that this plan might be perfected and passed by Congress before the end of the session of 1861-1862, and that it might be serviceable in obtaining the loans needed for the current year, it was after all a leisurely expedient for filling the treasury of a country in the throes of civil war, and events were already moving too fast for his calculations. Although his report made no reference to any immediate pressure on the Treasury and no suggestion of any new expedient for its rapid replenishment, the suspension of specie payment had already become as nearly certain as any future event can be. By some of the bank managers suspension had been contemplated for many weeks as the probable result of the locking up of their resources in government bonds and the gradual dissipation of their reserves by payments to the Treasury. By the first week in December this double process was so far advanced and the public disquiet was so great as to leave no doubt as to the issue in the minds of cool observers. The shock to credit was precipitated by a sudden alarm

as to possible war with England, and after some struggle the banks suspended on the 30th of December—earlier than they might have done had no special strain come upon them, but, after all, under the pressure of an irresistible movement, of which the cause was to be found in the policy pursued by the government in its dealings with them.

As a consequence of the suspension of specie payments, Mr. Chase found himself confronted by the demand for an issue of government notes, as a ready source of supply for the Treasury, before it was possible for him to draft a bill for a bank system. Interest at once centred upon this apparently unexpected demand, and the discussion had its issue in the first legal-tender act, approved February 25, 1862. By this act Congress, with a recommendation reluctantly given by the Secretary, adopted the expedient rejected by Mr. Chase in his report of December 9, and established a government currency, giving it, moreover, the quality of legal tender, which was probably not contemplated by him as possible, or as admissible even if possible. The plan of a bank currency, favored by Mr. Chase, then took the second place, and was finally thrown over to the next session of Congress.¹

It was pointed out at the time, and there seems to have been great force in the suggestion, that all the advantages of a secured currency could be gained by a method much more expeditious than the elaboration of a complete system of national banks. A comparatively simple measure, by which existing banks should be required to secure their notes by the pledge of United States bonds, to be placed in the custody of the Treasury, would have made their issues uniform and safe, and would have made them large permanent investors in government bonds. The banks of the three cities, New York, Boston, and Philadelphia, taken by themselves, had at the date of the suspension of payments an aggregate capital of \$1,200,000,000, and against their liabilities for deposits and circulation amounting to \$181,600,000 held a specie reserve of \$44,000,000, or twenty-four per cent. The issues of these banks, it was pointed out, if secured by bonds, could be used by the government

¹ A bill framed by E. G. Spaulding and Samuel Hooper was introduced on July 11, read twice, and referred to the Committee on Ways and Means, but a resolution to print 6000 copies was laid on the table July 15, and the bill was dropped. — *Cong. Globe*, 3258, 3293, 3362, 3370.

as safely as its own notes; the banks could be used as general depositories by the Treasury without risk; the inconveniences of the Independent Treasury, which adjusted itself with difficulty to the new conditions created by war, could be avoided; and the system which thus embraced the banks of the great cities could include without difficulty any bank anywhere that was strong enough to comply with the terms of such an arrangement. But whatever the financial merits of such an improvised national circulation may have been, it was not politically feasible. The existing banking interests were not then agreed as to the larger questions involved in their relations with the government; the public were not prepared for a revolution in the policy of the government with respect to banks; and finally the Secretary himself, having in mind the comprehensive scheme of a permanent national banking system, was little inclined to adopt a measure which, falling short of his aim, might be found ultimately to stand in his way. The proposition had little strength then and attracted but little attention.

When Mr. Chase again brought forward his plan,¹ at the beginning of the session of 1862-1863, it was under greatly altered conditions. Two legal-tender acts had been passed, giving authority for the issue of \$250,000,000 of United States notes, and of this amount all but \$27,000,000 had been paid out. The price of gold had been rising through the year and now stood above 130, and the prices of merchandise were advancing. It was estimated by the Secretary that the banks of the loyal states in the course of twelve months had increased their circulation from \$130,000,000 to \$167,000,000, and their deposits from \$205,000,000 to \$354,000,000, making an increase of liabilities under both heads of about thirty per cent, and had increased their investments by not far from \$70,000,000. With great ingenuity of reasoning he contended that nearly the whole increase in the volume of the currency was "legitimately demanded by the changed condition of the country," but that if there were any redundancy it was due to the issues of the banks and not to the new element added to the circulation by the government.

In this state of things, with what appeared to most observers an alarming depreciation well under way, the need of funds for the immediate wants of the Treasury was again pressing. The

¹ *Finance Report*, 1862, p. 17.

sale of the bonds authorized by the legal-tender acts had been trifling, and comparatively little was to be counted upon from that source. Indeed, Congress had blocked the way to any important sales, by providing that the bonds should be sold by the Treasury at the market price only,¹ and that legal-tender notes should be exchangeable for bonds at the pleasure of the holder, thus in effect limiting the price of bonds to par, and leaving purchasers little chance for a profit. The repeal of these provisions Mr. Chase asked for and secured at the end of the session, together with authority for borrowing in other forms to a vast amount. It was not by his advice,² however, that Congress at the same time made its third resort to an issue of legal-tender notes, authorizing an increase of the active legal-tender currency to \$400,000,000, and the issue of an equal amount of legal-tender notes in other forms. He still maintained that an issue of government notes as a permanent system was open to grave objection, and that if it were used for temporary relief, it must be with a sparing hand; and he was more firmly persuaded than ever that the cure for the increasing disorder of the currency must be found in the resort to national bank-notes as the substitute for all other paper issues. He therefore pressed upon Congress at some length the considerations which weighed with him in favor of immediate legislation for this purpose.

A comparison of the reasons urged by Mr. Chase in 1862 with those briefly indicated by him in 1861 shows little change in his general estimate of the advantages promised by a permanent system of national banking. He adds in 1862 the consideration that under such a system the banks could be used safely as depositories in connection with the Independent Treasury, with advantages which perhaps experience had finally led him to rate

¹ Chase construed the provision of the statute authorizing the sale of bonds "at the market value thereof" to prevent sales below the current New York quotations, though in Congress the view was expressed that market rate signified whatever price the government could secure. Chase was clearly right, for otherwise the provision in question would have had no reason for its insertion.

² As in the case of the earlier legal-tender acts, Chase readily acquiesced in the views of the majority in Congress. In January, 1863, he prepared a bill, in response to a request from the Senate Committee on Finance, as a substitute for a pending measure authorizing a further issue of greenbacks, and his substitute accepted that proposal, merely adding provisions to facilitate the sale of bonds. — *Cong. Globe*, p. 270.

more highly than at first. He also declares his opinion that in no way can the ultimate resumption of specie payment be made so certain as by the conversion of the entire paper circulation into an issue of bank-notes, secured by bonds bearing coin interest. On the whole the suggested advantages of the system, although substantial, are remote. Even the direct gain expected from the absorption of bonds by the banks is described as a sale amounting to \$250,000,000 or more "within a very few years," promising, however, very little aid during the current year, and perhaps not much for the next. In this part of his recommendation, Mr. Chase, in December, 1862, was looking far beyond the wants of the moment, to the time when the legal-tender notes, after serving their temporary purpose, should have disappeared, and the bank-notes should have become the sole and permanent currency; and so far did he carry his forecast of the future in this respect that he even took note of the probable payment of the national debt, and the necessity in this case of finding some new basis for the bank circulation. "But these considerations," he said, "may be for another generation."

The national currency bill, which by the strong influence of Mr. Chase and his supporters was passed by Congress and became a law February 25, 1863,¹ was framed on the familiar lines of the New York system, with details perfected by comparison with the banking systems of other states. It prescribed no limit for the number of national banking associations, but fixed the aggregate of notes to be issued by them at \$300,000,000. Of this aggregate one-half was to be apportioned among the states, territories, and the federal district in proportion to population, and one-half to have due regard to "existing banking capital, resources, and business." The notes were to be issued under the superintendence of a Comptroller of the Currency, to be secured by interest-bearing bonds of the United States, and to be redeemable in "lawful money," this term including legal-tender notes as well as specie. The banks were not required, however, to redeem their notes anywhere except at their own counters. Provision was made for the organization of banking associations by any applicants who should comply with certain conditions named in the act, and also for the conversion of state banks into national bank-

¹ 12 "Statutes at Large," p. 665.

ing associations upon application in due form. By a provision inserted upon motion of a Senator from New York and but little discussed,¹ it was also provided that any state bank, holding United States bonds to the extent of one-half its capital, might, upon transferring the bonds to the Treasurer of the United States, be authorized to issue notes to the amount of eighty per cent of the bonds transferred, the notes thus issued being supplied by the Comptroller of the Currency and payable at the Treasury in case of the failure of the issuing bank, in the same manner as other notes issued under the act.

This bill did not pass without difficulty. In the Senate the vote upon its passage was 23 yeas to 21 nays and in the House 78 yeas to 64 nays. These votes did not closely represent either political or sectional divisions, members of the same party from the same state being in some cases upon opposite sides. The bill had to encounter objections resting upon several different grounds. Not only was it opposed by some for political reasons and merely as a measure of the administration, but it was also viewed with great distrust by others, as a proposition for a vast financial consolidation, incomparably more formidable than the former Bank of the United States. The friends of the state banks eyed it with special jealousy, believing that the two systems, national and local, could not long stand side by side; and in this they were justified by the avowed purpose of Mr. Chase, and by the strong language of some of his adherents. And among those who might not have been averse to a national banking system under some conditions, there was doubt and apprehension as to the opportuneness and the details of this particular measure. While the bill was under discussion, Congress was maturing the third legal-tender act, and the premium on gold, which had passed thirty in December, was rising from fifty to sixty, passing the latter point before the vote on the bank bill was taken in the House. The Secretary had seen in the bill a means for prescribing more surely for ultimate specie payment; but, it was asked, what safe reliance could there be upon a system under which solvency meant simply payment in depreciating paper and the security against insolvency was found in bonds which were sinking with the paper? In ordinary times the bill probably could not have made

¹ *Cong. Globe*, February, 1863, p. 850.

its way against these various elements of opposition; but no inconsiderable part of its strength was due to the gloomy circumstances of the winter of 1862-1863. In Congress as well as among the people at large the resolution to stand by the government carried many to the point of relinquishing private objections to a measure declared necessary by the administration; and so the bank bill gained a majority, not resting altogether upon conviction.

Capital showed but little alacrity in organizing under the bank act of 1863. Seven months after its passage only 66 banks, with a capital of little over \$7,000,000, had begun operations, and ten months from its passage only 139, with a capital of \$14,740,000, reported to the Comptroller. The six states, Ohio, Indiana, Illinois, Michigan, Iowa, and Wisconsin, supplied 35 out of the 66 banks reporting in October, 1863, and 79 out of the 139 reporting in January, 1864. At the latter date New England had organized but 14 national banks, New York 16, and Pennsylvania 20. The Comptroller of the Currency regretted the opening of so many new banks in states where there was no deficiency of banks already. In general, in the first year under the new act, a few strong banks had been established, as the First and Second National Banks of New York, the First of Philadelphia, the First of Pittsburg, the First of Cincinnati, and the First of Chicago; but the existing banks for the most part held aloof, and new capital came in but sparingly. The report of the banks in the beginning of April, 1864, showed an investment by them in United States bonds of but \$41,175,100. At this time, however, the importance of the new system as a market for government securities had pretty well disappeared. The desire of the administration, expressed on every occasion, was that the great mass of state banks, and especially the strong institutions in the older states, should be reorganized as national banks. These banks had already become large holders of government obligations, for reasons quite unconnected with any possible future reorganization under the national system. The depression of business which continued through the years 1862 and 1863 had diminished the demand for regular commercial loans, and many banks with large resources at command found it difficult to procure the usual amount of business proper. Tempted by the high rate of income which securities bearing gold interest began to pay, and anxious to employ their funds, banks were investing

freely in bonds of the United States and also in one-year certificates of indebtedness issued by the Treasury. In November, 1863, the banks of Massachusetts, though but three among them were national banks, owned government securities to the amount of over \$53,000,000; and the banks of New York, city and country, probably held similar investments to an amount not far below their capital of \$109,000,000. These holdings were unequally distributed, no doubt, but they far exceeded in the aggregate the amount of securities which the banks would have been required to deposit under the national bank act, so that the absorption of the existing banks by the national system then promised to create little additional demand for bonds.

The interest in the new system had in fact been concentrated entirely upon its practical merits and upon the expediency of substituting it for the state system. From the passage of the act of 1863 the Treasury had pursued the policy of actively stimulating the adoption of the national system. By a fortunate choice Mr. Hugh McCulloch, president of the Bank of the State of Indiana, had been appointed Comptroller of the Currency,—a gentleman widely known as an experienced and prudent manager and a strong advocate of a sound currency, originally opposed to the passage of the act, but finally convinced of its expediency and the wisdom of its leading provisions. It was characteristic of the policy of the Treasury as administered by McCulloch, that while the conversion of state banks into national was urged by every argument and persuasion, those sections of the bank acts which allowed the deposit of bonds and issue of notes without the abandonment of state charters remained dormant. The Comptroller, in a public circular, discouraged the use of these provisions, and although he admitted that if applications were made he “must obey the law,” it is probable that his discouragement was in every case as emphatic as he found necessary for complete effect. It was his opinion that the state systems and the national could not long coexist; “one or the other will fully occupy the field,” and he had no doubts which would and should be the survivor. The issue was made up, then, in 1863, and the real object of public debate was henceforward the national system, its merits, and its general adoption.

The year 1863 was therefore a year of discussion, fruitful in pamphlets, criticisms, and propositions for amending the act. In

some cases writers, representing large existing interests, showed a deep distrust for the whole scheme, and were ready to see state bank issues withdrawn and the field of circulation temporarily occupied by Treasury notes, rather than embark the whole banking capital of the country in an experiment. On all sides defects in the act were pointed out which justified the reluctance of solid banks to take out new charters under it. It was urged that the redemption of bank-notes at convenient centres was absolutely necessary in order to hold individual banks to any responsibility whatever and as a safeguard against general overissue. Provision for requiring the accumulation of surplus, omitted in the act of 1863, was called for to insure the strengthening of weak banks. It was pointed out that the act did not make the government responsible for the safety of the bonds deposited with it, and that the banks were therefore called upon to entrust a vast amount of securities to the fidelity of agents over whom they had no control. The act had authorized the Secretary of the Treasury to employ national banks as depositories of the public moneys at his discretion, but without any requirement as to security; and it was urged that although with proper provisions of this kind the banks could be used as depositories freely and the proved inconveniences and evils of the Independent Treasury greatly mitigated, any system of deposit banks without such provision must be liable to abuse and would probably be found dangerous. The act had also made no provision for the voluntary winding up of banks, so that the extrication of capital from an unprofitable business appeared to be impossible. In much that was written in that year it was either assumed or advised that the provisions for the issue of secured national notes by state banks, contained in the act of 1863, should be retained and brought into use; and the policy of discouragement pursued by the Comptroller of the Currency, already referred to, did not escape sharp criticism. There was also very general condemnation of the practice adopted by the Comptroller, apparently without warrant of law, of requiring all banks reorganizing under the national act to give up their distinctive names and become simply the First, Twentieth, or Fortieth National Bank of some town or city, as might happen. The names of established banks represent a good will and an earned reputation and credit. They are also a security for the public,

who know banks by name for good or ill, but cannot have an equal familiarity with a list of mere numbers. The Comptroller had urged as a reason for requiring the use of numbers instead of names by reorganized banks that all who came under the system had an interest in "making it symmetrical and harmonious, as well as national," but it was difficult to believe that this was all; and, with the strong objection to partial loss of identity felt by the banks, there was also a certain vague impression that something more than met the eye was implied in the proposition to make them all indistinguishable members of a vast system having its centre of control at Washington.

At the session of 1863-1864 Congress proceeded to revise the whole system in the light of the year's experience. A bill for that purpose was reported March 13, 1864, and from that time the subject was before Congress, in one form or another, until the final votes of the two Houses on May 31 perfected the measure, under which the national banking system was at last fully established.¹ Many of the suggestions brought forward in popular discussion had been adopted by the Comptroller and recommended in his annual report at the beginning of the session, and others were adopted by Congress upon advice received from other sources. The law was completely recast. The provision for apportioning the \$300,000,000 of circulation among the states was repealed; it was provided that only registered bonds should be deposited as security, and that the property of the banks should thus be made safe while in the hands of the government; redemption of notes by every bank in some reserve city, as well as at its own counter, was provided for; the accumulation of a surplus equal to at least one-fifth of the capital of any bank was required; provision was made for requiring full security from banks used as depositories by the Treasury; the provisions as to the amount of capital and the terms on which a bank could begin its business were somewhat strengthened; and in short the whole system was made firmer and more harmonious. Without entering into the details of the legislation, it is enough to say that in the act of June 3, 1864, the national banking system took the form which in essentials it still retains.

In its provisions with respect to the state banks the act of

¹ 13 "Statutes at Large," p. 95.

1864 made two significant changes. It provided expressly that state banks reorganizing under the national system might come in under their former names and without change in the amount of their shares. Special provision was even made for the exemption of stockholders from personal liability, under conditions intended to meet the case of the Bank of Commerce of New York and in fact applicable to no other.¹ The sections, however, which allowed the issue of secured national currency to state banks were omitted in the revised act, and thus Congress planted itself finally on the ground of an exclusively national system, and invited the adhesion of all existing banks, but rejected any connection short of complete responsibility to national authority. No special taxation was prescribed for the purpose of compelling the adhesion of distrustful or reluctant banks, but the language used by the advocates of the new law left little room for doubt that such measures would follow. For the present it was enough that the current of public opinion was setting in favor of the national system, and that many who had once opposed it now accepted the settled policy of the government and withdrew their opposition.

The hesitation of the state banks as to reorganizing under the national system began to give way in the summer of 1864. The discussion of the system in Congress and the adoption of the amended act removed many special objections to the law, and made it certain that final acquiescence would be the only condition on which the right of issue could be enjoyed. The financial strain of the war and the depreciation of the currency, shown by the price of gold, which fluctuated violently between 200 and 285, had put an end to all probability of an early recovery, and made a long dependence on legal-tender paper of uncertain value altogether likely. To adjust themselves to the present state of things began then to be thought wise by many who had hitherto maintained a merely expectant attitude. The announcements of intention to reorganize began to be frequent in June and July. At the close of November the Comptroller reported that 584 national banks were in existence, of which probably about one-third were reorganized state banks; and he was able to say that of the last 100 banks organized, 67 were state banks, that nearly all the bank-

¹ This exemption applied to existing state banks having a capital of not less than \$5,000,000 and a surplus of twenty per cent.

ing capital of Philadelphia had then been reorganized, and that of the numerous applications then coming in most were for the conversion of old banks. It was noticeable, however, that at that time only one of the banks in New York City had reorganized, although several new banks had been established under the national system. Indeed, the Comptroller was plainly embarrassed by the hostile influence of the banks in New York; for after noticing the fear of some that the national banks might reproduce the evils of the weaker state banks, he remarked in thinly veiled language that these apprehensions, entertained "or professed to be entertained by the bankers of a state, in which a system similar in some of its main features was in practical operation, intimidated for a time the capitalists of other states, and retarded the reorganization of state banks." A group of New York banks, however, took steps looking in the direction of reorganization in December;¹ by the end of that month 21 of the Boston banks had reorganized, and the stream of applications soon became so strong that nearly 500 banks were chartered in the five months from December 1, 1864, a large proportion of them being state banks reorganized. The change from the old system to the new went on throughout the year 1865, and at the close of December was nearly complete, 1582 banks then reporting to the Comptroller, of which more than 900 were formerly state banks.

Several influences had expedited this change. In the states having a large amount of bank capital, enabling acts had been passed in many cases, authorizing incorporated banks to exchange their state charters for those of the United States without dissolution or winding up, thus preventing the expense, interruption to business, and loss incident to the collection and distribution of assets which would otherwise have been necessary upon the cessation of corporate existence under state laws, and making the reorganization a merely formal proceeding which left the identity of a bank unchanged. Acts of this sort were adopted in 1863 and

¹ The Fourth National, the first bank with large capital to be organized in New York under the national system, was due to the influence of Jay Cooke; and the fear of the formation by him of a bank with a capital of \$50,000,000 is said by Mr. Cooke to have been a factor in the change of policy of the other banks. See "A Decade of American Finance," *North American Review*, November, 1902.—EDITOR'S NOTE.

1864 by Massachusetts, Connecticut, and Pennsylvania, and early in 1865 by Maine, Rhode Island, New York, New Jersey, Maryland, and Indiana. In some states, also, as in Massachusetts, the neglect or disinclination of the legislature to repeal the special tax laid by the state upon its banks had a serious effect in turning the scale in favor of change.

Far more important, however, was the influence exerted by the belief that Congress would take steps to drive from the field all notes issued by state banks, and the passage of a measure for this purpose, to take full effect in 1866. The Comptroller of the Currency, in the first year of the new system, had refrained from advising any such action, but in his report of 1864 he clearly expressed the opinion that the time had come for Congress to compel the withdrawal of all state issues.

When the bill amending the internal revenue act came before the House at the session of 1864-1865 this subject was discussed in a somewhat desultory manner, and opinion was found to be evenly divided, but the House finally, on February 18, by a vote of 68 to 67, inserted in the bill a section imposing a tax of ten per cent on all state bank notes paid out by any national or state bank after January 1, 1866.¹ The bill then went to the Senate, and on March 1 a motion to strike out this section was refused by a vote of 20 to 22. On the next day the section was amended by substituting July 1 for January 1 as the date when the tax should take effect, and a motion to strike out was then refused, 17 to 21. This amendment was assented to by the House upon the report of a committee of conference, and the section accordingly became a part of the internal revenue amendment act, approved March 3, 1865. It was looked upon by all parties as the natural sequel of the national bank acts, delayed by doubt or policy for a time, but in fact a vital part of the scheme. It suppressed the state bank notes by destroying the profit of issue, but it avoided the severity of some propositions for the same object, which would have taxed outstanding circulation, or would have taken effect earlier; and this degree of moderation was apparently necessary for the success of the measure in either House. Adopted at a moment when the establishment of the national system was well advanced, the section stood as a threat

¹ 13 "Statutes at Large," p. 484.

for the next sixteen months; and when at last it took effect, the state bank issues were rapidly disappearing.

There is no doubt also that the high premium on gold from the spring of 1864 to the spring of 1865 had an important influence in bringing many banks to an immediate decision of the question of reorganization. When the suspension of specie payments took place, the banks in twenty-two loyal states, excluding those on the Pacific coast, held not far from \$76,000,000 in specie, of which the banks of Boston, New York, and Philadelphia held \$33,000,000. During the year 1862 the holdings for all the states referred to were above \$81,000,000, and the banks in the three cities at the end of the year had a specie reserve of \$48,000,000. The high rates for gold which prevailed throughout 1863 tempted many banks to sell their coin, and probably caused a considerable redistribution of that which remained; but in January, 1864, the banks in the three cities still held \$37,000,000. Gold was then quoted at one hundred and fifty-one, but it soon began to advance rapidly. On the 21st of June it passed two hundred, and with violent fluctuations remained above this point for most of the time until March, 1865. There was plainly a strong inducement for banks holding large stocks of gold but carrying on their business upon the paper basis, obliged to receive legal-tender notes in all payments, and not bound to make payment in any other medium, to sell their specie for legal tender at these high rates. So long as any need of preparation for eventual specie payments had been felt to exist, or so long as further advance in the premium on gold was looked for, the specie might well be held; but as affairs stood in the summer of 1864 it is not surprising that the disposition to collect the profit to be made by the sale of gold began to strengthen.

Not a few of the more conservative managers of the banks saw with regret this tendency to place the whole business of banking upon the paper basis and were reluctant to admit that all the responsibility for facilitating an ultimate return to the specie standard could be thrown upon the government. From several quarters the proposition was made that the national banks should be required to accumulate as a specie reserve some part of the coin interest received by them on the bonds deposited to secure their notes. The New York Clearing-house banks proposed a small accumulation of this kind, which was rejected by

the House without a count. In the Senate, Mr. Collamer of Vermont proposed that one-half of the coin interest should be added by the banks to their reserves until the entire reserve required by law should consist of coin. Amended so as to require but one-fourth of the coin interest to be so retained, Mr. Collamer's proposition was rejected by a vote of 15 to 20; and thus the amended law of 1864 went into effect in a form which completely ignored the question of providing for a return to specie. The banks sold their gold freely as a preparation for reorganizing under the national system, and the gold thus released swelled the strong current of exported metal, forced out of the country by the paper currency in the years 1864, 1865, and 1866. By July, 1865, the specie held by the banks in the three cities, Boston, New York, and Philadelphia, had sunk to \$20,000,000, and by January, 1866, the aggregate of specie held by the 1582 national banks of the United States was under \$20,000,000, and so far as shown by the quarterly reports it remained below this point until 1868. In some cases the profit reaped by the banks from the sale of their specie, with other undivided profits already in hand, was paid out as an extra dividend to stockholders upon the surrender of the state charters; in others it was used as the foundation for the surplus which national banks were required to accumulate to the extent of one-fifth of their capital, or was added to surplus funds already held; and in others still the opportunity was taken to increase capital by making stock dividends.

THE CIRCULATION OF THE NATIONAL BANKS, 1865-1900¹

THE effects of the rapid conversion of state banks into national were visible for many years, in the unequal distribution of capital under the national system between the several states and sections. The amended bank act of 1864 repealed the provision for apportioning the \$300,000,000 of bank circulation among the states, and early in 1865 it began to be seen that, by the conversion *en masse* of the banks in states well provided with banking capital, the limit of aggregate circulation was likely to be reached so soon, as to leave little opportunity for the enjoyment of the right of issue in states where the number of banks already organized was small. By a mistake of administration, an effort made by Congress to provide for this possibility only hastened the absorption of the right of circulation by the states which could most easily make use of it at short notice. A clause in the act of March 3, 1865, for amending the bank act, revived the provision by which circulation should be allotted to banks in the several states, one-half according to population and one-half according to existing banking capital, resources, and business.² In the internal revenue amendment act of the same date, however, a section was inserted providing that any state bank having a capital of \$75,000 or more, applying before the first day of July, 1865, for authority to become a national bank and found to be in good credit, should receive such authority in preference to new banks applying for the same.³ It was clearly possible to interpret the two provisions so as to give effect to both, by simply giving the banks already existing in any state the preference in allotting the circulation apportioned to that state; and the two acts being of even date and neither provision purporting to limit or control the other, it was plainly the duty of the treasury authorities to execute both.

¹ See note, p. 314 above.

² 13 "Statutes at Large," p. 498.

³ *Ibid.*, p. 469.

Mr. Clarke, the Comptroller of the Currency, however, with the approval of Mr. McCulloch, who had then become Secretary of the Treasury, adopted a course which rendered the provision for apportionment entirely nugatory. Starting from the correct assumption, that it was the purpose of Congress as well as of the administration to effect the general conversion of the state banks, the comptroller proceeded to give to existing banks coming under the national system authority for the issue of currency, as fast as they applied, without regard to the provision of law limiting the amount to be allowed to any one state. The states, which already had much banking capital and were ready to move at once, had therefore the good fortune to see their banks easily provided with the right of issue, while the states which came later, or which had to organize new banks, soon found the aggregate so far filled up as to leave little or no room for them. The fact that the preference allowed to existing banks was confined to such banks as should apply before July 1 hastened the applications, and therefore some time before that date was reached the elaborate apportionment of circulation contemplated by Congress had been buried beyond the possibility of resurrection.¹ As early as June 10, 1865, more than \$250,000,000 out of the aggregate of \$300,000,000 had been authorized. Massachusetts, Rhode Island, and Connecticut, where the existing banks had gone over to the national system almost in a body, were entitled under the legal apportionment to less than \$34,000,000, but had received authority for \$85,000,000. New York, New Jersey, Pennsylvania, and Ohio had more than filled their legal quotas; the West and Northwest, Indiana and Minnesota excepted, generally were still short of theirs; and the states in the South and the states and territories west of the Missouri entitled to nearly \$100,000,000 had received authority for only about \$5,000,000, of which nearly three-fourths was in Kentucky and Missouri.² From the 22d of May, banks in New York, Philadelphia, Providence, Boston, and Hartford, applying for conversion, were called upon to waive their rights to ask for currency in excess of one-third of their capitals; but it was then too late to do much

¹ In a debate in the Senate, a few years later, Mr. Sherman declared "that this whole difficulty grew out of a disregard of the law; that it was not the defect of the law, but a violation of the law." — *Cong. Globe*, January 24, 1870, p. 699.

² *Bankers' Magazine*, July, 1865, p. 54.

more than take precautions against overrunning the aggregate of \$300,000,000. Apparently not all of the circulation, applied for and at first allotted in these hasty proceedings, was actually issued; but a startling result showed itself in October, 1866, when \$292,673,000 of notes had finally been given out for circulation. The allotment between certain groups of states then stood as follows:¹—

	Quota if apportioned In millions	Amount issued In millions
Of states having an excess :		
Six New England	\$45.7	\$103.5
Five Middle	94.9	124.2
Ohio, Indiana, Minnesota	28.3	30.7
Of states deficient :		
Six Western	37.7	18.9
Kentucky, Tennessee, Arkansas	22.	3.6
Nine Southern, Atlantic, and Gulf	66.2	6.9

It is probable that in this remarkable disregard of the rule of apportionment laid down by Congress, both the Secretary of the Treasury and the Comptroller of the Currency were taken by surprise by the extent and rapidity of the movement for the conversion of state banks, and that they also had a mistaken belief that, after all, the resulting disproportion would not be of long duration. The fact already noticed, that a large number of the Eastern banks applying to be admitted as national banks late in May, 1865, were induced to agree to a reduction in the amount of circulation which they could claim, indicated that the demand for the right of circulation by the Eastern and Middle states had gone beyond the amount which could be readily used. For several reasons, moreover, the authorities at the Treasury may have underrated the real importance of the inequality which they were sanctioning. It was the opinion of the Comptroller that the establishment of an effective system of central redemption for national bank-notes would materially curtail the issue, and would destroy the interest of many banks in keeping up a large circulation.² An active move-

¹ The quota for every state, if \$300,000,000 of circulation had been apportioned according to the act of Congress, is shown in 7 *House Exec. Doc. No. 33 of 1865-1866*. The amount issued to banks up to October 1, 1866, in the aggregate, \$292,673,000, is given for every state in the *Comptroller's Report* for that year, p. 66.

² See *Comptroller's Report* for 1865, p. 6; and also a letter by the Comptroller, dated July 15, 1865, in the *Bankers' Magazine* for September, 1865, p. 205. Mr. Hurl-

ment was then in progress for establishing such a system, and for maintaining assorting houses in New York, Boston, and Philadelphia, from which all notes of banks not providing for the par redemption of their notes in one of these three cities should be promptly sent home for payment.¹ The general principle of this scheme appears to have been sanctioned by the Secretary, and the expectation of some such action was assigned by the Comptroller as a ground on which some banks, unable to secure any part by the right of issue, might hope to obtain a share at a future time. The effect of a system of real redemption in sending home the notes of any bank after a brief currency, may therefore very well have been counted upon as a probable discouragement of weak banks, and as likely to make the original allotment of the right of issue, in part at least, merely provisional.

It must also be borne in mind that in the spring and summer of 1865, the expectation of an early movement toward specie payment was general. The Secretary of the Treasury was strongly in favor of such a movement, and in his report in December even fixed upon January 1, 1868, as the date at which he believed redemption practicable.² Although in the winter of 1865-1866 he had the mortification of seeing developed in Congress a serious opposition to his efforts in this direction, and was forced to submit to a jealous limitation of the powers which he thought necessary for his purpose, still, for many months after the close of the war in April, 1865, he was strong with the public and confident in his policy, and he even appeared to have the support of Congress when it met in December. With the expectation then that specie payments were not far distant, he may easily have believed that the bank circulation would soon right itself by the disappearance of all provisions for any limit of the total amount of bank-notes. The national bank act was so drawn as to adapt itself in all other respects to the state of things in which coin should become the only legal tender, and Mr. McCulloch therefore not improbably believed that free banking would soon supersede the embarrassing burd, who was Deputy Comptroller in 1865, and afterwards Comptroller, urged the importance of the central redemption and its restrictive influence in all his reports from 1866 to 1870.

¹ For the action of the banks of the three cities on this subject, and for a letter by Mr. McCulloch, see *Bankers' Magazine*, 1865-1866, pp. 193, 401, 415.

² See *Finance Report*, 1865, p. 36.

provisions of the existing act. Entertaining such a belief, he was not by nature the man to be strict as to the precise terms of the authority upon which his powers rested. It may also have been thought that the agricultural states of the South and West would not be able to use their quota of circulation without a good deal of delay, and the relief of resumption would be early enough to meet their needs. Considerations of this nature were no doubt strengthened by the fact that to limit the circulation of banks in the Eastern and Middle states to the proportion required by Congress would have caused a heavy reduction of the bank circulation enjoyed by those states for many years under the system of state banks.

The attainment of the limit of aggregate circulation instantly checked the growth of the national banking system, as regards the number and capital of the banks organized. 1644 national banks reported to the Comptroller October 1, 1866; the number rose slightly the next quarter, and then fell off, became stationary, and at last declined, until in October, 1870, it was 1615, sixty banks having in the meantime gone into voluntary liquidation. The capital of the banks rose from \$415,050,000 to the neighborhood of \$420,000,000, where it stood until near the middle of 1869. These figures sufficiently show the restraint upon the organization of new banks, at a time when dividends averaging ten per cent and a considerable increase of surplus showed that the banks organized under the system were in the main prosperous. But this restraint was felt in different parts of the country in very unequal degrees. In the Eastern and Middle states, although the wealth and activity of the community gave them a wide field for the employment of banking capital, the large share of circulation which they had obtained under the national act gave them a provision adequate to their needs for several years. The greater density of their population, moreover, would have made it easier for them in any case to supply deficiencies by banks of deposit and discount under state laws or by trust companies, the convenience of which for some banking purposes was then beginning to be understood. But in the West and Northwest the condition of things was far different. Those sections felt the keen stimulus to enterprise which the restoration of peace had brought with it. Their populations were once more rapidly increasing by immigration; their railway systems were opening up new territories with feverish

haste; and there was every presage of a period of wonderful growth. But the increase of banking which should normally attend and foster this development was practically impossible. For the multiplication of banks of issue there was no room under the national system, and mere banks of deposit and discount under that system neither answered the needs of the community, nor presented attractions to capital. In the group of Western states already noticed as deficient in bank circulation in October, 1866, there was, therefore, a gain of only three national banks in the next four years. The gain in circulation in the same states was for the same period only \$5,000,000, in spite of the most ingenious and sometimes costly efforts to secure the rights surrendered by banks going into liquidation or contracting their business.¹

With the central Southern states and those of the Southern Atlantic and Gulf group, the case was even worse. Many of those states had been devastated by the war and all of them had suffered heavy losses of property. Their social and industrial systems had been overturned and, with everything to be reconstructed, they were harassed by misfortune, political as well as economic. In any case, they must have been slow in rebuilding their banks and probably dependent in good degree upon the reluctant aid of outside capital. It is doubtful whether, if entire freedom of organization had then existed, the South could in those years have done much toward the extension of its banking upon any sound basis. Before this could be accomplished time was needed, not only to repair the losses of the war, but to secure political peace and confidence in the future, and to enable the South, moreover, to regain possession of its own state governments. There is little question, however, that the process of financial reconstruction was made slower and more difficult by the impossibility of securing any reasonable share of the right of issue. In the four years from Octo-

¹ Mr. Sherman asserted in the Senate in June, 1868, that "there are banks in existence in the Western states that have paid from ten to forty thousand dollars in New England and New York for the privilege of starting banks whenever banks there have failed." Mr. Pomeroy added that "the banks of the West have been compelled to buy the circulation of New England and New York and pay three and four per cent for it." *Cong. Globe*, 1867-1868, p. 3187. In 1872 the rate paid to brokers for notes of banks closing or insolvent, was said to be "from four to six per cent." — *Finance Report*, 1872, p. 74.

ber, 1866, the nine Southern states on the coast lost five of their forty-eight banks, and gained less than \$2,000,000 in circulation. The interior group, Kentucky, Tennessee, and Arkansas, gained nine banks, chiefly of small capital in Tennessee, but with an increase of circulation of only \$700,000. Whether the South could otherwise have availed itself of the national system to any great extent or not, it appeared to be practically cut off from making the trial, by the absorption of the right of issue in the North and East.

It must not be forgotten, however, that even if the apportionment had been carried out in strict compliance with the terms of the law, the evils complained of would only have changed their place without being prevented. The theory on which Congress proceeded, of allotting the right of issue, in proportion partly to population and partly to an indefinite basis of estimated capital, could never have distributed the note issue in the proportion in which it would have distributed itself if left entirely free. Probably the existing banking capital and surplus would have made a much nearer approach to a natural allotment than the basis proposed by Congress, since it represented more nearly the essential needs and capacities for banking as they then existed in the several parts of the Union. The allotment of a limited amount of circulation upon the basis adopted by Congress would have given the South and West freedom for bank expansion, which they might or might not have used, but would have compelled a heavy reduction of banking facilities in the Eastern and Middle states, not only checking their natural growth, but causing a positive diminution of existing financial machinery. The conditions of the case presented a dilemma, therefore, from which there was no escape so long as the limit upon the aggregate issue of bank-notes should remain.

The course pursued by the Comptroller, as has been seen, threw the pressure of a limited right of issue upon the South and West. The sections thus harshly treated were not slow in making their complaints heard. Little notice was taken of the subject in the reports of the Secretary and Comptroller for 1865, but some effort was made in Congress at the session of 1865-1866 to find a remedy. The choice lay between an increase of the aggregate issue and the withdrawal of circulation from states having an excess under the rule established by Congress, and its distribution among those found

deficient. The latter expedient met strong opposition from the states which would have been drawn upon for the supply of the others; and an increased total issue was also opposed as threatening a multiplication of the obstacles to early specie resumption. Congress found it impossible, either at that session or at several succeeding sessions, to act upon a question thus beset with difficulties. At the session of 1867-1868 a bill passed the Senate,¹ withdrawing and redistributing \$20,000,000 of bank circulation; but the House at the next session substituted for this plan a provision for the allotment of \$150,000,000 of circulation according to the appraised value of property in the several states,² and the end of the session found the two Houses in hopeless disagreement.³ At the spring session of 1869 the Senate passed a bill redistributing \$30,000,000,⁴ but no action was taken upon it in the House.

At the session of 1869-1870 the subject again came up and, after much debate and a series of disagreements between the two Houses, a bill was framed to reconcile the differing opinions of those who agreed as to the necessity for some action for the relief of the South and West. Under two acts passed in 1867 and 1868 Congress had authorized an issue of temporary loan certificates, to be used in redeeming certain legal-tender compound-interest notes issued in the latter part of the war. These certificates, bearing interest at three per cent, by the terms of the act authorizing their issue could be held by banks as part of their reserve, and were still outstanding to the amount of \$45,500,000. The withdrawal of this amount of paper serving one of the purposes of money was accordingly proposed as an offset for an increase of national bank-notes, and upon this basis Congress passed the act of July 12, 1870.⁵ This act provided that \$54,000,000 of bank-notes might be issued to banks in states having less than their due proportion under the act of 1865, and that the three per cent certificates should be called in and redeemed as fast as the bank-notes should be issued. This operation completed, a further amount of \$25,000,000 was then to be withdrawn from states having an excess of bank circulation, and issued to banks in states having less than their due proportion; and provision was also made by which, in addition,

¹ *Cong. Globe*, 1867-1868, p. 3222.

² *Ibid.*, 1868-1869, p. 1333.

³ *Ibid.*, p. 1897.

⁴ *Ibid.*, 1869, p. 371.

⁵ 16 "Statutes at Large," p. 251.

banking associations might be moved from any state having an excess of bank circulation to any state found deficient.¹ The same measure provided for the establishment of gold banks, issuing notes redeemable in gold coin upon the security of United States bonds, and in other respects carrying on their business upon a gold basis. This addition to the national system was made in view of some supposed needs in the Atlantic ports and also of the anomalous condition of the Pacific states, where, by popular will, aided by local legislation, the gold standard had been retained during and after the war.² It was in fact an experiment in free banking on the specie basis.³ The gold notes to be issued were not subject to any aggregate limit, and their introduction was not looked upon as having any relation to the questions raised by the mass of inconvertible paper. The establishment of such a system carried with it, however, some implication that the redemption of the remainder of the national currency in specie was now felt to be too remote to be counted upon. This impression was confirmed by the course of debates on the various plans for a redistribution of the national bank issues, and by the strength of the minority which favored the plan of giving relief to the South and West by some form of paper expansion.

There was no delay in taking advantage of the act of 1870. When the Comptroller made his next report, dated November 7, 1870, thirty-one banks had already been organized under the new law, and two hundred and fifty applications were on file. Many of the latter were believed to be speculative or unsupported by capital; but it was clear that a considerable movement had started.⁴ Of the banks organized twenty were in the Western states, eight in Kentucky and Tennessee, and only three in Vir-

¹ The Senate had proposed an increase of \$45,000,000, and the House \$95,000,000. The Senate conferees agreed to \$54,000,000 as the equivalent of \$45,000,000, and of the reserves, estimated at 20 per cent, which the banks would have to keep; and this calculation was accepted on the part of the House. — *Cong. Globe*, July 6, 1870, p. 5285.

² See an article by Professor Moses, "Legal-tender Notes in California," in the *Quarterly Journal of Economics*, October, 1892.

³ The bill as passed by the Senate provided that the notes should be redeemed in "gold or silver coin." "But," said Mr. Garfield, one of the conferees on the part of the House, "we strike out the words 'or silver,' so that there shall not be two metals named as the money in which the notes shall be redeemed. *Silver is not, under our laws, a legal tender except for sums of five dollars or less.* To this modification the Senate agreed." — *Cong. Globe*, June 28, 1870, p. 4949. ⁴ *Comptroller's Report*, 1870, p. 25.

ginia and Georgia; but of the applications nearly one-fourth, representing one-third of the capital called for, were from the Southern coast states. The movement thus begun went on, until at the close of 1873 Mr. John Jay Knox, who had then become Comptroller of the Currency, reported that all but a small fraction of the additional \$54,000,000 had been issued or authorized, and that he should next proceed to the withdrawal of \$25,000,000 of circulation from the banks of Massachusetts, the city of New York, the city of Providence, and Connecticut, and its allotment among banks in states having a deficiency. This allotment it was necessary to make, under the terms of the act of 1870, on the basis afforded by the census of that year, and the Comptroller had already given a table in his report for 1872, showing the circulation then actually authorized and the allotment of \$354,000,000 which would be required under the law of 1865.¹ This table and the returns for 1870 and 1873 enable us to make the following comparison:—

	CIRCULATION OCTOBER 1, 1870	CIRCULATION NOVEMBER 1, 1873	CIRCULATION IF APPORTIONED
Of states having an excess in 1866:			
Six New England	104.5	110.5	39.8
Five Middle	125.4	124.6	115.2
Ohio, Indiana, Minnesota	31.	41.9	43.9
Of states deficient in 1866:			
Six Western	24.7	42.5	43.9
Kentucky, Tennessee, Arkansas . .	4.1	11.2	21.5
Nine Southern, Atlantic, and Gulf .	6.1	16.6	47.8

These figures show plainly the strength of the demand for banking facilities in the deficient sections. They also show the singular crudity of the expedients by which Congress had undertaken the apportionment of bank circulation. Upon a mixed basis of population and resources the West, even with the relief afforded by a fresh allotment under the new census, was sure to find its proportion under the law too narrow for it; and the South was as certain to find it impossible to use its quota, even when

¹ The acts of 1863 and 1865 called in identical words for the apportionment of half of the issue, "having due regard to the existing banking capital, resources, and business" of the states. In 1872 Mr. Knox, after consultation with the Secretary of the Treasury, contented himself with using the reported valuations of the states found in the census, in satisfaction of the above requirements. See *Finance Report*, 1872, p. 72. In 1865 Secretary McCulloch made an allotment which is not to be reconciled with the valuation of 1860.

reduced in accordance with the diminished importance of those states. It is easier, however, to see the defects of the method adopted than to imagine a substitute which would have made any satisfactory allotment of a limited right of issue. As regards the mere use of the bank-notes as currency, they flowed like the legal-tender notes with the current of mercantile payments, and the place of issue was as little important in the one case as in the other. Once in circulation, a bank-note passed from hand to hand without inquiry as to the particular bank from which it was issued. Its source was easily seen, but in the absence of any effective redemption there was no motive for returning it thither, and so it passed as an undistinguished drop in the ocean of paper currency. As early as 1868 the Comptroller complained that even the notes of banks in liquidation were not presented and that the owners of such banks were able to reap all the benefit of their circulation after they had ceased to carry on any real business; and it was to meet this evil that the act of July 14, 1870, was passed, requiring all banks in liquidation to deposit lawful money and withdraw their bonds from the Treasury within a fixed limit of time.¹ This legislation hastened the settlement between the issuing banks and the Treasury, but the notes, whether issued by active or by defunct banks, still gravitated as slowly as ever toward the place of redemption. In short, the bank-note was nearly as destitute of any domicile as coin itself, and therefore it followed that, of the whole mass of currency afloat at any given moment, any particular state enjoyed only such proportion as it was entitled to by its financial relations with other states and sections, as it might in the case of coin or of legal-tender notes. The debtor states were deficient in anything that could serve as a medium of payment, and the creditor states found currency abundant. It is not to be supposed then that the South or any part of the West really had less currency for use by reason of their failure to obtain their proportion of the right of issue.

Those states undoubtedly suffered from a lack of general bank accommodation. The requirement made by the law that every national bank, whether issuing notes or not, should qualify itself for issue by a deposit of bonds equal to at least a third of its capital, was by itself a serious drawback for banks in most parts

¹ 16 "Statutes at Large," p. 274.

of the North and West, for it diverted an important fraction of their scanty capital from its primary function as a supply of loans for the local demand. For city banks, deriving any considerable aid from deposits, this locking up of capital might not be a serious difficulty, but for banks in sparsely settled districts it made the situation difficult. When failure to obtain the right of issue was added to the diversion of capital from loans to bonds, the country banks found themselves practically excluded from the national banking system and sometimes from all banking except as private banks. State banks under imperfect regulation or private bankers were then the chief resort for the deficient states and sections. Hampered in some degree these states and sections probably would have been in any case, being poor in capital and, at least in the South, unable for a time from political causes to secure a free supply of capital from outside; but their situation, unfavorable in any case, was made far worse by the singular manner in which the law had been made to operate upon them.

With the great financial revulsion of 1873 the national banks and the legislation of Congress for their regulation entered upon a new stage of development. The complete prostration of business from the latter part of September, 1873, instantly checked the establishment of new banks, so that a comparison of the returns of September 12, 1873, and June 26, 1874, shows an increase of only seven banks and an absolute loss in both capital and circulation. A comparison by states shows that the sudden loss of inducements for the investment of capital in banking was universal. To a large party in Congress, however, this continued depression appeared to be the result of a deficient circulation, and not of that loss of confidence which must follow a panic under any system of currency whatever; and the assembling of Congress was the signal, therefore, for a multitude of propositions for the increase of paper issues, for their extension, especially in the states poor in capital, and for warding off the supposed evils of contraction and approach to the specie basis. On the other hand, the advocates of specie payments found the moment opportune for pressing the argument that the destruction of credit and the depression of prices by the financial panic had already done the worst that could be feared from contraction, and that there was neither excuse for delaying resumption nor safety to be found without it.

A wearisome debate of several months produced a bill for increasing the issue of legal-tender notes and of bank-notes to \$400,000,000 each, and this measure was vetoed by President Grant, after some vacillation which had nearly caused his approval of the measure. Congress, then, after two months of further consideration, passed a bill which became a law June 20, 1874, by which \$30,000,000 was added to the sum of \$25,000,000 which, under the act of 1870, was to be withdrawn from banks in states having an excess of bank currency under the legal allotment and distributed in states found to be deficient.¹ The act further provided for discontinuing the redemption of bank issues by agents in the redemption cities, and substituted the method of actual redemption at the Treasury of the United States, every bank being required for that purpose to maintain in the Treasury a deposit of cash equal to five per cent of its outstanding circulation.² The law also made an important provision for the relief of banks which found the right of issue unimportant, by authorizing any bank, upon the withdrawal or reduction of its circulation, to reduce its deposit of bonds to any amount not less than \$50,000.

Of these provisions of the act of 1874, those relating to treasury redemption and to reducing the deposit of bonds are still in force and have never ceased to be regarded as valuable improvements, defective only from their failure to go far enough. Although successive Comptrollers have seen in treasury redemption only a provision for securing a physically clean issue of notes, it has been the means of sifting out from the mass of notes somewhat more certainly and expeditiously the issues of insolvent or closing banks, and has also done something to maintain the theory of a system of central redemption, which a turn of affairs might almost any day have made important. The diminution of the compulsory investments in United States bonds was a step toward freeing the banks from making more use of the right of issue than their business naturally required. Banks of small capital, required to invest one-third of it in bonds, were left under the necessity of using the credit which so large an investment would afford.³ Still, the act

¹ 18 "Statutes at Large," p. 123.

² The notes ceased to be subject to the general reserve requirements which had hitherto applied to them as well as to deposits.

³ Mr. Knox, the Comptroller, had advised, in 1872, that the requirement be reduced to a deposit of \$10,000 of bonds.

of 1874 left the larger banks, for whom \$50,000 invested at a low return was not so serious a matter, more freedom of action than had been allowed them before, and so had some tendency to diminish issues in the important banking centres, and, therefore, to make room for increase of issues elsewhere.

So far as the act of 1874 provided for the redistribution of a part of the bank circulation, it followed the line marked out by previous legislation, and endeavored by small and temporary adjustments to arrive at such an apportionment of a limited issue as should satisfy the most clamorous of present needs. If the new provisions had been long-lived, the question of some fresh adjustment must have come before Congress before long in the familiar form of a contest between the thriving younger states and the richer banking communities of the East; but happily the moment was near when decisive measures for the return to specie payment destroyed all anxiety as to the allotment of bank issues. In fact, the stress of the times began to narrow the field for circulation even before the passage of the resumption act. The returns of the banks for October and December, 1874, showed a loss in circulation of more than \$7,000,000 for the last half of the year. This was the net result of new or increased issues of notes on the one hand, and of still more important surrenders of issue on the other, irregularly distributed, and showing important changes of banking conditions in particular states. Down to November 1, New York and Missouri each surrendered more than \$2,000,000; Kentucky, Indiana, and Illinois together received more than \$2,000,000.¹ The Comptroller reported at the beginning of the session that the withdrawals of notes by some banks and the liquidation of others placed at his disposal \$14,200,000 of circulation, probably enabling him to satisfy demands from new banks for some months to come.²

The demand for the right of issue was declining, therefore, when Congress, by the resumption act of January 14, 1875,³ providing for a return to specie payment in 1879, repealed all provisions of law, fixing a limit to the aggregate of bank circulation, and thus introduced free banking from the date of the act. The present narrative does not call for any review of the circumstances under which the resumption act was passed, or any estimate of it as a measure

¹ *Comptroller's Report*, 1874, p. 128.

² *Ibid.*, p. 129.

³ 18 "Statutes at Large," p. 296.

for carrying out a great reform. It succeeded, and by making the greenback redeemable in coin brought the banks also to a coin basis on the day appointed. The introduction of free banking was an essential part of the plan of operations by which this was to be effected. The act contemplated the substitution of national bank-notes for greenbacks and the possible reduction of the latter by this process to \$300,000,000, as a preliminary for the safe resumption of payment on the remainder. The issue of bank-notes was made free, therefore, with the cautious provision that as fast as notes should be issued to new banks or to banks increasing their circulation, legal-tender notes should be withdrawn to the amount of eighty per cent of the bank-notes thus issued, this arrangement resting on the calculation that an issue of bank-notes would in its practical working imply a reserve of not far from twenty per cent, so that the effective addition to note circulation by the banks would be tolerably well offset by the withdrawal of greenbacks, and no important change be made, therefore, in the amount of paper in circulation.

The course of affairs in the next few years defeated many predictions as to the operation of the resumption act. The depression which had followed the great revulsion of 1873 continued and even deepened in the years from 1875 to 1878. The loans of banks fell off somewhat in the general stagnation of business, and it was not until 1879 was well advanced that the banks again had full employment for their funds. But these discouraging conditions did not act uniformly upon all sections nor upon all localities or banks in any one section. In some cases additional banking capital and circulation was called for, and in others banks reduced their circulation as allowed under the act of 1874, or even went into liquidation; and thus the actual change which took place was the net result of two opposing movements. For the last half of 1874 the issues of new circulation somewhat exceeded the withdrawals; but in 1875 the withdrawals exceeded the new issues, and in 1876 the decline of bank circulation was strong. For the year ending November 1, 1876, with issues of new circulation amounting to a little more than \$7,000,000, the amount retired under the act of 1874 was over \$24,392,255, the amount retired by banks in liquidation was \$3,114,726, and \$4,022,883 was surrendered by banks not relinquishing the right of issue. This made a net loss of circulation of about \$24,000,000, in which all the sections and nearly all the states par-

anticipated, although in unequal proportion.¹ The year ending November 1, 1877, also showed some excess of withdrawals, although a considerable increase was shown by New York and New England. The tide turned in the year ending November 1, 1878, and in 1879 the national bank circulation had its part in the general activity. That its inability to grow under the freedom of the resumption act was in part the result of general business conditions is clear from the fact that the dividends of the national banks fell from 10.96 per cent of capital and surplus in 1873 to 5.49 per cent in 1879; and that the aggregate surplus of all the banks in the system, which had steadily gained until the middle of 1875, from that point fell as steadily until the middle of 1879, declining from \$133,000,000 to \$114,000,000.

But besides the discouragement which the banks at this time felt in common with all business interests, they had begun to suffer from one special depressing influence, which was destined to have a lasting effect on their gains from the right of issue. In 1870, of the bonds deposited by the banks to secure their circulation, nearly three-quarters bore interest at 6 per cent and the remainder at 5; by 1876 the refunding of the former had gone so far that less than one-third of the bonds on deposit were 6 per cents; by 1879 more than one-third of the bonds were at 5 per cent; and in 1883 the deposit of \$348,000,000 was made up of \$41,000,000 at 4½, \$106,000,000 at 4, and \$201,000,000 at 3. The circulation of the banks, which from the end of 1879 to the end of 1881 had fluctuated between \$300,000,000 and \$325,000,000, began to decline in 1882 and was withdrawn with some regularity until in the first half of 1891 it stood at about \$123,000,000. The turning-point was reached when in the summer of 1891 the price of the United States 4 per cents fell enough to return to the purchasers of bonds nearly 3 per cent and the circulation slowly increased until in May, 1893, it had reached \$150,000,000. During the summer many banks took out further circulation to supply the demand for money suitable for everyday use, the dearth of which was one of the most striking features of the crisis of 1893, and by October the total note issue stood at \$183,000,000.

¹ The New England and Middle states lost in circulation \$11,800,000; the Central states, \$7,300,000; the South and Southwestern states, \$4,300,000. — *Comptroller's Report*, 1875, p. 253, and 1876, p. 262.

In the disturbed years which followed the issue fell slightly, then rose to nearly \$211,000,000 at the end of 1896, with a further increase of the earning power of the investment in bonds, and during the three years following fluctuated between \$191,000,000 and \$215,000,000.¹ The experience of these years proved that the expansion or diminution of national bank currency was powerfully affected by an influence quite distinct from the need of bank currency for use by the public. Mr. Chase, when advocating the adoption of the national system, had foreseen the possibility that payment of the public debt might compel "a future generation" to find for the bank-notes some security other than United States bonds,² but it probably did not occur to him or the other founders of the system that the rise of public credit by itself might cause the curtailment and even threaten the extinguishment of the note issue.

The unexpected results of the bond requirement were of course moderated by the wise provision of the act of 1874, referred to above, making \$50,000 the maximum amount of bonds which a national bank is compelled to deposit. But even with this material modification the bond requirement has been a serious element in determining the geographical distribution of the national banks. The causes which to a considerable extent excluded many states in the South and West from taking any important share in the system down to the passage of the resumption act in 1875 have already been stated: In the years of depression which followed, ending with the actual resumption in 1879, these sections suffered serious losses in national bank capital and circulation, losing far more than their proportion of the total diminution in the United States. The great revival of business which began in 1879 and the improved political and industrial condition of the South increased the need of banking facilities and made it easier to provide the necessary capital, but any considerable expansion of national banking in the South and West, except in a few of the wealthy and rapidly growing states of the Middle West, was then checked by the rising value of government securities and the consequent low return afforded by them. The distribution of the national banks therefore underwent little change. The system continued

¹ See a table giving the investment value of United States bonds, in the *Report of the Comptroller of the Currency*, 1899, p. 411.

² *Finance Report*, 1862, p. 20.

to thrive in the great belt of states north of the Potomac and Ohio rivers, finding increasing difficulty as it crossed the Mississippi. The sparsely settled states, having in the nature of the case the strongest need of banks of issue, still found themselves practically cut off from the advantage of the national system.

Some relief from this difficulty might have been obtained, perhaps, from the establishment of branches by the banks of urban communities, but this practice is not now permitted by the statutes of the United States,¹ and, although it has always existed in this country to some extent as in the days of the first and second banks of the United States and among state banks under the laws of some states, there has been a strong disinclination to introduce it in the national banking system. Palliatives have been discussed, such as a diminution of the minimum capital with which a national bank can be established, in order to bring national banking within the reach of smaller communities, or the increase of the note issue to the par value of the bonds deposited, instead of limiting it, as heretofore, to ninety per cent of that value; but these measures obviously do not go to the root of the evil complained of. Far more radical is the proposed abandonment of the principle of a specially secured currency and the substitution of a prior lien upon the general assets of the issuing bank, with perhaps a revival of the systematic central redemption of notes, formerly practised in some of the states and now in vogue in Scotland and in Canada.

In the meanwhile, the states and sections which found the national bank system ill adapted by its requirements to their condition have sought relief in many cases by an extraordinary development of banking under state laws. Banks with as small a capital as \$10,000, and in Kansas, Nebraska, and the Dakotas only \$5000, have organized by the hundred, having no power of note issue, of course, and in many cases with singular looseness of control by the state authority. By these agencies the states in question have secured a rapid increase of bank facilities, with some neglect of provisions for its soundness. Their needs of tangible currency for use are necessarily variable, and to satisfy

¹ For the purposes of the Columbian Exposition of 1893, a special act of Congress was passed, authorizing for two years the existence of branch offices of Chicago banks on the exhibition grounds. — 27 "Statutes at Large," p. 33.

them the movement of large masses of government or bank notes from the states farther east is annually required. But the inelastic quality of issues, whose volume depends in great degree upon the attractiveness of an investment in bonds, makes this annual flow of currency a disturbing event and not seldom the cause of serious disturbances in the money market. It follows, therefore, that, while the national banking system has created an issue of notes of undoubted solidity, and of equal value in every part of the Union, as the founders of the system expected, it has not yet created a system of banking adapted to the wants of all sections or tending to unify their interests. The national system is no doubt the foundation on which any reorganization of the paper currency of the United States ought to rest, but it is still only a foundation, with the superstructure scarcely more advanced than it was a generation ago.

INDEX

- Adams, Henry, on character of Hamilton's reports, 74.
- Adams, J. Q., report of, on weights and measures, 23.
- Alabama, direct tax of 1861 in, 105.
- Amsterdam, banking in, 132, 142, 145.
- Antwerp, 147.
- Apportionment of national bank-notes, by the act of 1863, 335; repealed 1864, 340; renewed 1865, 346; legal and actual state quotas in 1865, 347-348; explanation of disregard of law for, 348-350; effects of, on distribution of the banks, 350-352; act of 1870 for, 353; legal and actual in 1873, 355; act of 1874 for, 358; repealed in 1875, 359.
- Arkansas, collection of direct tax of 1861 in, 105 note; banks unconstitutional in, 270.
- Bagelot, W., on condition of economic thought, 40; on deposits, 175.
- Baltimore, banks of, in the crisis of 1857, 280, 288; in the crisis of 1860, 301, 309.
- Baltimore Plan, nature of, 234; chief defect of, 243.
- Banco del Giro, founding of, 156; organization of, 157-158; history of, 159-161, 166-167; effect of suspension on value of currency of, 161-165.
- Banco di Rialto, establishment of, 153; functions of, 153-155; close of, 156.
- Banking, the facilitation of payments at first its chief function, 145-148; the use of credit the source of profit in, 183.
- Banking, Free, in New York, 270, 297, 317, 321-322; in the West, 271, 297, 310, 323-325; list of states permitting, in 1860, 322 note.
- Banking in Venice, influence of, in England, 135-136, 140-141; legendary origin of, 143; works on, 144-145, 166; private, 145-153; suppression of, 153; Banco di Rialto, 153-155, 156; renewal of private, 155-156; Banco del Giro, 155-167.
- Bank-notes, depreciation of, 163, 287-288; analogous to deposits, 173; the subject of far more legislation, 174; deposit currency renders, less important, 179-181; government notes not a substitute for, 184; state laws concerning, 192. *See* Elasticity, and National Bank-notes.
- Bank of Commerce, special provision to secure adhesion of, to the national banking system, 341.
- Bank of England, model for the first bank of the United States, 90-93; publication of accounts of, 171; relation of, to gold exports, 257; and the crisis of 1857, 277, 279, 286; analogy between suspension of Peel's act and the use of clearing-house loan certificates, 308.
- Bank of France, and gold exports, 257.
- Bank of New York, constitution of, written by Hamilton, 90 note.
- Bank of the United States, First, a Northern measure, 17; services of, 18; the Bank of England taken by Hamilton as a model for, 90-93; accounts of, 168-171; notes and deposits of, 174.
- Bank of the United States, Second, consequences of the war against, 18-19.
- Banks, projects for, in England, 1581-1678, 135-142.
- Banks, State, deposits of, 177-178; attractions of, compared with national banks, 184; bills for repeal of tax on notes of, 188 note; legislation regulating, 188-190, 192; geographical distribution of, 190-191, 230-233; growth of, with small capital, 195-197, 235, 362; repeal of tax on notes of, undesirable, 198-206; issue of national currency by, allowed in act of 1863, 202-203, 336, 338; repealed in 1864, 341; character and situation of, in 1857, 269-271; effect of the crisis of 1857 on, 287-288; position of, prior to crisis of 1860, 296-299; effect of crisis, 309-310; survey of, in 1860, 314-329; the government not concerned with, after 1846, 314; diversity of system, 315; distribution of, 315-316; under special charter, 317; in New England, 318-320; in New York, 317, 321-322; free banks in the West, 323-324; discount on notes of, 324; counterfeiting notes of, 324-325;

- banks of the States, 325-329; entrance of, into the national system in 1863, 337; in 1864, 341; enabling acts for, 342-343; tax on notes of, 343-344.
- Bascom, J., economic writings of, 12.
- Bastiat, F., influence of Carey on, 14; reasoning of, affected by ethical aims, 49.
- Bigelow, E. B., on protection, 23.
- Bonds of the States, fall of price of Southern, in 1860, 301; losses on Western bank-notes secured by, in 1860, 310; use of, as security by free banks in the West, 323.
- Bonds of the United States, requirement of, burdensome to small national banks, 232-234, 358; sale of, in 1894-1896, 222; purchase of, by the treasury in 1857, 281; price of, in 1857, 285; sale of, in 1860, 301; slow sale of, in 1862, 334; effect of requirement of, from national banks on sale of, 335; holdings of, by national and state banks in 1864, 337-338; requirement of, from national banks changed in 1864, 358; relation of national bank circulation to price of, 361.
- Boston, banks of, in the crisis of 1857, 278, 282, 283, 288; in 1860, 300; policy of, in the crisis of 1860, 309; pressure exerted on county banks, 319; banks of, enter the national system, 342.
- Boutwell, Secretary, proposal of, to retire the legal tenders, 211.
- Bowen, F., economic writings of, 12.
- Bowery Bank, failure of, 283.
- Branch banking, advantages of, 196-197; would improve the national banking system, 363.
- Breckenridge, R. M., on Canadian bank-notes, 242 notes.
- Briscoe, J., 142.
- Buckner, Congressman, on bank-notes, 181 note.
- Cairnes, J. E., on economic method, 30, 31, 34, 35, 38, 39, 47.
- Calhoun, J. C., as an economist, 9.
- California, gold of, 314.
- Canada, redemption of bank-notes in, 242; banks of, successfully meet the crisis of 1857, 284.
- Cantillon, R., cited, 164 note.
- Capital, state banks in the West and South with small, 191, 195, 235, 363; reduction of, required from national banks undesirable, 236; relation of foreign investments of, to gold movements, 253-258.
- Capitation tax, 97.
- Carey, H. C., writings of, 14-16; quoted, 47.
- Carlisle, Secretary, cited, 236 note.
- Carlyle, Thomas, quoted, 5.
- Carriage tax, case of *Hylton v. United States*, 97, 101.
- Central America*, loss of steamer, 280.
- Chamberlayne, H., 142.
- Chase, Secretary, on the meaning of direct taxes in the Constitution, 98; direct tax proposed by, in 1861, 101; national banking proposed by, in 1861, 330-332; renewed in 1862, 333-336; carried by influence of, 335; foresaw end of present system of note issue, 362.
- Chemical Bank, 283, 308.
- Clarke, F., comptroller of the currency, 239 note, 247.
- Clay, Henry, as an economist, 9.
- Clearing-house of New York, returns of, in 1857, 281, 286; established in 1851, 322.
- Clearing-house loan certificates, use of, in 1860, 307-308.
- Cohn, G., method of, 42.
- Coinage, legislation concerning, more stable than that for government paper, 220.
- Collamer, Senator, on the direct tax of 1861, 101 note; proposal by, in 1864, of a coin reserve for national banks, 345.
- Columbian Exposition of 1893, 363 note.
- Colwell, S., 12, 16 note, 155 note.
- Competition, disappearance of, under branch banking improbable, 237.
- Compound-interest, notes of 1864-1865, 353.
- Connecticut, banks of, in 1860, 320.
- Contarini, D., bank of, in Venice, 1597, 155.
- Contarini, T., speech of, on Venetian banking, 144, 147-150.
- Cooke, T., on the distribution of banks in the West, 235-236.
- Cooper, Thomas, 111.
- Cotton, importance of American, 2, 251-252.
- Cotton manufacture, effect of the crisis of 1857 on, 290.
- Counterfeiting of bank-notes, 324-325; New England Association for the suppression of, 325.
- Courtois, A., on deposits, 176 note.
- Cradocke, F., banking projects of, 138-140.
- Credit, long terms of, prior to crisis of 1857, 269, 291, 298.
- Creditor countries, power of, over gold movements, 256-258.
- Crisis of 1857, causes of, foreign trade, 266-269; banking operations, 269-272; railroad speculation, 272; general economic conditions prior to, 274-276; condition of the banks, 276-278; outbreak of, 279; mistaken policy of New York banks, 280-282; suspension of specie payments, 282-284; business paralysis, 284-285; improvement after suspension, 285-287; discredit of Western banks, 287-288;

- resumption, 288-289; effects of the crisis on land and railroad speculation, 289; on labor, 289-290; recovery from, 291-293.
- Crisis of 1860, conditions prior to, 294-299; the political situation, 299-300; the position of the banks, 300; monetary pressure in October, 301; Lincoln's election followed by panic, 302; course of, 302-305; relief measures of New York banks, 305-308; of Boston banks, 309; suspension of specie payments in the South and West, 309-310; specie movement during, 311; slow recovery from, owing to non-payment of Southern debts, 312-313.
- Crisis of 1873, 20; effect of, on national bank circulation, 317.
- Crisis of 1893, effect of, on American imports, 250-251; effect of, on national bank circulation, 361.
- Currency, U. S., summary history of, 16-21; morbid fear of contraction, 172, 219; profit from government unimportant, 183, 225-226; unsteady purpose in legislation concerning, 216-224; elements of, in 1857, 272. *See* National Bank-notes, Treasury notes, and U. S. notes.
- Daru, P. A., cited, 145, 164 note.
- Debtor countries, relation of, to gold movements, 253-256.
- Deductive method in economics, analysis of, Mill's use of, 31-34; constant use of, by writers of the historical school, 41-44.
- Deposits, early use of, in Venice, 149; a currency more important than bank-notes, 173; true nature seen by Hamilton and Gallatin, 173-174; explanation of failure to recognize their true nature, 174-176; statistics of, in the United States, 177-179; use of, renders fear of currency contraction illusory, 179; payment of interest on, 276, 292.
- Dew, T. R., 12.
- Direct taxes, ineffectiveness of national in the United States, 94; conception of, derived from the physiocrats, 95-97; precedents for levying by apportionment, 97; judicial determination of, 97-98, 107, 133; imposition of, in 1798, 98; in 1813, 99; in 1815, 100; in 1861, 100; assumption of, by the loyal states, 103; proceeds of, 104; collection of, from the seceded states, 104-105; collection of, discontinued, 106; amount of, uncollected, 108; collection of, in South Carolina, 109-110; proposed methods of refunding, 111-113; refunding of, 114.
- Dividends of national banks, 350, 361.
- Dühring, Dr., quoted, 15.
- Dupont de Nemours on direct taxes, 96.
- East River Bank, failure of, 283.
- Economic science in America to 1876, the development of the country a favorable field for, 1-6; writings of statesmen, 6-10; of scholars, 11-16; meagre results of, 16; political conditions unfavorable to, 16-21; practical aspect of American life unfavorable to, 22-25; disregard of teachings of, 25-28; greater development and influence of, in the future predicted, 28-29.
- Economics, leading position of England in, 1; held by Germany in 1876, 2; the reaction in, 30; analysis of the deductive method in, 31-34; scope of the conclusions of, 35; meagre results of, 36; direction of further progress indicated, 38-40; the inductive or historical school in, 40; its methods, 41-46; its attitude toward the State, 46; the place of *laissez faire* in, 47; the place of ethical considerations in, 48-49; value of historical movement to, 50-51; increasing academic importance of, 52-53; and in public estimation, 53; position of, in American universities, 54; scientific method in its study, 55-56; special treatment demanded for subjects under public discussion, 56-59; an impossible demand, 59-60; the determination and application of economic laws, 61-64; the proper attitude of the teacher of, 65-67.
- Edmunds, Senator, on the reissue of the legal tenders, 240 note.
- Elasticity of bank-notes, true meaning of, 237-238; absent in case of national bank-notes, 240; importance of, 241; redemption the only means of securing, 242.
- Elder, Wm., a disciple of Carey, 16.
- Election of 1860, attitude of North and South prior to, 299; economic effect of, 300.
- Ely, R. T., quoted, 41, 45 note.
- Enabling Acts, for state banks entering the national system, 342.
- England, financial experience of, closely followed by Hamilton, 74; land tax of, 97, 99 note; smoothly working taxation system of, 118; income tax of, 120 note, 121, 126-127, 131; early banking schemes in, 135-142; relative importance of notes and deposits in, 176; branch banking in, 196 note; stable currency system of, 215, 225; ability of, to attract gold, 257; gold imports and exports of 1882-1893, 260-264.
- Erie railroad, bankruptcy of in 1857, 282.
- Ethics, relation of, to economics, 48-49.
- Europe, commercial situation of, in 1857, 274.

- Everett, A. H., economic writings of, 11.
- Fairchild, C. S., on foreign exchange, 257 note.
- Ferrara, F., investigations of, in Venetian banking, 144; frequent references to, 144-166.
- Florida, collection of direct tax of 1861 in, 105 note; banks unconstitutional in, 270.
- Foodstuffs, American exports of, 252; European demand for, in 1858-1859, 295; in 1860, 298-299.
- Foreign exchange, movement of, in crisis of 1857, 274, 277, 279, 281, 284, 286; in crisis of 1860, 304, 311.
- Foreign investments, advantages from, in the United States, 253; effect of, on gold exports, 254-258.
- Foreign trade of the United States, analysis of, 249-252; from 1850 to 1857, 266-269; in 1857, 274-275; from 1858 to 1860, 289, 295-296.
- Fourth National Bank of New York City, 340 note.
- France, economic science in, 1; bankruptcy of, in 1790, 74; stable currency system of, 215, 225; gold exports and imports of 1882-1898, 260-264.
- Franklin, Benjamin, the economic writings of, 6-7.
- Gage, Secretary, on the monetary system of the United States, 257 note, 262 note.
- Gallatin, Albert, economic writings of, 9; on the public debt, 79 note, 88; the direct tax, 99, 101 note; accounts of the first bank of the United States, 168-170; recognized the true nature of deposits, 174.
- Garfield, J. A., on the position of silver as a legal tender, 354 note.
- Geneva award, 254 note.
- Georgia, collection of the direct tax of 1861 in, 107.
- Gerbier, B., banking plan of, 139 note.
- Germany, economic science in, 2, 54; stable currency system of, 216, 225; gold imports and exports of 1882-1898, 260-264.
- Gibbs, G., cited, 73 note.
- Gold, California, 3, 266; unprecedented increase of, in the United States in 1898, 248; export demand for, concentrated on the Treasury, 249; advantages of the U. S. for retaining, 250-253; debtor position of the U. S. not a disturbing factor, 253-256; comparison with England, 257-260; exports and imports of leading countries compared, 260-264; consumption of, in the arts, 364; amount of, in the U. S. in 1899, 264-265; disposition of holdings of U. S. banks, 1862-1865, 344-345.
- Gold Bill, 209.
- Gold reserve of the United States, borrowing for, 222; gold for export taken from, 249.
- Grant, President, vetoes inflation bill, 212, 358.
- Grist, F. R., 160 note, 161 note.
- Grocer's Bank, failure of, 283.
- Grosvenor, W. M., 23.
- Hackett, F. W., cited, 254 note.
- Hagenbuck, C., bank proposed by, 135.
- Hamilton, Alexander, economic writings of, 7-8; congressional request for report on the finances, 72; previous training of, 73; reliance upon English experience, 73-74; plan of, for refunding, 75-76; comparison with English precedents, 76-79; not a plan for a permanent debt, 79-81; views as to the benefits of a public debt, 81-82; sinking fund, proposal of, 82-89; early banking ideas of, 89-90, 93 note; plan of, for the first bank of the United States, 90-93; rank of, as a financier, 93; on direct tax, 95; true nature of deposits explained by, 173.
- Harrison, President, attitude of, toward free silver coinage, 221.
- Harter, M. D., currency proposals of, 193, 201-203.
- Hill, J. A., cited, 125 note, 127 note, 133 note.
- Historical school in economics, methods of, 40-44; attitude of, toward State interference, 45.
- Hooper, S., bill of, for national banks, 332 note.
- Hulburd, H. R., comptroller of the currency, 239 note, 348 note.
- Huskinson, cited, 83 note.
- Illinois, banks of, in 1860, 302, 310, 323-324; proposed State Bank in, 328.
- Illinois Central Railroad, bankruptcy of, in 1857, 282.
- Immigration to the United States, 4; effect of crisis of 1857 on, 289.
- Impôt foncier*, 97.
- Income tax, principle of sound, 117; defects of, 118; fiscal advantages of, 118; of England, 118, 120 note, 121, 126-127, 131; of Prussia, 120 note, 121, 127-128, 131; of 1864, 120, 122, 123, 125.
- Income tax of 1894, explanation of its enactment, 116; a badly devised measure, 117; inheritance provisions of, 120-122; determination of income, 123-127; assessment at the source, 128-130; levied on past income, 130-132; declared unconstitutional, 133.
- Independent Treasury, necessity for, 19; establishment of, 314; national banks expected to supplement, 334.

- Indiana, free banks of, in 1860, 323; Bank of the State of, 325; State Bank of, 326.
- Inductive method in economics, use of, not confined to the historical school, 40-43.
- Inflation, possibility of, from deposits as well as from notes, 185; desire of debtor communities, 192-194; does not provide a local currency if redeemable, 204-206.
- Inflation bill of 1874, 212, 358.
- Ingram, J. K., cited, 41 note.
- Interest on foreign investments in the United States in 1859, 296.
- International securities, effect of, upon gold exports, 255-256.
- International trade, advantages of the United States in, 249, demand for imports not urgent, 250-251; for exports imperative, 251-252; subject to wide fluctuation, 252.
- Iowa, State Bank of, 327-328.
- Iron and steel, effect of crisis of 1857 on, 290.
- Italy, economic science in, 2.
- James, E., quoted, 38 note, 45 note.
- Jarvis, E., 23.
- Jefferson, President, as an economist, 8, 17; on Hamilton's public debt policy, 79 note, 82 note; on the publication of bank accounts, 169, 170.
- Jevons, W. S., true nature of deposits not seen by, 175.
- Jordan, C. N., on the effect of the Sherman act of 1890, 262 note.
- Kansas, state and national banks in, 191, 231, 235.
- Kentucky, banks of, maintain specie payments in 1851, 283; and in 1860, 309.
- Keynes, J. N., on the application of economic principles, 62 note.
- King, R., 94 note, 97.
- Kniess, K., function of deposits not perceived by, 177 note.
- Knox, J. J., 168, 355, 358.
- Labor, effect of the crisis of 1857 on, 289-290.
- Laissez faire*, its place in economics, 45-48.
- Lambe, S., banking projects of, 137-138.
- Land, public, railroad grants prior to 1837, 272; effect of crisis on sale of, 289.
- Lattes, E., investigations of, in Venetian banking, 144; frequent references to, 144-156.
- Laveleye, E., de, on economic method, 47 note, 50.
- Lee, Henry, report on tariff duties, 23.
- Legal Tender Acts, passage of, 208-209, 332-334.
See United States Notes.
- Leroy-Beaulieu, P., quoted, 123.
- Lewis, M., banking pamphlets of, 140-142; on banking in Venice, 161 note, 163, 166.
- Lincoln, President, economic consequences of the election of, 299-302.
- List, F., 14, 16 note.
- Loan certificates of 1867 and 1868, 353.
- Louisiana, banks of, specie reserves of, strongest in the country before the Civil War, 271, 297.
- Lyons, fair of, 147, 152.
- Maclay, W., and the public debt, 79 note.
- McCulloch, J. R., 11, 34, 35, 47, 68.
- McCulloch, Secretary, opposed issue of national currency by state banks, 203, 338; urged early resumption in 1865, 210; first president of the Bank of the State of Indiana, 327; disregard of the law apportioning national bank circulation, 347, 349, 355 note.
- McLeod, H. D., on banking in Venice, 143 note; on deposits, 173.
- Madison, President, as an economist, 8; vetoes bank bill, 18; on the public debt, 71-72.
- Maine, banks of, 318.
- Malpiero, 152 note.
- Malthus, reply to, by A. H. Everett, 11; by H. C. Carey, 15; method of, 34, 47.
- Malynes, G., 139, 161 and note.
- Manhattan Company, 320.
- Manufactures, effect of crisis of 1857 on, 290.
- Marperger, 144.
- Marshall, A., on economic laws, 64 note.
- Massachusetts, failure of tax on personal property in, 124; ratio of notes to deposit before 1860, 175; forbids banks to pay notes of other banks, 242; effect of crisis of 1857 on note circulation of, 288; requires a specie reserve, 292; banking system of, in 1860, 318-320; bond investments of banks in 1864, 337.
- Mercier de la Rivière, on direct taxes, 96.
- Michigan Central Railroad, bankruptcy of, in 1857, 282.
- Mill, J. S., 1, 14; economic method of, 31-34, 38, 39, 47; quoted, 38, 53, 69, 117.
- Missouri, state and national banks in, 191, 231; banks of, in 1860, 310, 324; bonds of, largely held by Western free banks, 323.
- Mithoff, Dr., cited, 42 note.
- Money, explanation of dearth of, in the West and South, 193, 204-206, 245-246, 356; distribution of, if redeemable, 204; if irredeemable, 205.
- Morosini, quoted, 153 note.

- Morris, Gouverneur, author of constitutional provision for direct taxation, 94-95.
- Morris, Robert, 9, 89, 90.
- Moses, B., cited, 354 note.
- Nasse, E., cited, 147 note.
- National banking system, notes and deposits under, 178-180; note issue requirements check growth of, 182-185; loss from insolvency, 186-187, 234; distribution of, 190, 230-233, 362; unsuited to sparsely settled regions, 195, 233-236, 362-363; bond requirement burdensome, 196, 231-233; also capital requirement, 196, 235; branches the suitable remedy, 196, 236; uniformity a valuable feature of, 199; legislation far more consistent than for legal tenders, 224; certain changes urged, 246-247; Chase's proposal in 1861, 330-333; in 1862, 333-335; act of 1863, 335-337; few banks organized, 337; defects of the act of 1863, 338-340; act of 1864, 340-341; rapid conversion of state banks, 341-343; accumulation of surplus by sale of gold, 343-345; effect of the apportionment of circulation on the growth of, 346-359; proposed changes in, 363-364.
- National bank-notes, no double profit from, 182-183; restrictions on issue check growth of the system, 185, 234; possible changes considered, 185-186; inelasticity of, 197, 237; uniformity of, a great advantage, 228; issue of, against assets favored, 234; redemption requirements, 238-240, 348-349, 358; similar to government paper, 356; amount of, in circulation, 1874-1900, 359-362. *See* Apportionment.
- National gold banks, 354.
- Nebraska, state and national banks in, 191, 231, 233, 235.
- New Dry Dock Company, 321.
- New England, survey of banks of, in 1860, 318-320.
- New England Association for the Suppression of Counterfeiting, 325.
- New Hampshire, banks of, in 1860, 318.
- Newman, S. P., 12.
- New Orleans, banks of, withstand the crisis of 1857, 283; in the crisis of 1860, 297; suspend in 1861, 310.
- New York, banks of, in 1860, 317, 320-322; bond holdings of, in 1864, 338.
- New York City, banks of, operation of, prior to the crisis of 1857, 275-276; already the reserve centre of the country, 276-277; during the crisis prior to suspension of specie payments, 278-283; after suspension, 285-286; resolve in 1858 to require a twenty per cent reserve and against the payment of interest on deposits, 292; in 1860, 300; loan certificate device resorted to, 305-308; unfavorable in 1864 to the national banking system, 337; enter system, 341-342; propose in 1864 that banks keep a coin reserve, 344.
- Noyes, A. D., cited, 259 note.
- Ohio, real estate mortgages in, 289; State Bank of, 327.
- Ohio Life Insurance and Trust Company, failure of, 279.
- Overstone, Lord, quoted, 293.
- Patten, S. N., cited, 52 note.
- Patterson, Justice, on the meaning of direct taxes in the Constitution, 97.
- Pennsylvania, citizens of, petition Congress for action on the public credit, 72; industries of, depressed after the crisis of 1857, 290; state election in 1860, 300.
- Perry, A. L., economic writings of, 13.
- Philadelphia, banks of, in the crisis of 1857, 280, 288; in the crisis of 1860, 300, 309; beginning of national banking in, 337, 341.
- Phillips, Willard, as an economist, 7, 11.
- Physiocrats, relation of, to direct taxation in the Constitution, 95-96.
- Pinckney, C. C., 94 note.
- Pitt, William (the younger), tontine measures of, 78; sinking fund arrangements of, 83-86.
- Pollock *v.* Farmers' Loan and Trust Company, 133 note.
- Porter, A. G., 109 note.
- Potter, A., 12.
- Potter, W., banking project of, 136.
- Price, F. G. H., cited, 135, 136.
- Price, R., work of, on sinking funds, 83.
- Private banks, deposits of 1878-1882, 177-178.
- Prussia, income tax of, 120 note, 121, 127-128, 131.
- Public debt of the United States, funding of, by Hamilton, 75-79; sinking fund for, 82-89.
- Quesnay, F., on direct taxes, 96.
- Rae, John, 12.
- Railroads, speculative construction of, prior to the crisis of 1857, 272; effect of the crisis on, 282, 289.
- Raymond, D., economic writings of, 11.
- Reading Railroad, bankruptcy of, in 1857, 282.
- Redemption of bank-notes, sole means of securing elasticity, 237; imperfect under the national banking law, 238-240; advantages of, 240-242; methods for se-

- curing, 243-244; equity of, 244-245; the Suffolk system, 319; in New York and Philadelphia in 1860, 322 and note; provision for, in the national banking law of 1863, 335; of 1864, 340; of 1874, 358.
- Reichbank and gold exports, 257.
- Republican Convention of 1868, opposes repudiation, 211.
- Reserves of other banks largely held in New York in 1857, 276; of banks in 1859, 297; requirement for national bank notes changed in 1874, 358.
- Resources of the United States in 1876, 2-4.
- Resumption act, exact meaning of, purposely left uncertain, 172, 212-213; removed limit on total circulation of the national banks, 359.
- Resumption, *see* Specie payments.
- Rezasco, cited, 156 note, 157 note, 159.
- Rhode Island, cotton manufactures of, depressed after the crisis of 1857, 290; banks of, in 1860, 318.
- Ricardo D., American edition of, 11; theories of, disputed by Carey, 14; economic method of, 34, 39, 68-70; on Pitt's sinking fund, 84 note.
- Richardson, Secretary, reissue of legal tenders in 1873 by, 212.
- Roberts, L., cited, 139.
- Robinson, H., cited, 139.
- Rogers, Thorold, investigations of, 44.
- Roscher, William, cited, 16; method of, 42, 44.
- Rota, cited, 158 note, 164 note.
- Royall, W. L., quoted, 245 note.
- Savary, cited, 144 note.
- Schmoller, G., method of, 41, 44.
- Schoenberg, Dr., 45 note.
- Scotland, branch banking in, 196 note.
- Seligman, E. R. A., quoted, 40.
- Senior, N. W., economic method of, 34, 35, 47, 49.
- Sherbrooke, Lord, quoted, 37.
- Sherman, Senator, on the direct tax, 114 note; on resumption, 172; on legal tender notes, 209, 211, 212, 240, 241; on national bank notes, 238, 347, 351.
- Shipping of the United States, 1850-1857, 228.
- Silver Coinage Act of 1853, 270.
- Silver Purchase Act of 1890, passage of, 214; repeal of, 215; explanations of its passage, 221; consequences of, 262.
- Sinking fund, Hamilton's opinion as to the importance of, 80-82; of 1862, 81 note; proposal of, for the Confederation, 82 note; of the younger Pitt, 83-84; Ricardo's criticism, 84 note; Hamilton's proposals, 85; commissioners for, 85 note; of 1790, 85; of 1792, 86; of 1795, 87; of 1802, 88; views of Hamilton and Pitt sound, 88-89.
- Smith, Adam, influence of, on Franklin, 7; on Hamilton, 8; on the method and limitations of economics, 34, 35, 37, 47, 62; taxation terms used by, 95.
- Smith, E. P., 16.
- Soresina, A., on Venetian banking, 166.
- South Carolina, collection of direct tax in, 105 note, 109-110; refunding of, in, 114.
- South The, national and state banks in, 230-233; national system unsuited to needs of, 233-236, 362-363; explanation of dearth of currency in, 245-246; use of credit in, prior to 1857, 269; rapid recovery of, from the crisis of 1857, 291, 294; during the campaign of 1860, 299; Northern loss on debts of, in 1861, 303, 312; apportionment of circulation in 1865, 347-348; checks growth of national banks in, 351, 354-355.
- Spaulding, E. G., national bank bill of, 332 note.
- Specie, natural effect of exports of, thwarted under our currency system, 240-241; movement of, during the crisis of 1857, 277, 279, 286; during the crisis of 1860; 302, 304, 311; held by the banks, 1863-1868, 344-345.
- Specie payments, suspension of, in 1857, 280-284; resumption of, 288; suspension in 1860, 309-310; in 1861, 331; proposal in 1864 that banks prepare for resumption, 344; public opinion in 1865 favorable to, 348; resumption in 1879, 359.
- Springer v. United States, 98.
- Stanhope, Lord, 84 note.
- Stevens, T., quoted, 101 note.
- Suffolk bank system, the, 319.
- Sugar, 291; speculation of 1857 in, 275.
- Surplus of national banks, required by act of 1864, 339, 340; from the sale of gold, 344-345; amount of, 350, 361.
- Taille réelle, 97.
- Tariff, varying policy as to, 26; demand for unscientific teaching of, 157; of 1890, and the Silver Purchase Act, 221; *ad valorem* system of 1846, 268.
- Taxation, of personal property ineffective, 124; of state bank-notes, 343. *See* Direct Tax and Income Tax.
- Teller, Senator, on the Silver Purchase Act of 1890, 221.
- Tennessee, collection of direct tax in, 105 note.
- Texas, number and bond-holdings of national banks in, 230-233; state banks unconstitutional in, 232, 270.
- Thompson, R. E., 16.

- Tobacco, 3, 291.
- Tontine measures of Hamilton and Pitt, 78.
- Tooke, T., on bank accounts, 171.
- Treasury of the United States, purchases bonds during the crisis of 1857, 281, 285. *See* Independent Treasury.
- Treasury, Secretary of, early position of, 71; decline of influence of, 216.
- Treasury notes of 1890. *See* Silver Purchase Act.
- Trenholm, W. L., 180, 184.
- Trevisan, B., 157 note.
- Trust companies, deposits of, 177-178; development of, after the Civil War, 350.
- Tucker, G., 12.
- Turbolo, 161 and notes.
- Turgot, A. R. J., on direct taxes, 96.
- Unites States *v.* Louisiana, 107.
- United States, development of its resources to 1876, 2-4; economic writings of statesmen, 6-10; of scholars, 10-16; summary of currency history of, 16-21; slight influence of economic science in, 21-29; popular dread of contraction in, 172; currency history of 1862-1894, 208-215; advantages of, in foreign trade, 249-253; financial relations with other countries, 253-256; in comparison with England as to ability to attract gold, 256-260; gold imports and exports of 1882-1898, 260-264; foreign trade of 1850-1857, 66-69.
- United States notes, acts for, 208, 330, 332-334; depreciation of, 200; partial retirement of, 210; reissue of, 211; retirement under the Resumption Act, 212; retirement discontinued, 213, 360; gold reserve for, 214.
- Veazie Bank *v.* Fenno, 98.
- Vendramin, G., and the Banco del Giro, 156-157.
- Venice, *see* Bank of Venice.
- Vermont, banks of, in 1860, 318, 320.
- Vethake, H., economic writings of, 12.
- Virginia, collection of direct tax in, 105 note.
- Wagner, A., on economic method, 42, on deposits, 177 note.
- Walker, Amasa, economic writings of, p. 13.
- Walker, F. A., 23, 42 note.
- Wayland, President, economic writings of, 12.
- Wealth, relation of, its growth to general progress, 5.
- Webster, Daniel, 7; as an economist, 9; on banks, 18, 314.
- Wells, D. H., 23.
- West The, national and state banks in, 230-333; national system unsuited to, 233-336, 362-363; explanation of dearth of currency in, 245-246; speculation in prior to the crisis of 1857, 269, 271-273; effect of crisis on, 287; slow recovery of, 291, 295, 298-299; currency of, in 1860, 302; effect of crisis of 1860 on banks of, 310; banking system in 1860, 323-329; extension of national system checked in 1865, 350.
- Whigs, theory of, as to the currency, 314.
- White, H., cited, 234 note.
- Wilson, James, and the direct tax in the Constitution, 95, 96, 97.
- Wisconsin, banks of in 1860, 302, 312, 323; bank-notes of, 324.
- Wolcott, O., on the public debt, 73 note; on the sinking fund, 87; on direct taxes, 98, 99.
- Yates, Governor, 310.

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