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BY ERNEST SYKES

WITH AN INTRODUCTION BY

F. E. STEELE.

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BY

ERNEST SYKES, B.A. [Oxon.],

FORMERLY OF THE LONDON AND COUNTY BANK.

Lecturer on Banking and Currency to the London Chamber of Commerce.

With an Introduction,

BY

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FELLOW OF THE INSTITUTE OF BANKERS.

Examiner in Banking and Currency to the London Chamber of Commerce.

LONDON:

BUTTERWORTH & CO., 12, Bell Yard, Temple Bar, W.C.

Law Publishers.

1905.

LONDON:
PRINTED BY BUTTERWORTH & CO., CRANE COURT, E.C.

PREFACE.

THIS book is intended mainly as a text-book for Students, and it is hoped that it may be of some assistance to those who are reading for the Examinations held under the auspices of the Institute of Bankers, the London Chamber of Commerce, and other examining bodies.

Though the scope and size of the work forbid a detailed handling of many of the subjects treated, an endeavour has been made to give a broadly outlined account of those branches of business and finance with which the banker is chiefly brought into contact.

The Author feels that some apology is due from him for adding to the already long list of works on the subject of banking and currency, but the excuse is offered that he

has found the want of a book which treats, within the dimensions of a single volume and in a manner suitable to the requirements of students, of the kindred subjects which form the title to the present work.

E. S.

LONDON,
November, 1904.

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INTRODUCTION

By F. E. Steele.

THERE is only one school in which the practice of banking can be properly learned, and that school is—a bank. In that school, however, as in others, text-books are required, since in banking, as in most businesses requiring few heads but many hands, the principle of the Division of Labour is very fully exemplified. In a large banking office, a man may spend years of his life doing the same thing over and over again in one department, remaining to a great extent in ignorance, so far as regards actual experience—the best of teachers—of the working of the machine as a whole, and its manifold relationship to the complex mechanism of commerce. For even a bowing acquaintance with these, he must, for a time, look mainly to books, the second best teachers, and these, if of the right kind, will assist in filling the inevitable gaps.

Whilst the art of banking is best learned by dint of practical experience, —"*à force de forger on devient forgeron*,"—the science of banking, and the laws which govern currency, can, for sheer lack of opportunity, be so learned by only a few, and text-books, desirable as adjuncts in banking practice,

become a prime necessity in studying that groundwork of theory on which all sound practice is reared. For instance, thanks to its discoverer and his followers, Gresham's Law, to which Mr. Sykes devotes some of his best pages, is to-day a currency commonplace, but centuries of bungling and of loss on the part of nations elapsed before the knowledge that a debtor will always pay his creditor in the least valuable medium which will be accepted, was carried to its logical issue, made a principle of currency, and recognised in national and international finance. To-day, thanks to earlier thinkers and writers, the novice may learn from a currency text-book what the best heads in Europe failed for centuries to gather from experiment.

Suitable text-books, therefore, must be found, and such a book is this of Mr. Sykes. In the theory of Currency and of Banking he is well versed, whilst in practical banking he has had the best of all forms of banking education; a varied banking experience. *Primâ facie*, we expect him to be instructive, and in this respect the present work fulfils our expectation. But this is not enough. To introduce a book as "instructive" is, in these days, to pronounce its doom. It must do more than instruct; it must interest, if it is to survive; and this book, though necessarily much condensed, will be found to fulfil this further condition. That this should be so is probably due to the fact that the substance of much of it was first delivered in the form of lectures to City men; and to hold the attention of a hundred or more City men after they (and the lecturer) have

gone through a full day of banking, stock-broking, bill-discounting, or what not, is no easy task; it is an impossible one unless, in addition to knowing your subject, you can contrive to make it fairly attractive. Speaking broadly and candidly, only two kinds of purely financial writing can be classed as interesting. The first belongs to a generation now almost past; the generation of Bagehot and of Giffen; the second consists of those parts of the City articles of the daily papers which deal with the stocks and shares we hold, or hope to hold.

Though he would probably not lay claim to the main characteristics of either school, Mr. Sykes contrives to put his points in a manner which invites attention. In dealing with elementary matters of currency, for example, he refers to the shilling as the "degenerate descendant" of the twentieth part of a pound weight of silver, and in discussing financial crises he compares the raising of the rate of interest to the application of the brake to a bicycle descending a steep hill. "A rash use of the brake at the worst part of the hill will probably only precipitate the calamity which it is desired to avoid"—a simile, homely but apt, which carries the writer's shaft home.

The outstanding feature of the book, however, is not this. It is the fact that it brings together, within two covers, information some of which is not to be found in books at all, but of which the greater part would have to be sought in many other books. If we want information on currency problems, we

turn to the works of Jevons, Walker or Nicholson; for the Foreign Exchanges we go to Goschen and Clare; for Banking Law to Paget, Grant, or Hart; for Banking History to Gilbart, Andréadès, and MacLeod; for Banking Practice to Hutchison if we have leisure and means; to Moxon if there is pressure on our time and pocket; and to George Rae if the combination of a colloquial style and a ripe experience appeals to us. In this book of Mr. Sykes's all these subjects are handled; none of them so voluminously, of course, as in the works of some of the writers referred to, but all in a manner which fully suffices to give the reader a clear working idea of their nature and scope. This is the characteristic which will commend the book both to the practical banker and to the student of banking and currency problems.

F. E. STEELE.

BANKING AND CURRENCY.

CHAPTER I.

THE FUNCTIONS AND ATTRIBUTES OF MONEY.

It has long been the practice in certain quarters to point the finger of scorn at the theorist in banking matters, to taunt him with the old proverbs that "an ounce of practice is worth a peck of theory," and that "a little knowledge is a dangerous thing." Perhaps this tendency has been less marked of late years, for not only in banking but in nearly every branch of human activity it has been recognised that scientific knowledge is desirable, if not absolutely necessary, and this desire for knowledge has been manifested in the recent development of educational and examining bodies in most professions and businesses.

In spite, however, of this widespread thirst for information, it is wise to remember that the above time-honoured proverbs still contain a certain amount of truth in them. Banking certainly is a profession or business, whichever one may prefer to call it, in which the more practical virtues are altogether indispensable. Tact, knowledge of character,

a clear head and a cool judgment, combined with that capacity for taking infinite pains which has rather mistakenly been held to be the chief attribute of genius, all these are required to make a successful banker, and without a considerable share of them, no amount of theory will suffice. It is well then to remember that the theory of banking must supplement and not take the place of those business habits which are essential to success. "You cannot make a silk purse out of a sow's ear," and a raw junior clerk cannot fit himself for the management of a bank by two or three months' desultory reading of text books.

Keeping this proviso in mind there is, however, no doubt whatever that a thorough knowledge of the theory of banking is a most useful possession, one with which no bank clerk can afford to dispense. Given equal conditions in other respects, the man in any station of life who does his work intelligently is always superior to the man who obeys instructions blindly. Place these men in a position outside the usual routine to which they have been accustomed, and the difference between them becomes still more apparent. The bank clerk who is content to fulfil merely routine duties may find that a knowledge of banking theory is unnecessary, but to the man who is ambitious to rise to positions of greater responsibility, such knowledge is not only necessary but imperative.

When we approach the subject-matter in hand we are met at the outset by the difficulty of a proper definition. What is meant by "currency"? Such

well-known authorities as Sir Robert Peel and Lord Overstone excluded from the term all forms of paper money except bankers' promissory notes payable to bearer on demand, though neither of them had a satisfactory reason for so doing. The fact that a Bank of England note is legal tender seems to have misled many people into drawing a distinction between it and all other forms of paper money, and the word currency is often used therefore to denote that part of the circulating medium which is legal tender. When, however, we come to discuss those monetary problems which have so long vexed the world and for which a satisfactory solution has yet to be found, problems which are intimately connected with the relation between money and prices and the maintenance of a stable standard of value, we shall find that no broad distinctions exist between the various forms of paper money. Not only so, but it will be found convenient for most purposes to group together coin and paper money, and for this reason the term currency is generally used to denote the whole of the circulating medium by means of which debts are paid and prices are measured. It is synonymous with money in its broader sense, and contains the two subdivisions of the coinage and the paper circulation, that is, bills, notes, cheques, postal orders and similar forms of money.

To establish a satisfactory monetary system and to keep that system in a proper condition are tasks which have sorely tried many generations of statesmen and economists. Experience has shown that a debased or depreciated currency is a national evil of the greatest magnitude. The English Statute Book

bristles with harsh enactments designed to repress these evils, and nearly all of them failed entirely to have the desired effect owing to ignorance of the proper principles which should govern a monetary system. In the time of Blackstone counterfeit coining was treason, the most serious crime in English law, while even as late as 1832 the penalty for counterfeit coining was death.

The functions of money are three in number. It acts as—

(1) A medium of exchange;

(2) A measure of value;

(3) A standard of value for deferred payments.

To consider the first function; without a medium of exchange mankind would be reduced to the expedient of bartering goods against goods. English history shews abundant traces of this cumbersome form of payment. The manorial system was based upon it. In the Middle Ages money was very scarce in England outside the towns, the villein was in nearly all cases paid for his services in goods, and rent took the form of a proportion of the yield of the land, paid in kind. Needless to say it is far too cumbersome a system for commercial nations, and severe limits were placed upon its use in England by the Truck Act of 1831, which forbade the payment of workmen wholly or in part by goods, a method of payment which had proved capable of great abuses.

Secondly, money acts as a measure of value, and it is necessary to warn the student against any misconception of the meaning of this latter term.

Value and utility are based upon two very different sets of ideas. Value is not absolute, but always implies a ratio—a relation to another article or articles. The utility of an article on the other hand is simply its power of supplying the wants of mankind, a vague power which cannot be measured. Such terms as "intrinsic value" should be used with extreme caution, or they will cause great confusion of thought.

Value is usually defined as "ratio of exchangeability." Transposed into common language, this means that the value of anything is what it will fetch. Unlike utility, value can be accurately measured and expressed; for instance, the value of gold bullion in relation to silver bullion is, say, 37 to 1, in other words an ounce of gold will buy thirty-seven ounces of silver. You can express the value of any article in terms of any other article, but it is obvious that in a very early stage of civilisation mankind would realise the advantage of having some single article by which to measure the value of other articles. If one man measured the value of his vendible commodities in corn, another in beef, and a third in cloth, and so on, endless confusion and dispute would infallibly ensue. This common measure of value is money, and value when expressed in terms of money is called "price." The distinction between value and price should never be overlooked, especially since the terms are somewhat loosely used in ordinary language. The value of gold to silver bullion we stated to be, roughly, 37 to 1; but the price of silver bullion is, say, 2*s*. 3*d*. an ounce. It is an economic error to speak of the value of wheat as being 30*s*. a quarter;

thirty shillings is the expression of the value of a quarter of wheat in terms of money and is therefore its price.

As civilisation advanced beyond its early stages the necessity for the third function of money began to gain in importance. When a settled form of government was gradually evolved and commerce and industry became organised, men entered into contracts to be fulfilled at some future time, and the necessity of a standard of value arose. In arranging a monetary contract the parties to it would naturally wish that it should be fulfilled under the same conditions, so far as possible, as those under which it was entered upon. If a man borrows a thousand pounds to be repaid at the end of twenty years, it will be a serious matter for him if the value of the pound, as regards commodities generally, has risen at the end of the twenty years to three times its original proportions, for in effect he will have to repay three times the amount he borrowed. Money, therefore, since it has to fulfil the function of a standard of value, should be so far as possible stable in value, that is, its value with regard to other articles generally should change as little as possible.

Bearing in mind these three functions or duties which money is required to fulfil, we shall be easily able to enumerate and understand those attributes which a perfect system should possess. Jevons (*a*)

(*a*) Money and the Mechanism of Exchange, chap. 5.

mentions the following seven qualities as necessary:

(1) Value of material;
(2) Portability;
(3) Indestructibility;
(4) Homogeneity;
(5) Divisibility;
(6) Stability of value;
(7) Cognisability.

Money as a medium of exchange demands the second, third, fourth, fifth and seventh attributes. It must be portable and, so far as possible, indestructible. The material of which it is made must also be homogeneous, that is, any one unit of it must be of the same value as any other unit of the same size and weight. Any substance which differs in value in the mass would be unfit for use as money because of the action of Gresham's law, as we shall see later.

Obviously again the material of which the medium of exchange is to be made must be capable of being divided without losing its value. Precious stones, for instance, possess many of the necessary attributes, but not this one of divisibility. If you cut a diamond into four equal portions, not only does it lose weight in the process, but the four portions are each worth perhaps not an eighth of the original value of the stone. Lastly, the medium of exchange must possess the quality of cognisability; it must be of some substance easily recognisable as such without

expert knowledge, and which cannot readily be counterfeited. None of our money possess this attribute in perfection, and the counterfeit coiner still carries on his lucrative, if risky, profession, but it is not easy to turn out a counterfeit gold coin which will defy a close examination.

Money as a measure of value must, according to Jevons, possess the first attribute, that is, it must be made of some material which possesses value apart from its use as money. At first sight this may seem undoubtedly true, but a little reflection forces us to modify Jevons's statement. He is quite right in urging that such archaic forms of money as the West African "cowries" did possess some value as ornaments, but it is quite possible that money may be made of a comparatively valueless material and yet possess value as money. Sir John Maundeville, in his highly interesting book of travels, speaks of the Emperor of Tartary as follows: "He spendeth and maketh no money but of imprinted leather or of paper; . . . . they make no money either of gold or of silver and therefore he may spend enough and outrageously." Perhaps Sir John is not a sufficiently trustworthy chronicler to be quoted in a book on an economic subject, but we can find other examples nearer home. A Bank of England note is made of paper, the value of which as paper can be disregarded. Of course, the value of the note is due to the fact that it can be changed at will for a certain fixed number of sovereigns; but under certain circumstances, which we shall examine in a later chapter, this power of demanding gold for a note may be, and frequently has been, suspended, and yet

the value of the note has remained practically unchanged. Given certain conditions, an inconvertible paper currency may retain its value with regard to other commodities for an indefinite period, and for this reason, Jevons's dictum that value of material is an essential attribute of money, must be regarded as inconclusive.

Money, as regards its third function, that of a standard of value, demands more especially the sixth attribute, stability of valûe ; and this attribute, which is possibly the most necessary and important, is certainly the most difficult of attainment. A stable standard of value has hitherto proved an impossibility, and we seem no nearer to it now than at any time in monetary history. All we can do is to accept the best substitute for a perfect material. All civilised nations have in historic times agreed in the choice of gold and silver as the nearest approach to perfection, with copper, bronze and nickel for the coins of smaller denomination. But both gold and silver have varied widely in their value as regards commodities generally ; they are neither of them sufficiently portable to meet the requirements of modern conditions, for the cost of transmitting even gold for long distances is a heavy item which is never incurred when it can be well avoided. Neither are they indestructible, as can be easily proved by a cursory examination of any English silver coin dating back for twenty years or more ; and lastly, as many know to their cost, they are not always recognisable and are capable of being counterfeited.

CHAPTER II.

THE VALUE OF MONEY.

SINCE price is the expression of value in terms of money, we can measure and record the values of all vendible commodities by means of their prices, but in the case of money we are met with the difficulty that, being itself the measure and standard of value, there is no medium in which to express its price. The value of money is expressed by the general level of the price of all other commodities. If the reader will always bear in mind the fact that value always implies a relation to something else, he will be saved from confusion of thought on this head. The values of all commodities are measured by their relation to money; the higher their price the greater their value. But you cannot have a relation between money and money, and the value of a sovereign therefore is measured by its relation to other commodities; the higher the price of these articles, the *lower* the value of the sovereign. The value of money is its purchasing power; if prices generally rise, the purchasing power of money has become less, because the same amount of money will buy less than when prices were lower. The value of money and the value of commodities therefore vary

inversely; they are each the opposing scale in a balance, if one rises the other falls, and *vice versâ*.

Beware of the expression "Mint price of gold." It is an awkward phrase, and one in which the word "price" is very misleading to the unwary. The Mint price of gold is the price paid by the Mint in sovereigns for gold bullion. It is the value of the rough metal in finished coin.

In England the Mint price of gold is £3 17*s*. 10½*d*. an ounce, that is to say, an ounce of gold is coined into 3·89 sovereigns, or, in other words, a sovereign weighs 123·27447 grains of standard gold.

Continuing our simile of the pair of scales, we can easily see that the value of money is affected by two different sets of causes, operating on either of the two scales of the balance; on the one hand we have a set of causes intimately connected with the supply of vendible commodities, on the other hand we have to consider the amount of money and the economies in its use.

As an illustration of what is meant by this, let us take the supposed case of a general all-round cheapening in the processes of production, due to increased knowledge and greater skill in the invention and use of labour-saving appliances. If the amount of money remains the same and the same economies in its use are in force, we shall get an all-round reduction in prices; in other words, the value or purchasing power of money will rise.

Look at the other scale of the balance. Suppose in this case that the cost of production of vendible

commodities remains the same, but that the amount of money in circulation is less, due, let us say, to the exhaustion of some of the principal gold fields; prices will be affected in the same way. Money, obeying the general law of supply and demand, will rise in value owing to the reduction in supply.

It is the action of this double set of causes which renders so difficult the problem of keeping the value of money stable. As we saw in the last chapter, stability is the essential quality for our standard of value, and any changes are an evil to be avoided. Rising prices may give a stimulus to the producing classes for a time, although this stimulus is partly at the expense of the consuming classes, but prices cannot continually rise, and the inevitable reaction is one of the chief causes of those periods of commercial depression and stagnation which characterise our modern industrialism.

If we could artificially regulate the supply and economy of money we should not have attained our object, because the value of money would still be open to the influence of the other set of causes.

We will, however, for the present confine our attention to the value of money as dependent on its supply and use. The general rule is, that this value depends on the quantity of money in circulation together with the economy in its use, or, in other words, the "rapidity of its circulation." The greater the quantity of money in circulation the less will be its value, and the higher will be the level of prices, and conversely.

In the same way the more work that each piece of money will do the less will be its value and the higher will be the level of prices. In John Stuart Mill's words (*a*), "the amount of goods and of transactions being the same, the value of money is inversely as its quantity multiplied by what is called the rapidity of circulation."

But we shall do well to remember that the quantity of money does not depend absolutely upon the supplies of the precious metals from the mines. By far the larger proportion of the money of most industrial nations consists of paper money, obligations to pay gold or silver either on demand or at a fixed period. A very small proportion of these promises is ever liquidated in coin. The supply of the precious metals is far too small to liquidate the obligations existing at any one moment, and most of them are cancelled by a transfer of indebtedness. This superstructure of credit is based upon the quantity of the precious metals in circulation, and its quantity is, roughly, proportionate to that of its basis; there is no exact proportion, however, and so the paper circulation possesses the useful attribute of "elasticity."

At certain periods, when trade is more than usually prosperous and transactions are multiplied, the work which the money of a country has to perform is correspondingly greater, and a demand for an increase in the quantity of the currency often occurs;

(*a*) Mill: Political Economy, bk. iii., chap. 8, § 3.

this demand is met by an increase in the superstructure of credit, which, in a proper system, expands and contracts automatically. This power of expansion is called "elasticity," and is, up to a certain point, beneficial, since it tends to steady prices. It will be seen that this power of automatic expansion is a modification of the general rule that, other things being equal, the value of money depends upon the quantity in circulation, for a rise in the value of money may, under certain conditions, result in an increase in that quantity.

CHAPTER III.

GRESHAM'S LAW.

THE monetary history of most civilised nations, up to quite a recent date, is a long record of failures to keep the currency in a proper condition of repair, failures marked by extreme ignorance of the general laws which govern all currency systems, and marred by a long list of severe penal statutes, intended to take the place of this want of knowledge, statutes, which, in spite of their extreme severity, were generally inoperative. In our own country, fresh issues of new coins were from time to time made, only to disappear almost immediately. The coins in circulation were worn, clipped, debased, and of a bewildering multiplicity of design and weight. The weaker portion of the community necessarily suffered greatly, and the less scrupulous found a constant harvest of profit ready at hand.

The most important of these principles, and the one most constantly ignored, is that known as Gresham's law. It is, of course, a scientific law, not a political law. A scientific law is the expression of a universal tendency which experience has shown to follow certain conditions through the action of a known cause. A political law, or legislative

enactment, says that a certain course of events *must* take place; a scientific law states that a certain event *does* occur under stated conditions.

Gresham's law is named after an Elizabethan knight, founder of the Royal Exchange, who is supposed to have inspired a Royal proclamation in which the law is first stated. Although first published as early as Elizabeth's reign, the law was not generally recognised until long after, and this early statement of the law was only one of several aspects in which it can be viewed.

In its earliest and simplest form it is expressed as follows: "*If coins of the same metal, but of varying weight and quality, circulate together at the same nominal value, the worse coins will tend to drive the better from circulation, but the better will never drive out the worse.*"

Legislators could not understand why people should prefer the light coins to those of full weight, and when they issued new full-weight coins they constantly expected them to take the place of the worn coins already in circulation, and were as constantly disappointed. A little reflection will, however, show that the action of the law is quite in accord with the elementary facts of human nature. The essential feature of the coinage is that it is meant to be circulated, to be passed on, and when a man has to part with anything, he naturally parts with the least valuable, provided it will exchange for as much as the more valuable article.

We must remember that until modern banking methods were developed, men saved money by

hoarding coins in a chest or the traditional old stocking, and the newest and heaviest coins would be selected for this purpose. Even in these days of scientific knowledge, most men, although they gain nothing by it, have a lurking inclination to keep a brand new coin, fresh from the Mint, when it comes into their possession. In days when the condition of the coinage left much to be desired, and when the possession of a light coin meant a probable loss to its owner, this tendency was very strong. Again, money changers and others who exported coin or bullion, would have to make good any deficiency in the weight of the coins they exported, for in international transactions currency always goes by weight and not by tale. Therefore, such men would withdraw the heavy coins from circulation. Thirdly, the fraudulently inclined could, with very slight risk of detection, and with certain profit to themselves, clip and "sweat" the newer coins so as to reduce them to the general level of those in circulation.

This, then, is the operation of Gresham's law in its simplest form. The heavy coins disappear from circulation, not necessarily from the country. Some are exported or melted down, others are hoarded, and some are fraudulently depreciated in weight; to use a popular phrase, "the bad money drives out the good."

Now let us turn to a currency in which two precious metals are used, and both circulate concurrently at a mutual valuation fixed either permanently or from time to time by the State, and we shall find another application of the same

law. In such circumstances we shall find that the value of the two metals, which we will take to be gold and silver, towards each other, will at most periods exhibit two distinct ratios.

First, there is the ratio of the market value of the two metals as bullion, which varies within certain narrow limits from day to day, in obedience to the usual market influences which affect all commodities; and secondly, there is the State ratio at which the coins of the two metals are declared current—the "Mint ratio" as it is now called. So long as these ratios, the Mint ratio and the market ratio, remain identical, Gresham's law will be inoperative, but experience has shown that it is a matter of extreme difficulty, if not of impossibility, to keep these ratios for long at the same figure.

Directly a divergence occurs there is a tendency for the coins of the over-rated metal to drive the under-rated from circulation. Take the case of the Japanese currency at the time when that country was first opened up to European influences. At that time coins of gold and silver circulated at a ratio of about 5 to 1, which was approximately the market ratio in that country. The European trader was not long in discovering that he could buy an ounce of gold in Japan for about five ounces of silver and that this same ounce of gold was in Europe worth about fifteen ounces of silver. Of course the Japanese gold coinage rapidly disappeared from circulation.

Take another instance from English history. When gold was first coined in appreciable quantities

in England, in Edward I.'s reign, it constantly disappeared from circulation through being underrated. Gold "florences," or florins were proclaimed current at six silver shillings. But at the market value of the two metals to each other the florin was worth, we will say, seven silver shillings. By melting a gold florin and selling the bullion to a goldsmith seven shillings could be realised, while it would only settle a debt of six shillings at the proclaimed valuation. Consequently, people paid their debts in silver, and hoarded, melted or exported the gold, because this was the cheaper method.

We will then formulate this second application of Gresham's law as follows:—*If coins of two precious metals be circulated at a fixed ratio of exchange with one another, the overvalued metal will tend to drive the undervalued from circulation.*

There is a third form of this important principle applying to the relations between a metallic coinage and a paper currency. The excessive issue of paper money has been one of the most frequent causes of monetary confusion in the history of modern nations. So long as the paper money is redeemable in coin or bullion on demand, any excessive issue will soon automatically correct itself, but when in periods of acute financial embarrassment a government is driven to the expedient of issuing an inconvertible paper currency, great self-restraint is necessary to prevent an over-issue. So long as the limit is not exceeded, the limit prescribed by the usual needs of the commercial community, an inconvertible currency can retain its value unless the credit of the

government is unusually bad; but so soon as the issue becomes excessive, gold tends to disappear from circulation and the paper money becomes depreciated in value.

The abnormal increase in the amount of the currency results in a fall in its value and a rise in the price of commodities. Other nations find it cheaper to pay in goods than in gold or silver, and the surplus currency is gradually exported. Needless to say this exported surplus takes the form of coin or bullion, for other nations will not accept paper. The ensuing scarcity of coin encourages hoarding, and the stock of the precious metals in circulation rapidly dwindles. If the issue of paper still continues the next result is a divergence between paper prices and gold or silver prices. Gold or silver is said to be at a premium, paper is "depreciated." At this stage paper is obviously the cheaper medium for payment by the debtor, and the remainder of gold and silver all but entirely disappears.

In a later chapter we shall see the above tendency at work in this country, when the Restriction of Cash Payments at the end of the eighteenth century became the means of thoroughly ventilating the subject. For the present it is sufficient to note the working of the law in its third form: *If an inconvertible paper currency be issued in excess, that is to say, to such an extent that the total amount of the currency becomes greater than the normal amount required by the country, it will tend to drive the precious metals from circulation.*

These are the three applications of Gresham's law. It is perhaps necessary to explain that the law as originally formulated only covered the first of these phases. But since all three are but modifications of the same idea and are based upon the same general principle, it is expedient to classify them under the same generic title. The application of the law in some one of its phases is constantly claiming the attention of the student of monetary history, and a thorough grasp of its working is of vital importance.

CHAPTER IV.

THE ENGLISH COINAGE.

THE English coinage is regulated under what is called the system of Composite Legal Tender. A particular form of money is said to be legal tender in a country when it must be received if offered in payment of a debt. Money is full or unlimited legal tender if it can be so offered to an unlimited amount. It is limited legal tender if restrictions are imposed upon the debtor's power of compelling its acceptance.

The simplest monetary system is that of a single legal tender, but obviously there are disadvantages which outweigh the benefits conferred by simplicity. If the single metal is a dear one, like gold, it is difficult to coin pieces of sufficiently small value for everyday retail transactions. If, on the other hand, the single metal chosen is a cheaper one, the cost and inconvenience of transporting large amounts become insufferable. Of course a State can issue coins of two metals and make no proclamations or enactments at all, allowing the coins to circulate at a ratio varying with the market ratio of the metals of which they are composed, but such a system, or rather want of system, hardly commends itself to modern business methods.

If both metals are made unlimited legal tender and the ratio at which they are to circulate is fixed by the State, the operations of Gresham's law in its second form makes it a matter of extreme difficulty to keep both metals in circulation together for any length of time, as we shall see more plainly in the chapter on Bimetallism.

To obviate this difficulty, the English Government in 1816 adopted the compromise which is called the composite legal tender system, and which has been copied more or less closely by nearly all the civilised nations.

Gold is the sole unlimited legal tender in the British islands. Bank of England notes are full legal tender in England except by the Bank and its branches ; silver is legal tender in amounts not exceeding forty shillings, and bronze not exceeding one shilling.

In order to overcome the difficulty arising from the operation of Gresham's law, the Act of 1816, which is still the basis of our coinage system, enacted that silver, then worth about 5*s.* an ounce, should be coined at the rate of 5*s.* 6*d.* an ounce. In other words, there was in future to be only five shillings' worth of silver bullion in five and a-half coined shillings. This reduced our silver coins to the rank of "tokens," a token being a coin whose exchange value is greater than the value of the metal contained in it.

A little consideration will show that this would effectually prevent gold driving silver out of circulation. No one would export or melt silver coins,

because they would lose sixpence on every ounce while the market ratio remained at the level at which it then was. Silver was the over-rated metal,—very considerably over-rated. It would tend rapidly to drive gold from circulation ; but to prevent this the Government retained in its own hands the right of coining silver, and this power was only to be exercised sufficiently to provide the country with silver coin for small payments. This limitation of its amount effectually prevented silver from driving out gold. There was only sufficient in circulation for the purposes of small change, and in order still more effectually to prevent silver from being used in heavy payments, and also in order to protect creditors from being forced to receive large quantities of token coins which would not circulate at full value outside the kingdom, its tender was limited to forty shillings.

Our bronze coins are also tokens, and they are issued under similar conditions to those just described.

Gold then is the only unlimited legal tender in this country, and gold is the standard of value. All other forms of money retain their value, because they are legally exchangeable for a certain quantity of gold.

Any individual can take gold bullion to the Mint and demand sovereigns in exchange at the Mint price of £3 17*s.* 10½*d.* an ounce, free of all charge for coining. Previous to the Coinage Act of 1666 (18 Car. II. c. 5), the Crown made the public pay for this privilege. Not only was there a Mint charge to cover the expense of coining, now usually called

"brassage," but the Crown retained a varying proportion of the metal as a toll, called "seigneurage," though this latter term is often used to cover both these charges. The result of such charges was found to be a reluctance on the part of the public to bring bullion to the Mint, and the Crown was often compelled to call in older issues to provide metal for the new ones. Since 1666, therefore, the coinage of gold has been free in England, although many nations have retained the charge.

In practice, gold bullion is hardly ever taken to the Mint directly by the public. The Bank of England acts as the intermediary between the Mint and the public, and makes a small charge of $1\frac{1}{2}d.$ an ounce for so doing. The Bank is compelled by the terms of its charter to buy all gold offered to it at the fixed price of £3 17*s.* 9*d.* an ounce, and in return for the charge it gives the holder of bullion immediate payment, whereas if taken direct to the Mint a considerable delay would ensue.

English gold coins are made of standard gold, which is an "alloy" or mixture of eleven parts pure gold and one part of copper. Standard gold is therefore said to be "eleven-twelfths" fine or twenty-two carats fine, a carat being a goldsmith's term for a twenty-fourth part of an ounce. Most of the continental nations coin gold nine-tenths fine, and it is unfortunate that some international agreement on the subject has so far proved impossible, as this difference in fineness makes it necessary to refine foreign gold brought to the English Mint and *vice versâ*.

At the Mint price of £3 17*s.* 10½*d.* an ounce, a sovereign should weigh 123·27447 grains troy, but since absolute accuracy in weight was in former times, when the machinery was somewhat primitive, a matter of difficulty, the Mint is allowed a slight deviation called a "remedy," amounting to two-tenths of a grain in each sovereign. There is also a remedy in the fineness of the gold of two parts in a thousand. The remedy in weight is still allowed to the Mint, but with the perfect machinery now in use, they are capable of working within much narrower limits, and no new sovereign would now be issued varying as much as two-tenths of a grain from the standard weight. Half-sovereigns are issued of a proportionate weight and with a remedy of three-twentieths of a grain, and two pound pieces and five pound pieces are occasionally coined in strictly limited quantities.

Sovereigns are legal tender so long as they are not diminished by wear below the weight of one hundred and twenty-two and a half grains, and in the case of half-sovereigns, 61·1250 grains. Any individual to whom a coin weighing less than these respective amounts is tendered, is bound by law to deface it and hand it back to the individual who tenders it, and who has to bear the loss. At one time pocket balances adjusted to detect this difference were widely used; the provision has however been almost a dead letter, owing both to the difficulty of detection and to the absence of any penalty in the Act for a breach of this clause.

Until quite recent years, the State always fixed the onus of paying for the wear of the coinage upon

the public, but it was unable to keep it in a proper condition of repair. The Bank of England always charged for light gold tendered to them, and as a consequence other bankers sorted out the heavy coins by means of a weighing machine, and returned the lighter ones into circulation.

Gresham's law of course was in operation, and the gold coinage got into such a bad condition that Jevons estimated, in 1869, that 31½ per cent. of the sovereigns and 50 per cent. of the half sovereigns were below the legal limit in weight. About 1884 the bankers of the kingdom took the matter up, and eventually the Government so far receded from the position it had always maintained, that in 1889 a new Coinage Act was passed, providing for the calling in of pre-Victorian gold coins at the expense of the State. Exception was made in the case of coins which appeared to have been illegally or unfairly tampered with, the evidence of such ill-usage being the loss in weight of more than four grains. Such coins would be bought as bullion, but all other pre-Victorian sovereigns and half-soverigns were to be exchanged by the Mint, through the Bank of England, at their full nominal value. By a Royal Proclamation, pre-Victorian gold coins were declared to be no longer current after February 28th, 1891. In 1891 this Act was extended to all the gold coin in circulation, the evidence of ill-usage being altered to three grains loss in weight.

These two Acts mark the abandonment of the traditional view that the loss by wear of the coinage must be borne by the last holder. Whatever may

be the general opinion as to the justness or unjustness of this tradition, it had undoubtedly failed in practice, and the State has by passing these Acts definitely assumed the responsibility for keeping the gold coinage in repair. The effect on the currency has been excellent, and there is now small cause for discontent at the condition of our gold coins.

The condition of the silver coinage is of course of less importance, because it consists of token coins only, which are not required to circulate outside the kingdom, and which do not in any way owe their value to the value of the metal contained in them. Nevertheless some of the coins were a few years ago so worn that the inscription and impression were quite illegible. The duty of the State to bear the cost of replacing such coins is however plainer than in the case of the gold coins, because owing to the fall in the price of silver bullion, there is a handsome profit to the Mint upon the coinage of silver. The market price of silver is about 2*s.* 3*d.* an ounce, and this is coined into five and a-half shillings. Allowing for the expenses of the Mint, this leaves a profit of more than 100 per cent., so that there is every obligation thrown upon the State to keep the silver coinage in a proper state of repair. Accordingly, during the last ten years or so the Mint have advised the banks through the Bank of England that they will accept small quantities of badly worn silver at its nominal value, and the result is that our silver coinage, though far from perfect, has considerably improved during recent years.

SCHEDULE to the Coinage Act of 1891.

Denomination of Coin.	Standard of Fineness.	Remedy Allowance.		
		Weight per Piece.		Millesimal Fineness.
		Imperial Grains.	Metric Grams.	
GOLD:				
Five-pound	Eleven-twelfths fine gold, one-twelfth alloy; or millesimal fineness 916·6.	1·00	0·06479	2.
Two-pound		0·40	0·02592	
Sovereign		0·20	0·01296	
Half-sovereign		0·15	0·00972	
SILVER:				
Crown	Thirty-seven fortieths fine silver, three-fortieths alloy; or millesimal fineness 925.	2·000	0·1296	4
Double-florin		1·678	0·1087	
Half-crown		1·264	0·0788	
Florin		0·997	0·0646	
Shilling		0·578	0·0375	
Sixpence		0·346	0·0224	
Groat or Fourpence		0·262	0·0170	
Threepence		0·212	0·0138	
Twopence		0·144	0·0093	
Penny		0·087	0·0056	
BRONZE:				
Penny	Mixed metal, copper, tin and zinc.	2·91666	0·18899	None.
Halfpenny		1·75000	0·11339	
Farthing		0·87500	0·05669	

CHAPTER V.

ENGLAND'S ADOPTION OF THE GOLD STANDARD.

For the past century England has been unwavering in her allegiance to the gold standard of value. Other nations have changed or hesitated, and but for England's refusal to alter her present system, it is probable that some attempt to create a universal double standard would have been made. In this country there has, it is true, been at times an influential political minority in favour of change; but the banking and commercial classes have been unmistakably in favour of a continuance of the monetary policy which has done so much to build up London's financial reputation.

In these circumstances it is singular to reflect that England adopted the gold standard by a happy accident. The event which marked out England's future path as the upholder of gold monometallism is the rating of the guinea at twenty-one shillings in 1717, and this rating was due to an illogical and partial adoption of Sir Isaac Newton's report, a report which was intended to prevent, and not to hasten, the displacement of silver by gold in our currency.

Originally our standard was a silver one, based upon the Saxon pound's weight of that metal, and

our shilling, which weighs the sixty-sixth part of a pound, is the degenerate descendant of the twentieth part of a pound's weight of silver. Gold has circulated freely in the country since about the beginning of the fourteenth century, but at varying rates compared with silver. Until the beginning of the eighteenth century the bulk of the coinage was of silver, but soon after the great recoinage of silver in 1696 gold began to displace the less valuable metal in circumstances which aroused general alarm. This recoinage of William III.'s reign had been necessitated by the disgraceful condition into which the silver coinage had been allowed to fall, most of the coins in circulation being from 30 to 50 per cent. below their correct weight. This caused the rating of the guinea to vary according to the condition of the silver in the locality. Guineas had originally been coined in 1663 to circulate at twenty shillings; but owing to the depreciation in the silver coins their value with regard to the latter rose. The holders of guineas refused to part with them in some cases for less than thirty shillings, "not" as an anonymous pamphleteer remarks, "that gold became worth 30*s.* a guinea in good money, but in clipped and counterfeit coin."

After the recoinage of the silver at a cost to the nation of £2,700,000 the price of guineas fell to twenty-two shillings; but to the general alarm the new silver which had cost so much to issue, rapidly disappeared and gold poured into the country.

Gresham's law was in operation in its second form. Gold was overrated, and therefore was driving silver from circulation. At first sight it

seems difficult to see in what manner gold was overrated, because guineas circulated at a varying rate, and there was apparently no attempt on the part of the Government to fix a ratio between the two metals. How, then, can gold be said to have been overrated?

The following letter (*a*) issued by the Treasury Board to the Exchequer answers the question:

"Oct. 25th, 1697.

"Sir,

"The Lords Commissioners of his Majesty's Treasury desire you to signify to the tellers in the receipt of Exchequer, that they receive guineas at 22*s*. each, pursuant to the advertisement in the Gazette of Thursday last.

"(Signed) WM. LOWNDES."

This was tantamount to fixing the price of the guinea at twenty-two shillings, and at this ratio gold was overrated.

Sir Isaac Newton was asked to give his advice, and his report, issued in 1717, is a piece of thoroughly sound reasoning. He showed that in France, Holland, Italy, Germany, Poland, Denmark, and Sweden, the ratio between gold and silver did not exceed fifteen to one, and that at this ratio the guinea would be worth 20*s*. 8½*d*. in silver. But in England the guinea at this time passed at 21*s*. 6*d*., and it was therefore a profitable proceeding to send gold to England and buy silver with it for export to these countries.

(*a*) S. Dana Horton, The Silver Pound, p. 24.

Newton's advice was as follows (*b*): "If gold were lowered only to have the same proportion to the silver money in England which it hath to silver in the rest of Europe, there would be no temptation to export silver rather than gold to any other part of Europe. And to compass this last there seems nothing more requisite than to take off about 10*d*. or 12*d*. from the guinea. . . . But if only sixpence were taken off at present, it would diminish the temptation to export or melt down the silver coin, and by the effects would show hereafter better than can appear at present what further reduction would be most convenient for the public."

The report was enthusiastically received, and a Royal proclamation was issued rating the guinea at twenty-one shillings—a reduction of sixpence only. This should have been the first step only according to Newton, a provisional measure; but no further steps were taken, although this reduction was quite inadequate, as events soon proved.

There is nothing to show that the omission to proceed further was deliberate: it was apparently a blunder, and the proclamation which was intended to protect the silver coinage had the effect of sealing its fate as a part of the English standard of value.

From 1717 to 1816 both silver and gold were, by custom, in the absence of any legislation on the subject, legal tender to any amount. The Mint was open to the free coinage of both, and they circulated at a fixed ratio to each other. These, as we shall see later, are the three essential characteristics of a

(*b*) W. A. Shaw, Writers on Monetary History, p. 193.

perfect bimetallic system. Yet what was the condition of affairs in practice? No one brought silver to the Mint to be coined because it was worth more as bullion than it was as money. If a merchant had a remittance of silver bullion from the East it would pay him better to buy gold abroad and take the gold to the Mint than it would to take the silver to the Mint direct. In Europe he could buy as much gold as would make a guinea for twenty silver shillings and eightpence. If he took his silver to the Mint and received it back as coin, it would take twenty-one silver shillings to purchase as much as a gold guinea at the legal rating.

The inevitable consequence was that the amount of silver coin in circulation dwindled rapidly and became insufficient even for the purposes of change. What was left was so worn that in 1774 it became necessary to declare (14 Geo. 3, c. 42) that silver should be legal tender for sums exceeding £25, only by weight and not by tale (*i.e.*, number of coins) at 5*s.* 2*d.* an ounce.

For the first time in English history gold formed not only the bulk of the currency, but also the more popular part of the coinage. Gold supplanted silver against the wishes of the nation, but during the eighteenth century people became accustomed to it and grew to prefer it, so that when in 1816, after the great restriction of cash payments, the coinage had to be reorganised, there was never any question of reinstating silver in its old position. The Act of 1816 simply established on a legal basis what had long been settled in practice. The reduction of the

silver coins to token pieces was designed with two objects in view which have been well attained—the ensuring of a sufficient supply of silver coins for small change, and the establishment of gold as the bulk of the coinage and the standard of value.

At the same time one innovation was made by this Act which has been an incalculable saving of trouble. Previous to 1816 the standard unit of account in England did not coincide with the standard unit of the coinage. Sums have always been reckoned in pounds, shillings, and pence, the shilling having consistently been the twentieth part of a pound, originally, as we saw before, a twentieth of its weight. But the pound had never been coined before. Occasionally there had been gold coins in circulation which exchanged for twenty shillings, but the rating of the gold coins had previous to 1717 been very variable. For a century people had reckoned in pounds and paid in guineas, and we have a survival of those days in the custom of charging fees in the older professions, in guineas, and of giving subscriptions to charities in the same form. But this double system is very troublesome in dealing with large sums, and accordingly in 1816 the guinea was replaced by a smaller coin, the present sovereign, rated at twenty shillings, thus bringing the unit of the coinage into conformity with the unit of account.

CHAPTER VI.

BIMETALLISM.—I. THE FRENCH SYSTEM.

THE subject of bimetallism has been so recently the bone of contention between two hostile parties that it is difficult to obtain a clear and unbiassed view of its real meaning. As in most subjects which have formed the ground of political controversy, the issues at stake have become obscured and the main principles have been confused with various less important details.

The average man is prone to regard the subject as one of unfathomable complexity, best left to the expert. A deep study of the subject certainly does lead one into intricate byeways, but the main issues at stake are easy to understand.

The question to which each party claims to have found the answer is, how to obtain the most stable standard of value. As was explained in Chapter II., an absolutely stable standard of value has proved, and so far as we can see is likely to prove, impossible of attainment. The advocates of the single gold standard, with England at their head, do not attempt to deny the changes which have taken place in the value of gold towards commodities generally, but they do unhesitatingly claim that the single gold standard has best stood the test of experience.

The defenders of the bimetallic system on the other hand, with France at their head, claim that

under certain conditions the union of gold and silver as a joint and co-ordinate standard of value would prove more stable than the gold standard has been, but that the system has not had a fair trial, because the stated conditions have never yet occurred.

It is to some extent a contest of national temperament. England, the practical and conservative, stoutly adheres to the standard which, with all its faults, has served her better than any other, and refuses to relinquish it in favour of a system which in theory may be good but which has so far failed in practice. France, the logical and experimental, ever ready to risk failure in the hope of attaining perfection, strives to convert to her views the other nations without whose active concurrence she is helpless.

The subject divides itself naturally into two periods; the first, the attempt of France, with the aid of some of the other Latin nations, to maintain a bimetallic system in defiance of the resistance of the other commercial nations; the second, following on the failure of the first, the attempt to organise an international bimetallic system by united action on the part of the chief civilised countries of Europe and America.

As I explained in the last chapter, the characteristics of a perfect bimetallic system are three in number: concurrent circulation of gold and silver at a ratio fixed by the State; the opening of the mints to the coinage of both metals on equal terms; the establishment of unlimited legal tender for both metals.

These were the principles adopted by France when she reorganised her currency after the chaotic

mismanagement of her "assignats" and "mandats" at the end of the eighteenth century. The law of the 7th Germinal, 1803, embodied this system, the ratio between the two metals being fixed at $15\frac{1}{2}$ to 1. The weakness which eventually proved the ruin of the system, was the difficulty of keeping this mint ratio identical with the market ratio of the two metals as bullion. Directly the two ratios began to vary, Gresham's law came into operation and the over-rated metal tended to drive the other from circulation. In this way what was in theory a double standard, became in practice an *alternating* standard. At one time the preponderating bulk of the coinage was of gold, at another time of silver, but only for very short periods did they circulate together in anything like equal quantities.

This is well shown in the French monetary history of the nineteenth century. Below are given Dr. Soetbeer's (*a*) table of the average market ratio of gold to silver bullion during periods of ten and five years:

YEAR.	AVERAGE MARKET RATIO.
1811—1820	15·51 to 1
1821—1830	15·80 to 1
1831—1840	15·75 to 1
1841—1850	15·83 to 1
1851—1855	15·41 to 1
1856—1860	15·30 to 1
1861—1865	15·40 to 1

Observe that between 1811 and 1850 the average market ratio was always slightly above the French mint ratio of 15·5 to 1; consequently silver was over-

(*a*) Appendix to Final Report of the Gold and Silver Commission, p. 162.

rated in France and drove gold almost entirely from circulation. H. D. Macleod, the author of the "Theory and Practice of Banking," says, "I myself can testify that in 1839 there was not to be seen a gold coin in France in common use"(*b*).

This state of affairs lasted until the gold discoveries of the middle of the century. In 1848, the Californian gold fields were opened, followed in 1851 by similar discoveries in Australia. Most of this gold was alluvial, and therefore easily extracted. The output of the metal was enormously increased. Between 1831 and 1840 the estimated average annual production of gold was £2,830,000; between 1841 and 1850 this average rose to £7,638,000; and between 1851 and 1860, £27,815,000. Something like a panic occurred in the gold using countries, owing to the anticipated fall in the purchasing power of gold, due to this sudden increase of the quantity in circulation. History had no parallel on record except the silver discoveries in South America, following the exploitation of that country by the Spaniards in the sixteenth century, and in that case it is generally agreed that two important results ensued: First, a fall in the purchasing power of money was shown by the general rise of prices; and secondly, owing to the greater increase in the quantity of silver compared to gold, there was a disturbance in the market ratio between the two metals, which rose from about 11 to 1 to about 15 to 1 between 1550 and 1650. Extravagant prophecies were made of wholesale ruin to gold using countries like England, but fortunately events were not so bad

(*b*) H. D. Macleod, "Bimetalism," 2nd ed., p. 15.

as was anticipated. Both of the phenomena which distinguished the silver discoveries of the sixteenth century were repeated in the nineteenth century, but only to a very small extent.

It is still a contested point whether the rise in general prices which occurred between 1850 and 1860 was due to the gold discoveries, but it is unquestionably true that such a rise did take place. Prices are however the result of such a complex set of causes that it is not yet possible to assign with certainty a cause for the rise.

Professor Jevons worked out a table of what are called "index numbers," representing the average weekly price of about fifty of the staple articles of commerce. He took the year 1849 as equalling 100; by 1855 the index number had risen to 125; in 1860 it was 124, and in 1865, 121. Several well-known economists have worked out index numbers on separate lines and with very similar results, and there is no room for doubt that the rise in prices did take place. I think we can reasonably infer that this rise was due to the gold discoveries.

As to the second result anticipated, a disturbance in the ratio between the two metals, the table on p. 38 will show that this did occur, but that it was so small as to be apparently insignificant. It was not insignificant because it was sufficient to bring the market ratio below the French Mint ratio of $15\frac{1}{2}$ to 1, and it is to the history of the French currency that we must look for an explanation of the smallness of the change. This explanation was first given by Michael Chevalier, the well-known French authority on money.

Writing in the Revue des Deux Mondes in 1857, Chevalier pointed out that France had absorbed a large proportion of the new gold. Directly the market ratio fell below $15\frac{1}{2}$ to 1, gold became overrated in France, and began to displace silver. From 1822 to 1851, France imported every year, without exception, more silver than she exported, the excess of imports often being very large indeed. Between 1852 and 1864 the position was exactly reversed, and her exports of silver invariably exceeded her imports of that metal. Immense quantities of silver were exported from France in the years succeeding the gold discoveries, and its place was taken by the new Californian and Australian gold.

Thus, the French silver was set free for use in other countries, and the surplus gold was absorbed, and this naturally prevented any wide divergence of the ratio from its existing figure.

Gold was being produced at a more rapid rate than silver. France absorbed the gold, and set free her stock of silver. "In this way," says Chevalier, "France serves temporarily as a *parachute* to retard the fall of gold relatively to the other precious metals."

This is called the "*compensatory action of the double standard.*" France had absorbed the metal of which the supply had increased, and had set free the metal which tended to increase in value compared to the other. The rate of production of gold was threatening to become much greater than formerly; France set up a demand for gold, and, so to speak, compensated for the increase in its supply.

This compensatory action is, however, only possible under certain circumstances, and for a limited period. France was able to absorb the surplus gold because it happened that the bulk of her currency at the time consisted of silver. Directly France became "saturated" with gold the action ceased, and if the increased production of gold had continued, there would in all probability have been a more decided fall in the ratio.

But it did not continue. The bulk of the newly discovered gold was on the surface, the mines were soon exhausted of this easily obtained metal, and the output declined.

Summarising the results of the influence of the French bimetallic system upon the increased gold production, we arrive at the following conclusions:

(1) It helped to steady the market ratio between the two metals.

(2) To a lesser extent it helped to steady general prices, for the immense quantities of silver exported by France were not re-coined in Europe, but were probably partly exported to the East and partly used in other directions. Thus, the total metallic currency in Europe was reduced, and the rise in prices checked.

(3) Its action was only temporary, and ceased when silver was driven from the ordinary channels of circulation in France.

(4) Although this action was beneficial to Europe generally, it was very expensive to France. She not only had to bear the inconvenience resulting

from a change in the metal forming the practical standard of value, but she had to bear the cost of re-coining almost the whole of her currency. Between 1850 and 1857, France coined gold to the value of over £109,000,000 sterling.

We can hardly wonder then that England saw no valid reason for abandoning her gold standard in favour of the French system. France, indeed, rallied round her some of the other European States, Belgium, Italy, and Switzerland, who, on December 23rd, 1865, signed the monetary treaty called the Latin Union, afterwards joined by Greece. This treaty, according to the views expressed by the French Minister at Washington, "had a sole object, that of putting an end to the disappearance of fractional silver." France and her pupils, when the change in the ratio began to result in the disappearance of their silver, found the want of small change very inconvenient. Accordingly, they resolved to coin their smaller silver coins as tokens, maintaining the full weight and fineness of the five-franc piece. The terms of the Latin Union were:

(1) That gold coins and five-franc pieces of the fineness of nine-tenths were to be coined to an unlimited extent, to be of the same weight and equally legal tender in any of the countries which became signatories to the treaty.

(2) The smaller silver coins were to be of proportional weight, but only ·835 fine, thus reducing them to the rank of tokens and preventing them leaving the country; such coins to be limited by the population of each country, and to be legal tender

to the amount of fifty francs, only in the country which coined them.

The avowed object of this treaty was to protect the smaller silver coins, but hardly had it been signed when events occurred which once more raised the market ratio above $15\frac{1}{2}$ to one, and once more threatened to flood the bimetallic countries with silver.

These events were twofold: First, silver was discovered in apparently inexhaustible quantities in Nevada, and some of the other Western States of America. Secondly, a violent reaction in favour of gold as a single standard set in all over Europe. At an International Conference held in Paris in 1867, all the delegates, with the single exception of Holland, voted in favour of gold monometallism. Germany, in 1871, followed this up by starting to re-model her coinage, the bulk of which was at the time silver, and the model she adopted was the English system. Thus, we see that an immense increase in the supply of silver occurred almost simultaneously with a startling decrease in the demand for it for coinage purposes. The Latin Union were faced with an inevitable deluge of silver at the expense of the existing gold coinage.

They found the prospect too uninviting. The people had become accustomed to gold, and, like the English people in the preceding century, they were unwilling to abandon it for the more cumbersome silver currency.

Accordingly, in 1874, a meeting of the Union was held, at which it was resolved to close the mints

to the free coinage of standard five-franc pieces, and strictly limit the amount of these to be issued. In theory they still adhered to the double standard; in practice they had adopted a system hardly to be distinguished from the composite legal tender system. Silver was still legal tender to an unlimited amount, but the amount of silver in circulation was kept within strict bounds. It was a "limping" or "halting" system of bimetallism. The real French bimetallic system had proved a failure.

CHAPTER VII.

BIMETALLISM.—II. INTERNATIONAL ACTION.

With the closing of the mints of the Latin Union to the free coinage of silver in 1874, we enter upon the second phase of the bimetallic question. This second phase is quite distinct from the first, which had just ended disastrously, if not ignominiously. Though the object was the same, the maintenance of silver as a co-ordinate standard of value with gold, the motives were different and different means of attaining the desired object were advocated. The position of silver was forced upon the attention of the commercial nations by the impending danger that the rush for gold as a sole standard of value would result in a serious rise in the value of that metal. What had proved impossible of achievement to France and her Latin allies, it was now sought to attain by the united action of the civilised world.

The example of Germany in "demonetising" her silver was copied by several of her northern neighbours. Germany, just emerging into a fresh national life after the Franco-German war, proceeded energetically in the re-modelling of her coinage, and between 1873 and 1879 she threw upon the market more than 7,000,000 lbs. of silver (*a*). Holland and

(*a*) Shaw, History of Currency, p. 219.

the Scandinavian Governments pursued the same policy, and the United States of America in 1873 ceased the coinage of silver. This serious decrease in the demand for silver, and the increased supplies from the mines and from the "demonetised" silver currencies, soon resulted in a fall in the gold price of that metal. The price of silver bullion had for a couple of centuries or more averaged from 5*s.* to 5*s.* 2*d.* an ounce. In 1873 it dropped to 59¼*d.*; in 1875, 56⅞*d.*; in 1876 in six months it fell from 56⅛*d.* to 48¼*d.*, and has almost without intermission declined until it has reached its present price of about 2*s.* 3*d.* an ounce. Simultaneously with this fall in the gold price of silver, and in striking conformity with it, has occurred a fall in general prices, dating from about the same year, 1873.

These two phenomena, the fall in the price of silver and in the prices of all commodities, form the groundwork for the bimetallists' attack upon the single gold standard. Put shortly, their argument was as follows: There has been a sudden and unprecedented demand for gold for coinage purposes to take the place of the silver thrown upon the market; the supplies of gold are not only stationary, but actually declining, and the world's stock has proved quite inadequate to meet the demand. Consequently gold has risen or "appreciated" in value, in accordance with the accepted theory that the value of money depends upon the quantity in circulation and the amount of work that quantity has to perform. This "appreciation" shews itself in a fall in prices, and silver, having become a commodity and being no longer the standard of value, has

naturally shared in the fall. The remedy, the only remedy they said, was to come to some agreement to coin silver again, to circulate at a fixed ratio as legal tender. By so doing the quantity of money in circulation will be increased, and prices will rise again.

Their opponents, the gold monometallists, denied the premises upon which the bimetallists based their arguments. The year 1873 and its immediate predecessors, they said, were years of abnormally high prices, and all arguments based upon these prices were fallacious. The drop which occurred, however regrettable, was only a natural reaction; temporary rises and declines in prices were unfortunately unavoidable, but time would remedy the evil. As to recoining silver as a standard of value, the advocates of the single standard denied the possibility of raising silver to anything like its old price; they might increase the demand for it, but the supply had so grown that a return to the old level was not practicable. The smallest rise in price would stimulate production and cause mines hitherto regarded as unprofitable to be re-opened. Moreover, they regarded silver as a cumbersome and clumsy medium of exchange for large payments, and deprecated any attempt to open the mints again to its recoinage for this reason. As to any international agreement to maintain silver in circulation, a majority of the party frankly denied its possibility and viewed the proposal as quixotic.

In England the drop in the price of silver was regarded with comparative equanimity. England was neither a silver producing country, nor was she

a holder of silver to any extent. It was only in her Eastern possessions, particularly India, that the blow was severely felt. But the decline in general prices was a serious handicap to a commercial nation like ours, and the strength of the bimetallic party in England was mainly the result of its promise that the recoinage of silver would force prices up again.

There is and always has been considerable misunderstanding in the popular mind as to the supposed advantages of rising prices. It must be borne in mind that what we should always strive to maintain is a stable standard of value. *Any* change in the value of money is an evil. It is possible, though not certain, that to a nation like England, with a large foreign trade, a fall in the purchasing power of money, with its attendant rise in prices, is a lesser evil than its converse. For instance, the period between 1860 and 1873 was one of the most prosperous periods in English history, and prices were constantly on the up-grade. But we must remember that the nation was peculiarly able to bear the disadvantages arising from rising prices. It was the period succeeding the adoption of Free Trade, and though the connection is in some quarters denied, yet it must be admitted that our foreign trade increased so fast that a maintenance of the rate of growth could hardly be hoped for. Not only were prices rising but wages also rose, and the price of foodstuffs, so far from sharing in the rise, had greatly fallen. Rising prices as a rule mean hardship to the wage-earning classes of the community, a very large

proportion of the population, because prices usually rise faster than wages. This hardship was not felt to any great extent in the period preceding 1873, but if the programme of the bimetallic party had been carried out and their avowed object of raising prices been achieved, there is little doubt that it would have caused severe distress in some quarters, for such a rise must have necessarily been sudden.

The loss inflicted on the mercantile community by the fall in prices after 1873 was a real one, for it meant that the anticipated profit of the manufacturer would possibly be turned into an actual loss. Modern manufacturers do not work to order but must anticipate demand, and the margin of profit is so small that it requires but a very small drop in prices to change this profit into a loss. Constantly drooping prices to a certain extent paralyze industry, and so react on the whole community. Nevertheless it must be remembered that the loss is incurred during the process of the decline, and that a sudden jump upwards is not the remedy.

The history of the bimetallic movement is a record of abortive international conferences held at the instance of France or the United States, at Paris in 1878 and 1881, and at Brussels in 1892, with the object of rehabilitating silver as a standard of value, and maintaining it in circulation by international agreement. The question was thoroughly ventilated in this country by means of a Select Committee of the House of Commons appointed in 1876 to enquire into the depreciation in the value of silver, and also by the Royal Commission of 1886, usually called the "Gold and Silver Commission," but although a

considerable addition to our information on the subject was gained, no practical result ensued. The failure of the international conferences was undoubtedly chiefly due to the attitude adopted by England. London had acquired a reputation as the central gold market of the world, and the country was firm in its resolve not to jeopardise this reputation by rash experiment. Thus, while the English delegates usually shared in the opinion that silver ought to be maintained in circulation as much as possible, they neither would nor could promise England's active support in establishing a universal recoinage of the metal.

For many years the bimetallic question was the most prominent economic problem before the world, yet about the years 1897—1898 all interest in the matter suddenly dropped. With the recent recrudescence of Protection so fresh in our minds it is perhaps rash to say that bimetallism is dead, but at all events it has totally ceased to be a factor in the political world; if not dead it is at least dormant. How are we to account for this sudden loss of interest in a subject which only a few years ago divided the world into two hostile camps? The reason is that the chief arguments of the bimetallic party have been rendered useless by the recent trend of events. The ground has been cut away from their feet and the party has no longer a *raison d'être*.

First of all, the general level of prices, which had almost constantly dropped since 1873, became stationary about 1895—1897, and then slightly rose, as is shown by Mr. Sauerbeck's index numbers of

the prices of forty-five staple commodities published annually in the Journal of the Institute of Bankers. This cut away one prop of the party. Then the opening up of the South African Goldfields, and the rapid increase in the world's annual output of gold, cut away the other prop.

The bimetallists had argued that gold had appreciated in value owing to the supply being insufficient to meet the increased demand, hence the fall in prices. This insufficiency in the supply was being rapidly counteracted by the output of the South African mines, and the chief argument in favour of adopting a double standard of value was invalidated.

Looked at in one way this result was a triumph for the bimetallic party. The more extreme of the monometallists had denied that the increased use of gold had resulted in a scarcity of that metal, but the rise in prices which followed the increase in the gold supply seems a confirmation of the bimetallic argument.

From a purely theoretical point of view the arguments put forward by the bimetallic party were more logical than those of their opponents, but in England, at all events, it was not a question of theory. The victory of the gold monometallic party was a victory of strong common sense and practical business habits over abstract theory. Considering the length of the tradition which lay behind the use of gold as a single standard in England, the unique financial position which London had built up by

means of this gold standard, and the generally successful commercial position of the country, it would undoubtedly have been rash in the extreme on her part to abandon her coinage system in favour of a scheme which, however logical in theory, had, it must not be forgotten, been a distinct failure when put to the test of experience.

CHAPTER VIII.

CREDIT.—THE REGULATION OF NOTE ISSUES.

We have hitherto confined our attention to the metallic portion of the currency, and have treated the standard of value as if it were purely a gold standard. Speaking accurately, this is not quite true. Gold is but the basis of our currency, and forms only a part of the standard of value. Superimposed upon this basis of gold is an enormous mass of obligations and promises to pay gold, and the standard of value is therefore a mixture of gold and obligations to pay gold. In one sense we are perhaps justified in speaking of our standard of value as a gold one, since the paper portion of the standard is legally payable, either on demand or at some future time, in gold; but we must never forget that the value of money is in part determined by the amount of these obligations. If we could extinguish altogether the paper portion of the currency, the value of the remaining portion would undoubtedly rise enormously, and it is for this reason that we cannot with accuracy speak of our standard of value as a purely gold one, although it has a basis almost entirely of gold.

Mr. G. H. Pownall, in an interesting paper read before the Institute of Bankers on October 19th,

1881, gave the result of his statistical researches into the proportional amounts of the different kinds of money in active circulation. The following table shows the percentage of metallic and paper money received from the customers of country banks in 261 towns of England and Wales:

Gold	12·41 per cent.
Silver and bronze	2·79 „
Bank of England and country bank notes	11·94 „
Cheques and bills	72·86 „
	100·00

He further gives a similar table for ten banks in the city of London:

Coin	0·95 per cent.
Notes	2·48 „
Cheques and bills	96·57 „
	100·00

In the country the percentage of gold and silver coin was about 15 per cent., while in London it was less than 1 per cent.

The remainder can be classed together as "instruments of credit."

The word credit is used in many senses, but the meaning here attaching to the term is that of *a present right to the future possession of money*. Credit is a right, and necessarily implies an obligation, and the various forms of paper money are evidences of, and means of transferring, these rights. Smith gives

Brown a promissory note for £100 due in three months. Brown acquires an immediate right to the possession of £100 at the expiration of three months, and Smith incurs a similar obligation to pay the amount. Remember that Brown's right is an immediate one, and if he wishes to realise his right he can do so by selling the paper note which is the evidence of his right. He takes it to his banker, who buys it from him, charging him interest and perhaps a small commission.

Every creation of credit increases the quantity of money which may be put into circulation, and so has an effect on prices. The creation of credit increases the effective power of demanding goods, that is, it increases the power of demanding and paying for goods, and this is equivalent to an increase of the quantity of money.

The various instruments of credit in circulation are not all paid in gold, although they may be legally so payable; the amount of gold in circulation in England is only sufficient to pay a very small percentage of the paper obligations current at any particular time. By far the greater proportion is cancelled by the creation or transfer of other forms of credit. The whole of our monetary system in fact rests upon mutual confidence and forbearance, and when a temporary lapse of such confidence occurs we get a monetary crisis. All debts are legally payable in gold or Bank of England notes, for which gold can be at once demanded; but by implicit agreement, credit instruments or paper money, as we may call them, are almost universally accepted.

We pay with rights to demand gold, which are exchanged against one another, and only a small proportion of which are liquidated in gold.

The amount of credit which may be created on a given basis of gold is not a fixed quantity. But neither is it an unlimited quantity, and one of the greatest of dangers to modern commerce lies in the possibility of erecting too heavy a superstructure of credit upon the metallic base, a proceeding usually ending in temporary disaster, as we shall see in a later chapter. This amount varies according to trade conditions, the state of the public's confidence in each other, and the existence or absence of that vague atmosphere of speculation which plays such an important part in modern business life.

The various documents which are the evidences of the right to demand gold and the means of transferring such rights, instruments of credit as they are usually called, can be conveniently divided into two groups : on the one hand, bank notes and Government notes; on the other hand, cheques, bills, promissory notes, and the various modifications of such documents, as, for instance, postal orders and money orders. There is a broad line of distinction between the two groups ; the second one consists of forms of paper money which rarely circulate for long, except for the purposes of collection. The man to whom a cheque is given usually pays it in to the credit of his account with his banker, by whom it is at once presented for payment. Bills of exchange, as we shall see, are circulated during the period in which they are current, but usually only by endorsement and

delivery, the effect of which is that every fresh holder obtains a kind of guarantee from the previous holder.

But bank notes are payable to bearer and circulate freely from hand to hand, besides which they are in many cases legal tender. It may be years before they are presented for payment at the bank which issues them.

The consequence of this distinction is that the issue of bank notes requires strict and careful regulation, while the other class of documents can be left to such regulation as is afforded by the business habits of a mercantile community, and such legal protection to the various parties as experience shows to be necessary. The mere fact that bills and cheques are presented for payment, either upon their due date or shortly after they are issued, makes it difficult to issue them in excess, and even if it were thought desirable to place any restrictions upon their issue, it is not easy to see how this could be done, for the imposition of any restraints upon the creation of mercantile credit could not be tolerated for an instant in a country like this. Its regulation is best left to the prudence and business habits which are the growth of long experience in commercial matters.

But with bank notes it is far different. These are in many cases as freely accepted and passed on as are the coins of the realm. Once they acquire the sanction of custom, people do not inquire whether the bank which issues them is in a position to redeem all its obligations; they are freely accepted until

without warning the bank may suspend payment and the holders of the notes find them worthless.

The history of banking in England during the eighteenth century affords countless instances of bank notes, issued by entirely irresponsible individuals, which circulated freely for a time until the inevitable crash came. The Charter of the Bank of England rendered the establishment of powerful banks of issue an impossibility, and it was left to small tradesmen and others to issue as many notes as the public would accept, with the result that periodic convulsions of credit occurred, in which hundreds of these small bankers came to grief.

There is, or rather has been, a school of economists, called the Free Banking School, who insist that the issue of notes should be left unrestrained, except by the legal obligation of being payable in coin on demand, but these opinions are now generally discredited and we find a universal tendency over the civilised world to place restrictions of some kind upon their issue.

Before examining the chief methods of regulating a note issue, a few words are necessary on the important distinction between a convertible and an inconvertible note issue. Speaking briefly, any system of inconvertible notes is bad, and should only be resorted to in the direst national extremity. The weakness of a paper issue lies in the possibility of over issue, which lessens the value of the currency and destroys the stability of the standard of value; and the most powerful preventive of excessive issue is convertibility. An issue of inconvertible paper

may retain its value and perform all the functions of money so long as its amount is restricted, but experience shows that the power of issuing an inconvertible currency can rarely be used in moderation for any length of time and that the temptation to abuse the power of issue is so great as to be almost irresistible.

The chief qualification therefore of a note issue is that it should be legally payable on demand in coin of the realm. Then the problem arises, how to ensure this convertibility? We have to consider not only the ultimate solvency of the issuing bank, but the *immediate* convertibility of the note. A note is a promise to pay coin on demand, and it is not sufficient if the issuing bank, though unable to provide gold, yet has plenty of landed or other securities to cover its debt. There have been attempts in plenty to solve the monetary problem by issuing notes against the security of land or other forms of wealth, but all have failed when the impossibility of paying the notes in coin became apparent.

The most certain method of ensuring convertibility is, of course, to compel the deposit of gold in the strong room of the bank to an equal amount with the total of the notes issued—what is known as the "simple deposit method." The disadvantages are, however, obvious. In early times, when credit was in an embryo stage, such a method was pursued with success, as in the early days of the Bank of Amsterdam. But now-a-days the paper circulation is not only a substitute for the coinage, designed merely to save the cost of wear and tear—it is an addition to

the currency. Gold so deposited is gold lying idle. As we shall see, some gold must be kept idle in the shape of a reserve ; but to withdraw from circulation an amount of gold equal to the total note issue and to lock it up so that it cannot be touched, except by withdrawing those notes from circulation, is too wasteful for modern methods. The method which is usually adopted is some modification of the partial deposit system, which consists in allowing the banks concerned to issue only a limited amount of notes without the deposit of gold. This is the English system as governed by the Bank Charter Act of 1844, which is discussed in a separate chapter.

The Germans have copied us in this respect, but with an important modification. The English Act fixes a strict limit, beyond which all notes must have gold deposited to secure their convertibility, but the Germans have adopted provisions which enable the limit to be exceeded under certain conditions ; the limit is an " elastic " one. The Imperial Bank of Germany can issue notes to the value of £22,500,000 sterling against the deposit of securities, but beyond this amount all notes must be secured by the deposit of an equal amount of gold. But in order to give the bank the power of increasing the currency in an emergency, this limit can be exceeded on payment of a tax of 5 per cent. on the excess issue, provided there shall, at all times, be a gold reserve of at least one-third of the total note circulation.

The American system is based upon what is called a " proportional reserve " of coin or bullion. The United States note issues are divided into three

classes. First of all there are the "Gold Certificates," against the issue of which gold is deposited to the full nominal amount in the United States Treasury. These notes are not intended for general circulation, and are chiefly held by bankers in large amounts. Secondly, there are the Government legal tender notes or "greenbacks," originally issued to pay for the American Civil War; and, thirdly, there are the notes of the National Banks. The National Banks are required to keep a cash reserve, equal at all times to at least one-fourth of their total liabilities to the public, if they are situated in one of certain large towns, or 15 per cent. if outside these towns. In return they obtain the practical monopoly of issuing bank notes; the State Banks, which are not governed by these conditions, can only issue notes on payment of a tax of 10 per cent., which is practically prohibitive.

The proportional reserve system acts well in ordinary circumstances, but directly the reserve is allowed to reach the minimum (and a legal minimum reserve always tends to be a practical maximum reserve) it results in an exceptional contraction of credit.

Another method of ensuring convertibility is the "maximum issue" method. This is the system under which the circulation of the English country banks is governed by the Act of 1844. A maximum amount is fixed by the Act for each bank possessing the privilege, and beyond this amount the banks cannot issue except under heavy penalties.

The French system is also regulated by a legal maximum of issue, which is fixed at a high amount, being now 5,000,000,000 francs. The position of France is, however, somewhat exceptional. The metallic circulation of the country is a very large one, and an enormous cash reserve is held by the Bank of France, which takes all possible precautions against undue depletion, precautions which entail the relinquishment of the claim of Paris to be a free gold market.

CHAPTER IX.

THE RESTRICTION OF CASH PAYMENTS BY THE BANK OF ENGLAND.

ENGLAND has only once tasted the sweets and bitters of an inconvertible paper currency, but that short period is of exceptional interest, not only because of the national experience by which the country has so thoroughly profited, but also from the lessons which the student may learn as to the consequences of such an issue.

The years preceding the opening of the nineteenth century were one of the most critical periods in our history. England was at the head of the European confederation against revolutionary France, and she had to provide the greater part of the funds for carrying on the struggle. Pitt's constant remittances abroad to subsidise the lesser powers formed a standing menace to the financial well-being of the country. A demand for gold can take either of two forms. It may be a domestic demand, to fill up the gaps caused by a temporary failure of credit. In this case a great strain is thrown upon the Bank of England; when other paper is discredited the country has always been willing to accept the notes of the Bank of England, and has learnt to rely upon the Bank's assistance in cases of necessity. The latter

has accepted the responsibility, and has found by experience that the best means of allaying the public fears is to lend freely and generously.

The other form of a demand for gold is a foreign demand, that is to say, a demand for export purposes. In this case the traditional policy of the Bank (*a*) is to restrict her issues of notes and her loans. The consequent scarcity of credit results in a rise in the rate of interest, which attracts foreign gold to this country and so stays the drain.

In 1797 a demand for gold occurred from both these quarters. Pitt had repealed the clause in the charter of the Bank of England forbidding them to lend to the Government beyond the amount of their capital, and was drawing freely on the Bank, which was compelled to honour his drafts, although it lent under protest. Then rumours of a French landing in the North of England led to a panic in Newcastle, which quickly spread to London. The Bank directors were at their wits end. On the one hand policy dictated the free lending of money in order to steady the public nerves and assuage the panic ; but, on the other hand, Pitt's borrowings had so tied their hands, and reduced their stock of gold to such a low ebb, that this policy was impossible. On February 25th, 1797, therefore, as the only resource in these difficult circumstances, an Order in Council was issued directing the Bank to suspend payments in cash except under certain strict conditions, and an Act of Indemnity was quickly passed. This Act

(*a*) The word "Bank," when spelt with a capital letter, is used here and in the following pages to denote the Bank of England.

was only to be in force until June of the same year, and no better proof of the temporary nature of the Act can be found than the fact that Bank notes were not made legal tender, and no penalties were enacted for the refusal to receive them. As it turned out the Act was not finally repealed until the lapse of twenty-two years.

The country took the suspension well. The Bank being freed from anxiety as to its gold reserve, was enabled to lend freely, and confidence was soon restored. A Committee of the House of Commons examined the books of the Bank and reported it perfectly solvent, and the Bank were authorised to issue £1 and £2 notes to take the place of guineas in small payments.

For a time the condition of the currency appeared quite normal, and no inconvenience seems to have been felt from the suspension. About 1801 however, two phenomena began to attract attention: first, a rise of the market price of gold bullion considerably above the Mint price; secondly, an unusual and continued adverse state of the foreign exchanges.

The market price of gold rose in 1801 to £4 5*s.* per ounce, the Mint price being as now, £3 17*s.* 10½*d.* This meant that people were willing to pay £4 5*s.* for an ounce of gold bullion which, when taken to the Mint, would only yield £3 17*s.* 10½*d.* in coin.

The exchange with Hamburg, then the chief centre of exchange with England, fell to 14 per cent. below par.

We shall consider the foreign exchanges in a later chapter; suffice it to say now that this

meant that if an Englishman owed a debt in Hamburg, it cost him 14 per cent. more to pay the debt than it would in the case of a debt of the same amount payable in London. But the cost of shipping gold to Hamburg, the most expensive way of settling the debt, was only 7 per cent.: how was the other 7 per cent. to be accounted for? An explanation was given in what is usually called Lord King's law, though Lord King was not the first to see the truth of it. This law is: If a metallic and a paper currency circulate together, and the market price of bullion rise appreciably above the Mint price, accompanied by a fall in the foreign exchanges below the "bullion point," that is, a fall which is greater than the cost of transmitting bullion, this difference between the Mint and the market prices of bullion represents the measure of the depreciation of the paper currency.

It was obviously absurd that people should be willing to buy gold bullion for coin at the rate of £4 5*s.* an ounce, when they could only get it coined at the rate of £3 17*s.* 10½*d.* The fact, is the price of gold bullion was a *paper* price. A debt payable in Hamburg cost more to settle than one payable in London, because the former would have to be settled in coin or bullion, for the paper would not go abroad, while the latter would be settled in bank notes. The conclusion to be drawn was that these bank notes were depreciated, their purchasing power was less than gold of the same denomination.

This conclusion was at the time strenuously denied. It was pointed out that notes were not

legal tender, and therefore, although they were temporarily inconvertible, no one was compelled to take them. The Act of 1797 said that payments in bank notes was to be deemed payment in gold only if offered and accepted as such. The notes circulated freely, without compulsion, and perfect confidence was expressed and felt in the Bank of England on all hands. How then could the notes be depreciated?

The refusal to admit the depreciation was due to the failure to realize that the value of money depends, other things being equal, on the quantity in circulation. Notes were at a discount because they had been issued in excess. An excessive issue of an inconvertible paper currency, however good may be the reputation of the issuing bank or government, and however complete may be the public confidence in its stability, is bound to result in a depreciation of the value or purchasing power of such a currency. The suspension of cash payments had first of all encouraged the hoarding of coin. Gold paid into the Bank of England could only be withdrawn in part, and it was inevitable that the holders of gold should quietly put it by. The gaps caused in the circulation were filled by an increase in the note circulation. Further increases resulted in a surplus of the currency, and part of it was driven abroad. This part was the gold and silver coinage, for foreigners would of course not accept inconvertible paper. When the bulk of the gold had disappeared from the ordinary channels of circulation, any further increase in the issue of notes would result in a depreciation of the currency, which had by now become practically all paper, and prices

quoted would of course be paper prices. Between 1803 and 1809, the depreciation almost disappeared and the market price of gold was seldom above £4; but in 1809 and 1810 the evil became more pronounced than ever, and in the latter year the House of Commons appointed a "Committee to consider the high price of bullion." The report of this Committee, always called the Bullion Report, is of the utmost value as a study of the conditions governing an inconvertible currency.

The report first of all states five incontrovertible propositions:

(1) That the Mint price of gold is £3 17*s.* 10½*d.* an ounce.

(2) That the market price at the beginning of 1810 was between £4 10*s.* and £4 12*s.* an ounce.

(3) That the Exchanges on Hamburg and Amsterdam were depressed from 16 to 20 per cent. below par.

(4) That the issues of the Bank of England and the country banks have considerably increased in amount.

(5) That gold has been driven from circulation, though not from the country altogether.

Having stated these propositions, which were admitted on all hands, the Committee reported the conclusions which they drew from these facts:

(1) That the variations of the metallic exchange with foreign countries can never, for any considerable time, exceed the expense of transporting and insuring the precious metals from one country to another.

The value of a sovereign estimated in Flemish coin was about 34½ Flemish shillings. That was the value of the metals in the respective coins reckoned at the current price of silver, and is called the "par of exchange" between the two places, London and Hamburg. It is obvious that a debt payable in London may be worth slightly less in Hamburg, because it will have to be collected or liquidated in some way, and the proceeds remitted to Hamburg. This causes variations in the rate of exchange, but the Bullion Committee urged that such variations could not be more than the cost of settling the debt by remitting coin by sea.

Estimating this cost at 7 per cent. at the utmost, or 2½ Flemish shillings on each £1 sterling, the latter would be worth not less than 32 shillings. But at the rate quoted on the Exchange, a debt of £1 sterling due in London was selling for 29 Flemish shillings only in Hamburg.

As an explanation of this, the Committee lays down as the second of their conclusions:

That this difference of about 9 per cent. or more which could not be accounted for, was due to the excessive issues of inconvertible paper by the Bank of England. A debt due in London would be paid in this paper as a matter of course. If the debtor wished to pay in gold, he would have to buy gold, and £1 in paper was worth considerably less than £1 in gold.

The third conclusion was:

That the market price of gold bullion can never exceed the Mint price to any appreciable

extent, unless the currency in which the bullion is paid for, and in terms of which it is quoted, is depreciated below the value of full weight coins.

To all who have grasped the meaning of the term "Mint price of gold," this is obvious. The bullion may be quoted in terms of depreciated paper, as in this instance, or it may be quoted in terms of coins worn below their proper weight, but unless the currency be depreciated in some way, the difference cannot exist.

The fourth conclusion was the logical result of the third:

That therefore the difference between the market price of gold and the Mint price exactly measured the depreciation of the Bank of England notes.

The report continues: "Your Committee beg leave to report it to the House as their most clear opinion that, so long as the suspension of cash payments is permitted to subsist, the price of gold bullion and the general course of exchange with foreign countries, taken for any considerable period of time, form the best general criterion from which any inference can be drawn, as to the sufficiency or excess of paper currency in circulation; and that the Bank of England cannot safely regulate the amount of its issues, without having reference to the criterion presented by these two circumstances."

Finally, they strongly advise an immediate return to cash payments. "Upon a general view of the subject, your Committee are of opinion that no safe,

certain and constantly adequate provision against an excess of paper currency, either occasional or permanent, can be found, except in the convertibility of all such paper into specie . . . Your Committee therefore cannot but see reason to regret that the suspension of cash payments, which, in the most favourable light in which it can be viewed, was only a temporary measure, has been continued so long."

Moderate and clearly expressed as were the opinions of the Committee, the House refused to adopt them, for the question had become a party one, the peace party against the war party, and a series of resolutions denying the truth of the conclusions drawn by the Committee, was passed by a large majority.

But time soon gave the advocates of the Bullion Report their revenge, and clearly vindicated the correctness of their views. In 1813, Napoleon was overwhelmed at Leipzig and peace was declared. Violent speculation followed, ending in commercial disaster. In two years, eighty-nine country banks failed, and hundreds tottered on the verge of ruin, and their notes were discredited. The Restriction Act of 1797 had not applied to the country banks, but these had been able to pay their obligations in Bank notes, and had consequently greatly increased their circulation. What the circulation of country notes amounted to we have no means of ascertaining, for no official returns were then made, but the total was undoubtedly large, and the failures of 1814 of course resulted in a sudden decrease in the

total amount of the note circulation of the country. The Bullion Report stated the cause of the high price of gold bullion and the adverse condition of the exchanges to be due to an excess of paper. The diminution of the amount of the paper currency in 1814 should therefore have resulted in a fall in the price of gold bullion, and this is exactly what happened. In October, 1816, the market price of gold was £3 18*s.* 6*d.* an ounce, and the exchanges with Hamburg and Paris rose above par.

The Bank of England therefore began to resume the payment of its notes in gold. The first attempt was a failure owing to a sudden drain of gold to France caused by the attempts of that country to place its currency on a sounder basis, but in 1819 the resumption was successfully carried out.

Since then, England has never had an inconvertible paper currency in circulation, and we are apt to forget the possibilities of such a recurrence. The possibility, however, is always present; a glance at the history of our neighbours reveals the fact that, among others, the United States, France, Italy and Russia have all within the last forty years been reduced to the expedient, and have not all been successful in preventing the depreciation of their issues. If such a condition of affairs should ever occur again in this country, we shall find the lessons of 1797—1819 of great importance.

CHAPTER X.

THE BANK CHARTER ACT OF 1844.

THE report of the Bullion Committee contained a clear explanation of the proper method of regulating an inconvertible paper currency. The Bank Charter Act of 1844 governs and restricts the issue of bank notes convertible into gold on demand.

For some years preceding the passing of this Act, the condition of the note issues of this country had caused very general dissatisfaction in financial circles. Commercial crises had occurred at frequent periodic intervals, involving the failure of numerous country banks, and gravely imperilling the ability of the Bank of England to meet its engagements. These crises were in many quarters attributed to the excessive issue of notes both by the Bank of England and more especially by the country bankers. Gradually two hostile theories were evolved, each of which was claimed by its supporters to be the only method of governing a note issue. These two theories were the Currency Theory and the Banking Theory. The Currency Theory is this: In issuing bank notes, care should be taken that the amount in circulation should always be the same as the amount of gold would be, provided the notes did not exist. Mr. S. J. Loyd, better known as Lord Overstone,

was the chief exponent of these views, and the following is his opinion as expressed in his evidence before a Select Committee of the House of Commons on the note issue of the country in 1840:

"A metallic currency I conceive, by virtue of its own intrinsic value, will regulate itself; but a paper currency, having no intrinsic value, requires to be subjected to some artificial regulation respecting its amount. The use of paper currency is resorted to on account of its greater economy and convenience, but it is important that that paper currency should be made to conform to what a metallic currency would be, and especially that it should be kept of the same value with the metallic currency, by being kept at all times of the same amount. Now the influx and efflux of bullion is the only sure test of what would have been the variations of a metallic currency, and therefore I conceive that that constitutes the only proper rule by which to regulate the fluctuations of a paper currency."

Their opponents, the upholders of the Banking Theory, urged, on the other hand, that the only consideration a banker need bear in mind in regulating his issues of notes was whether these issues were made in legitimate banking transactions, as opposed to speculative dealings outside the ordinary commercial channels. If the amount of notes issued in this legitimate manner should be greater than that needed by the country, the excess will be automatically presented for payment.

Mr. J. W. Gilbart, the general manager of the London and Westminster Bank, was one of the

chief exponents of this view, and he ridiculed the idea that a country banker should regulate his issues by the movements of gold to and from the country. The country circulation, he said, increased or decreased according to local conditions, the state of the harvest, and of local trade.

Each of these contending theories contained a certain amount of truth, but they each overlooked vital details which greatly weakened their position.

The Currency Theorists were thoroughly justified in urging that in issuing notes which were payable in gold on demand, bankers should keep a careful eye upon the stock of gold in the country which was available for this purpose. But they did not realise that a paper currency is an *addition* to the metallic currency, and not merely a substitute for it; that elasticity is a necessity under existing commercial conditions, and that notes may be required to fill the gap caused by the temporary deficiency of gold. If their theory were put into practice, and the amount of notes strictly limited to the amount of gold deposited to secure them, this elasticity of the paper currency, excluding for the moment the action of other forms of paper currency, is destroyed.

Their opponents emphasized the necessity for issuing notes only for legitimate business purposes. If this were possible, no doubt the note supply might automatically adjust itself to the needs of the country, but unfortunately a banker cannot always enquire the purposes for which his notes are required, and he certainly is very often quite unable to gauge the character of the operations he is

assisting to finance. In fact, the power of a banker to control speculative operations is strictly limited. Neither of these theories then is entirely satisfactory, and perhaps this was realised by the framers of the Act, for it is a compromise, although leaning towards the position assumed by Lord Overstone and his adherents.

The main provisions of the Act were these :

(1) (*a*) The Bank of England was to be divided into two Departments, the Issue Department and the Banking Department, to be kept wholly distinct from each other.

(2) Securities to the value of £14,000,000 were to be transferred to the Issue Department, and notes were to be issued to this amount and transferred to the Banking Department. All coin and bullion not required for immediate use was to be deposited in the Issue Department, and all notes issued beyond the sum of £14,000,000 were to be secured by the deposit of gold and silver to an equal amount with that of such excess issue.

(3) The silver bullion held in the Issue Department was never to exceed a fourth part of the gold coin and bullion.

(4) Any one might demand notes from the Issue Department in exchange for gold bullion at the rate of £3 17*s.* 9*d.* per ounce.

(*a*) The numbers here given to the sections are not the numbers of the clauses of the Act.

(5) If any country bank should, after 1844, cease issuing notes, the Bank of England might be authorised by her Majesty in Council to increase the amount of the securities in the Issue Department to the extent of two-thirds of such lapsed issue, and to issue notes against such securities.

(6) An account of the notes issued, the securities and gold and silver coin and bullion in the Issue Department, the capital stock and deposits, the money and securities in the Banking Department was to be published weekly in the London Gazette.

(7) No stamp duty was to be payable on Bank of England notes.

(8) The Bank was to pay £180,000 a year for its privileges and exemption from stamp duty.

(9) All profits on the issue of notes beyond £14,000,000 were to go to the public.

(10) No person other than a banker was in future to issue notes payable to bearer on demand in the United Kingdom.

(11) After the passing of the Act no bankers were to issue notes payable to bearer on demand except such bankers as on May 6th, 1844, were issuing their own notes.

(12) If any such banker should become bankrupt or should from any causes cease to issue notes, he was not to resume such issues.

(13) Every banker claiming the right to issue notes was to send to the Commissioners of

Stamps a return of the average amount of such issues for the twelve weeks preceding April 27th, 1844, and no banker should in future exceed on an average of four weeks the amount of this average of twelve weeks.

(14) If the monthly average should ever exceed this fixed amount, the bank should forfeit an amount equal to such excess.

(15) Every bank of issue should in future send a weekly account of its issues to the Commissioners of Stamps, which was to be published in the London Gazette.

(16) All bankers were to send their names once a year to the Stamp Office.

(17) All bankers were in future to have the right of drawing, accepting, or endorsing any bills of exchange not payable to bearer on demand.

First of all it must be noted that the action of the Issue Department is quite automatic. If gold is offered, the Bank must buy it, and must issue notes against such gold, which notes, if not required for circulation by the public, are kept in the Banking Department. Every note issued by the Bank must be represented by an equal amount of gold in the Issue Department, with the important exception that £14,000,000 in notes may be issued against securities. This latter amount, called the "fiduciary issue," has, in accordance with paragraph (5), been periodically increased until it now stands at £18,450,000. To this extent, therefore, the Act is a departure from

the Currency Theory, and it is therefore described as a compromise. The second point to notice is that the Act aimed at the strict limitation and gradual extinction of the issues of the country banks, and by so doing it has conferred a practical monopoly of issuing notes upon the Bank of England, the reason for this step being not only that the country issues had in many instances proved untrustworthy, but that with the right of issue centred in one bank it would be an easier matter to control the note circulation than if scattered over a number of banks. Paragraphs (11), (12) and (13) have resulted in the gradual decline in the amount of the country circulation, which is now a purely local one. The number of banks which in 1844 retained the right of issuing notes in England and Wales was 279, with an authorised issue of £8,631,647, that being their average actual circulation for the twelve weeks preceding the date named in the Act. The number of banks who now retain the right is only thirty-eight, with an authorised issue of £1,889,484, and an actual circulation of less than half that amount.

The operation of the Act of 1844 is still a contested point, some bankers contending that it has been beneficial, others claiming that it is a standing menace to our financial position.

Let us see what were the objects of the framers of the Act, and how far these objects have been attained. Sir Robert Peel, in introducing the measure, spoke as follows: "Some apprehend that the proposed restriction upon issues will diminish the power of the Bank to act with energy at the

period of monetary crisis and commercial alarm and derangement. But the object of the measure is to *prevent* (as far as legislation can prevent) the recurrence of those evils from which we suffered in 1825, 1836 and 1839. It is better to prevent the paroxysm than to excite it and trust to desperate remedies for the means of recovery" (*b*).

Another member took an opposite view. He said: "The honourable member for Lambeth said that its object was to prevent speculations and bankruptcies. Now the Bill would not do this and did not profess to do this. It was intended to ensure convertibility, and that it would ensure."

Here, then, are the motives attributed to the promoters of the Act by the two contending parties in the House at the time; to prevent the occurrence of commercial crises or to ensure the convertibility of the note. Has the Act succeeded in both or either of these directions?

A glance at the events of the years succeeding the passing of the Act compels us unhesitatingly to answer "no" to this question. In 1847, within three years of the passing of the Act, in 1857, and again in 1866, England experienced acute crises amounting almost to panics, and in each case it was found necessary to suspend the clause of the Act forbidding the Bank of England to issue notes beyond the limit fixed except against the deposit of gold to an equal amount. In each of these cases the feeling of nervous anxiety and insecurity which

(*b*) Sir R. Peel's speech in Committee of the House of Commons on the Bill of 1844.

is the chief source of danger at such times, was almost instantly assuaged by the knowledge that this clause of the Act was suspended, and that notes could be obtained if required, whether gold were there to secure them or not. In each case not only the convertibility of the note, but the immediate solvency of the Bank was seriously endangered, and was undoubtedly secured not by the Act but by its suspension.

The Act had failed to prevent the occurrence of financial crises, it had also failed to ensure the convertibility of the Bank of England note.

Briefly, the reason of the failure was this: No one had sufficiently realised that not only is the Bank of England liable to pay gold for every note in the hands of the public, but it was also liable to pay gold for all the deposits in the Banking Department, and this gold was all to come from the one stock. The Act had divided the Bank into two departments, and had provided that all the gold except a small quantity for immediate use should be transferred to the Issue Department. The promoters of the Act seem to have taken it for granted that if this gold were withdrawn, the liabilities of the Bank in the shape of notes would suffer a corresponding diminution. But the whole of this stock of gold could be withdrawn by cheques drawn upon the Banking Department, without reducing the Bank's liabilities in the shape of notes to any extent whatever. The only way to make the convertibility of the notes absolutely assured would be to refuse to pay cheques and so confess the Bank insolvent.

The Act had said the two departments were to be entirely separate, but the reserve of gold was a reserve not only against note liabilities but also against liabilities in the form of deposits, that is to say banking liabilities, and you could only ensure one class of liabilities at the expense of the other.

The failure of the Act to fulfil the expectations of its supporters was due therefore to the rather unaccountable neglect of its promoters to take into sufficient account the action of cheques upon the reserve of gold.

Mr. F. T. Baring, speaking soon after the crisis of 1847, said: "I believe if we look back we shall find that the operation of the deposits and the question of the reserves was not sufficiently considered either by those who were favourable or those who were opposed to the Bill. It certainly never entered into the contemplation of anyone then (in 1844) considering the subject that £7,000,000 in gold should run off, and yet that the notes in the hands of the public would rather increase than diminish" (*c*).

But although the Act disappointed the hopes of its framers, it by no means follows that it has been a failure. On the contrary, its action is generally admitted to be beneficial, and although in some quarters modifications of the Act are suggested, there has been of late years nothing like a general desire for its repeal.

(*c*) Macleod, Theory and Practice of Banking. Vol. II., p. 165.

It has failed to check speculation, but it is now generally admitted that speculation is both unavoidable and, up to a certain point, beneficial, under existing economic conditions. Excessive speculation can only be avoided by the co-operation of all classes of business men, bankers and traders alike, guided by "the progressive wisdom of the commercial world, gathered as it must be from its own eventful experience."

The Act has failed to prevent the over issue of credit by bankers by means of the deposits in their hands, but it has undoubtedly checked the over issue of credit by means of bank notes, which is a more dangerous and specious method. Bankers are, in the one case, limited by the amount of their deposits, but notes, which circulate for a long time and pass freely from hand to hand, could, when the public mind is optimistically inclined, be issued to an almost unlimited extent were it not for legal restrictions. But beyond this the Act has had an undoubtedly good effect. It has ensured that there shall be an ultimate reserve of gold at the Bank of England which, though it cannot legally be touched except by the cancellation of a corresponding sum in notes, yet is there as a last resource, to which a resort can be had in emergency by the suspension of a clause of the Act.

Every note issued beyond the sum of £18,450,000 must be represented by gold in the Issue Department. Consequently the bullion in the Bank can never be exhausted unless the amount of notes in circulation shall fall below £18,450,000. The

amount of these notes has never yet fallen to within several millions of the statutory limit of issue against securities. We have therefore, even in the worst panics, always had a reserve of gold which could not be touched.

This is the strong point of the Act. Three times since 1844 the Bank has been reduced to such straits that this locked up reserve was all it had to fall back upon. Either it must use this gold, or what was tantamount to doing so, it must issue notes which were not secured by the deposit of bullion. In each case the operation of the Act in this particular was suspended by the intervention of Government, and in each case it was successful. We are therefore driven to the rather paradoxical conclusion that the real strength of the Act lies in the power of suspending it.

Fortunately for our financial well-being, the notes of the Bank of England have never during the last century been in the slightest discredited. Even in the most acute stages of panic the public have been perfectly willing to take notes if they could get them, and the chief fear has been that the supply was too limited. If the people declined to receive notes and a rush for gold ensued, nothing could save the country from a general suspension of payment. Fortunately this is not likely to happen, and therefore this power of creating credit in emergency by the suspension of the Act, at times when most other supplies of credit are cut off or discredited, is an extremely valuable one. We are by it enabled to retain intact that ultimate reserve of gold, which, to

a country like England with enormous foreign liabilities that may at any moment cause a demand for gold for export purposes, is a vital necessity.

The one point on which in some quarters a change is desired is in the substitution of the German "elastic limit" for the Government power of suspension. The Act has not been suspended since 1866, but in case of emergency there is no doubt that the public would again expect the intervention of the State. It is argued that a more logical method would be to allow the Bank of England on their own initiative to exceed the limit on payment of such a fine as would ensure against any abuse of the privilege. By this means it is contended the public would be spared the anxiety and stress of the days leading up to the stage when the Government would be expected to intervene, while the Bank would be in a better position to act with that promptitude and decision which go so far to allay public unrest.

CHAPTER XI.

THE DEVELOPMENT OF BANKING IN ENGLAND.

BANKING in the modern sense of the term can be said to have originated in England in the foundation of the Bank of England in 1694. Previously to this the goldsmiths had exercised some of the functions of a banker, and some of the oldest existing private banks are the direct descendants of these goldsmiths, notably Messrs. Child & Co. and Messrs. Hoare. At the time of the Great Rebellion men had found it convenient to lodge their money for security with the goldsmiths, who for the purposes of their own trade usually possessed ample accommodation for storing plate and jewellery. The depositors received a receipt, and when they wished to withdraw a portion of the money, the amount so withdrawn was often written across the face of the receipt. These receipts were the parents of the bank note, the transition from an acknowledgment of money received, to a promise to pay, being an easy one. But the development of banking on a large scale had been hindered by the weakness of public credit. Before the Revolution of 1689, public credit had depended upon the good faith of the individual monarch, and both Charles I. and Charles II. had shown how little reliance was to be

placed on this by confiscating for their own purposes money lodged by the public in the Exchequer. The accession of William III. introduced the system of parliamentary responsibility and parliamentary control over the national finances, and when once confidence was established in the integrity of the State, a system of credit based upon mutual confidence between man and man became possible. Without absolute good faith in monetary matters on the part of the State, a proper system of banking cannot be developed, hence the importance of the foundation of the Bank of England.

Bishop Burnet writing at the time said: "I had heard the Dutch often reckon up the great advantages they had from their banks, and they concluded that as long as England continued jealous of the Government, a bank could never be settled among us, nor gain credit enough to support itself; and upon that, they judged that the superiority in trade must still lie on their side." The Bank of England is, needless to say, not a State Bank; it is a corporation with exceptional privileges, but it owed its inception and continued career to its position as Government creditor and Government banker.

The Bank was not established, as might be supposed, with the idea of developing English commerce by the creation of a powerful bank; it was simply an expedient for gaining money for William III.'s continental wars against Louis XIV. The Bank was to lend the Government the amount of its capital in return for certain privileges. The idea was suggested by a Scotchman named Paterson and

taken up by Montague, the Chancellor of the Exchequer, with immediate success, the capital of £1,200,000 being at once subscribed. The whole of this amount was lent to the State at 8 per cent. per annum, plus £4,000 a year for the expenses of management. The Bank was empowered to issue notes to the same amount, £1,200,000, but not beyond.

The success of the Bank of England, which was a Whig scheme, induced the Tories to try a similar experiment, and they introduced and passed a measure for establishing a land bank. The scheme was a total failure, but to prevent its recurrence, the Whigs in 1708 passed an Act which forbade any other bank consisting of more than six persons, to "borrow owe or take up any sum or sums of money on their bills or notes, payable at demand, or at a less time than six months from the borrowing thereof."

This Act had a very great influence on the development of banking in this country. It did not forbid the establishment of joint stock or corporate banks, but it forbade such banks to issue notes, and such was the importance attached to this function, that no attempt was made for a century or more to found any serious rival to the Bank of England. It established the predominance of the latter, and this predominance has been the factor which has coloured the whole of the history of banking in this country. No restrictions whatever were placed upon small private bankers, and as a consequence the type of country bank in England was much less powerful and less reputable than it otherwise would have

been. In Scotland and Ireland, where no such monopoly existed, a group of more or less equally powerful banks has been evolved and the small banker has disappeared. The tendency is at work now in England, and a type of bank has been developed rivalling the Bank of England in many respects; but in the past, the English system has undoubtedly compared unfavourably with that which has long prevailed in Scotland, a result due in great measure to the influence of the Act of 1708 and similar enactments confirming it from time to time. During the eighteenth century this influence was especially noticeable, and notwithstanding many honourable exceptions which have survived to the present day, widespread ruin and distress resulted from the frequent convulsions which involved whole groups of country banks.

English banking during the eighteenth century developed in three directions:

First, the Bank of England, owing to the prestige derived from its position as the banker and agent of the State, constantly increased in influence and reputation as compared with the private banks, and gradually assumed an attitude of responsibility for the financial well-being of the country. No legal responsibility was attached to their position, but owing to the vast discrepancy between their resources and those of the majority of the private banks, men grew to regard the Bank of England as the pivot of the banking system, and to look to the Bank for such assistance as it could afford in times of stress; and the Bank did not disavow this

responsibility. The issue of notes was regarded as the principal function of the Bank, but at first these were not issued for small amounts, and it was not until 1759 that £15 and £10 notes were circulated, while £5 notes were not issued by the Bank of England until 1793.

The second line of development was by the private country bankers. The notes of the Bank of England did not circulate to any great extent out of London, for the first branches of the Bank of England were not opened until 1826. The country banks, however, issued notes for quite small sums which circulated locally. In 1775 it was found necessary to forbid the issue of such notes for less than £1, and in the next year the limit was raised to £5. These measures were necessitated by the number of small tradesmen who added the business of banking to their other occupations, and issued notes for insignificant amounts. The consequences of the measure have been felt to the present day, for notwithstanding the temporary revival of £1 and £2 notes during the restriction of cash payments, and in spite of several later attempts at a revival of small notes, England remains almost the only commercial country without a circulation of bank notes below a sum equal to £5.

The third development of banking was that of the London private banks. These banks at first issued notes like the other bankers, in fact, the London goldsmiths' cash notes were the earliest form of such paper money in England. But they soon found that the competition of the Bank of England was

too strong, and towards the end of the eighteenth century their issues entirely ceased. In place of this function they developed the system of deposit banking, and the London bankers were the first to issue printed books of cheques, to take the place of the informal letters, by means of which payments or transfers were at first made.

At the time of the resumption of cash payments in 1819, we have then these three groups of banks: the Bank of England, the only joint stock bank in the country, placed by its monopoly in a unique position as regards other banks; the country banks, limited to six partners, and almost entirely unregulated and unrestricted by the legislature; and the private bankers of London, most of them old established firms with good reputations, but whose note issues had entirely lapsed.

In 1825 occurred a serious financial crisis, and the weakness of the country banks aroused widespread comment. Almost for the first time the public began to realise the ill-effects of the monopoly of the Bank of England, and measures were at once brought forward to alleviate the evil.

First, the Bank of England were advised and authorised to open branches in some of the principal provincial towns, and to issue notes from these branches, the towns first selected being Gloucester, Manchester, and Swansea.

Secondly, the issue of notes under £5 was finally forbidden to the Bank of England as well as the country banks.

Thirdly, an important modification of the monopoly hitherto enjoyed by the Bank of England was effected by the Act of 1826, allowing the establishment of joint stock banks with the privilege of note issues provided they had no banking office in London or within a radius of sixty-five miles of London, and that they did not issue their notes at any place within such a radius. The larger towns outside the circle of sixty-five miles gradually availed themselves of this permission, and many of the existing country joint stock banks date from about this period.

Seven years later, in 1833, a clause was inserted in the Bank Charter Act of that year authorising the establishment of joint stock banks in London, provided they did not issue notes payable to bearer on demand. It will be remembered that the Act of 1708 and its complements had conferred upon the Bank of England the exclusive privilege of carrying on the business of banking with more than six partners, and had further defined this privilege as the right to issue notes to bearer on demand or at less than six months date. Doubt had been expressed in some quarters whether the Acts prevented a joint stock bank being established to carry on the business of a banker exclusive of the issue of notes, and this clause in the Act of 1833 was designed to decide the question. The immediate result was the foundation of the London and Westminster Bank in 1834, followed shortly after by the London Joint Stock Bank, the Union Bank of London, and the London and County Bank. The Act of 1833 further declared Bank of England notes

to be legal tender for all sums above £5, except by the Bank itself and its branches.

It is well to note that the Bank Charter Act of 1833, which renewed all the privileges of the Bank, is still in force, its provisions having been expressly confirmed by the Act of 1844, and it is in many instances owing to the clauses of the former, that the issues of country banks from time to time lapse. There is an erroneous impression prevailing that the Act of 1844 provides for the extinction of the note issue of any bank which amalgamates with another, but this is not so. The Act of 1844 stipulates that "it shall not be lawful for any company or partnership now consisting of only six or less than six persons to issue bank notes at any time after the number of partners therein shall exceed six . . ." If, therefore, a private bank increases its partners to more than six, either by amalgamation with another private bank or with a joint stock bank, it loses its right of issue; but the Act of 1844 expressly preserves the right of issue in cases where the amalgamation does not result in an increase in the partners beyond six.

If two joint stock banks, either of which possesses a note issue, amalgamate, the Act of 1844 does not in any way restrict the right of the new bank to issue notes, but if either of the joint stock banks has an office in London or within sixty-five miles, or if a joint stock bank having a note issue amalgamates with a private bank in London or within the radius, the Act of 1833 applies, and the right of issuing notes lapses. The same result happens if a country joint stock

bank with a note issue opens a branch in London, as for instance when the National Provincial Bank opened in London in 1867, and lost their authorised note issue of £442,371.

It is not easy nowadays to realise the position of the early joint stock banks. At the present time many of them overshadow the Bank of England itself in the amount of their deposits and the magnitude of their transactions. But at the time they were founded they were outcasts, regarded as intruders both by the Bank of England and the private bankers, and without even any corporate legal existence, except as a partnership of all the shareholders, necessitating the enumeration of all the names of the shareholders in the smallest action brought by the bank. Moreover, they were inexperienced, and found a difficulty in obtaining on their directorate or managing staff, men who had a sufficiently thorough knowledge of the business of banking.

It is therefore not surprising that the business of the early joint stock banks was at first often carried on in a manner which left much to be desired, but notwithstanding their mistakes, it is largely due to them that we owe the development which especially characterises English banking. Deposit banking, with its great facilities for economising capital, has developed to a greater extent in England than in any other country, and this is to a large extent due to the fact that the London joint stock banks have been forbidden to issue notes, and have therefore exerted all their energies in fostering deposit

banking, and that therefore cheques have to a large extent superseded notes in circulation. The early joint stock banks were all unlimited as regards the liability of the partners or shareholders for the debts of the bank. The shareholders of those country joint stock banks which were founded under the Act of 1826 were expressly declared to be liable in full for the debts of the company, while those established in London under the Act of 1833, being common law partnerships, were necessarily unlimited.

It has long been an established doctrine in English law that the partners of any trading or business firm are all personally and individually liable for the debts of the firm of which they are members. The doctrine was complete and far-reaching. If, after taking all the private property of the majority of the partners, the debts of the firm were still unsettled, and perhaps one partner remained solvent, he could be compelled to pay the whole of the remaining outstanding debts, if possessed of sufficient private means.

This was equitable enough in the case of private firms where each of the partners takes a personal share in the conduct of the business, but when joint stock companies came into prominence, the law regarded all the holders of shares as partners, and the doctrine of unlimited liability pressed rather hard on shareholders who had practically no control over the business policy of the company. In 1855, therefore, an Act was passed allowing trading companies under certain conditions to register themselves as limited liability companies, the shareholders being

liable to the extent of their nominal holdings of shares, but no further.

Banks were, however, excluded from this privilege; it was thought that bankers were in such a responsible position, and were debtors to the public in such large amounts, that it was unwise to afford them any protection in this respect. Two years later, in 1857, a severe monetary crisis resulted in the failure of several banks, notably the Western Bank of Scotland. It was found that the wealthier classes declined to incur the risk of holding bank shares, and that a large proportion of the shareholders of defaulting banks were not possessed of sufficient means to contribute towards the debts of the company. In order, therefore, to attract a more substantial class of shareholders, it was found desirable, in 1858, to extend the privilege of limited liability to such banks as cared to register under the Act. An exception was, however, made of the liability of shareholders for the note issues of those banks which circulated notes, and the shareholders of country banks are still fully liable for the amount of such issues.

Most of the large joint stock banks, however, held aloof, fearing that the limitation of the shareholders' liabilities would alarm the depositors in the banks, and result in a loss of business. But the collapse of the City of Glasgow Bank in 1878, and the complete ruin of most of the shareholders, caused such a panic among those who held shares in joint stock banks, that most of the banks were induced to register themselves as "limited." A new Act was passed

in 1879, which created what is called "reserved liability." Under the terms of this Act, limited companies could increase the nominal amount of their shares, with a condition that a certain proportion of this nominal increase should not be called up except in the event of the liquidation of the company, this uncallable proportion of the share capital being termed "reserved liability."

The effect of this provision was that while the shareholders of the companies were partly protected, in that the amount they could be called upon to pay in the event of liquidation was a definite ascertained sum, yet the depositors and other creditors of the bank felt that they had a reasonable security for the payment of the debts due to them.

Judging banks by the nature of their constitution, we have then five classes, as follows:

(1) The Bank of England is incorporated by Act of Parliament, the only English bank so incorporated, and is outside the application of the Companies Acts. It has a capital of £14,553,000 in stock, and the liability of the stockholders is held to be limited to the amount of their individual holding of stock. Thus, although the Bank of England is not registered under the Companies Acts, it possesses the same privilege as regards liability.

(2) There are a few joint stock banks registered under the Companies Acts, but without limited liability, the shareholders being fully responsible for all the debts of the company. The only banks so registered are a few which are by courtesy regarded

as private banks, the shares being held privately, and the banks being registered as companies for private reasons.

(3) There is the great body of joint stock banks registered with limited liability, most of whom have declared part of their share capital to be "reserved liability." The limitation of liability does not, however, extend to the note issues, if any.

(4) There is a rapidly diminishing class of private bankers, the number of whose partners must not exceed ten, and whose liability is, of course, unlimited.

(5) Lastly: Certain colonial banks, with head offices in London, have been incorporated by Royal Charter. The liability of the shareholders is regulated by the terms of the charter, in several instances being fixed at twice the nominal amount of the shares.

In the more recent development of English banking, two tendencies are very marked, the tendency towards concentration by means of amalgamation and purchase, and the spread of branch banking. According to Mr. Jas. Dick's calculations, as given in papers read before the Institute of Bankers (*a*), there were, in 1883, 317 banks in England and Wales, having 2,382 offices, being one office to every 11,315 head of population. In 1891 the number of banks had decreased to 261 with 3,231 offices, or one to every 8,915 inhabitants. In 1901 the figures were 172 banks with 4,872 offices, or one office to every 6,676 inhabitants.

(*a*) Journal of the Institute of Bankers, Vol. xiii., p. 320.

These figures are a striking testimony to the tendency towards concentration combined with expansion. A large part of this opening of new offices has resulted in the creation of entirely new business. Towns which twenty years ago supported two banks now have four, and yet each of the four may have as much or more business than the two formerly had, although the increase in population may be insignificant.

New resources have been tapped; the "habit of banking" as it is called, has spread. Fifty years ago cheques for small amounts, say under £5, were almost unknown, and none but the wealthy enjoyed the facilities offered by a bank. Now the members of almost every class above the artizan class, keep banking accounts, and even the poorest avail themselves of the Post Office and other savings' banks.

All this tends towards national efficiency. Instead of keeping money lying idle in old stockings or cash boxes, it is deposited in a bank and is eventually used in productive enterprise. It helps to cheapen capital, and England owes no small part of her wealth and position to the fact that cheap loanable capital has in the past been so abundant.

The process of concentration by amalgamation is part of a universal tendency. In every department of commercial activity we find this concentration of capital in a few controlling hands. In banking it was almost inevitable. It is not an unmixed blessing; the passing of the local banker to make room for the bank manager means a loss to the community which we are sometimes forced to

regret, but on the whole the change has been conducive to greater economy, and, in many cases we must add, to greater efficiency.

The amalgamations of the last fifty years can be divided into three main classes:

(1) The absorption of private country banks by joint stock banks,

(2) The absorption of the smaller London banks by the larger provincial banks.

(3) The amalgamations between the joint stock banks.

(1) Many of the existing joint stock banks now in the forefront owe their position almost entirely to this first process of amalgamation, by which country banks have been swallowed. Some of our leading joint stock banks have developed without any great recourse to this method of expansion, as, for instance, the London and Westminster Bank and the London and County Bank. But such banks as Barclay and Company and Lloyds Bank have attained to their present size quite recently and very rapidly owing to the number and importance of the banks they have absorbed. We are tempted to enquire, why have the London banks thought fit to buy or otherwise absorb these provincial banks? And why have the provincial banks sold their businesses?

If we look back to the years 1892—96 we shall find our answer to the first question. These years were times of extraordinary "cheap money," that is to say, the rates at which money could be lent and borrowed were abnormally low.

Now the banker who has a purely London business, that is to say, a City banker, without suburban or country branches, is much more dependent than the country banker upon the ruling rate of interest in the money market. Lending rates in the country are much more stable and less sensitive to market influences than those in the city. In the country the element of risk is greater, the security offered is not usually so good and the bills discounted are not usually "first-class" bills; these reasons are sufficient to account for the more constant rate of interest prevailing.

The result was that while the London bankers found it difficult to maintain their accustomed rate of profit, the country banks and those London banks with a country connection suffered much less severely. This, then, is one reason why the London bankers found it advantageous to obtain a country connection; they obtained a wider basis for their business and equalised their earning rates over a period of years.

The private country bankers accepted the offer made to them not necessarily as a sign of weakness, but because they saw a greater future before them. Most private bankers, relying in the absence of published accounts, upon their local reputation, found it naturally difficult to extend their business beyond the circle of their personal influence. In many cases too, want of capital was an obstacle to expansion. But the joint stock banks relied upon being able to develop and expand an old established local business more quickly than the private banker

could, and therefore offered the latter terms which it was difficult to refuse.

(2) The second class of amalgamations is that between the larger provincial banks and the smaller London bankers.

Many of the leading joint stock banks have risen into prominence in this way: For instance, Parr's Bank was a purely provincial bank at one time, with a head office in Warrington, until, in 1891, it swallowed the house of Fuller, Banbury & Co., of Lombard Street, and afterwards amalgamated with the Alliance Bank and the Consolidated Bank. The Metropolitan Bank is the result of an amalgamation between the Birmingham Banking Company and the Royal Exchange Bank. The Birmingham and Midland Bank joined with the Central Bank of London, in 1890, to form the London and Midland Bank, which afterwards united with the City Bank to form the London, City and Midland Bank. Most of the small London banks thus absorbed had seats at the Clearing House, and this was no doubt the principal inducement to the provincial banks. Admittance to the Clearing House is a privilege not easy to obtain, and yet without it a bank cannot easily rise to first-class rank.

Even without this entrance to the Clearing House, a London office is an undoubted advantage. London, as is so often insisted, is the financial centre of the world, and not only every English bank, but nearly all foreign banks find it absolutely necessary to be represented there either by an office of their own or by a London agent. It is this London

agent with which many of the more important provincial banks have now been able to dispense. Since they must be represented in London, it is at the same time more convenient and more economical to be represented directly by an office of their own.

(3) The third phase of development in the process of amalgamation is that of the large joint stock banks among themselves, including also the amalgamations between the large joint stock banks and the leading private bankers of London.

This is a process which may be yet only beginning. Instances will be fresh in the memory of all readers, the most recent being the amalgamation between the Union Bank of London and the old private bank of Messrs. Smith, Payne and Smith, with its provincial connections, and later on its absorption of Prescott's Bank, itself the result of many amalgamations. Announcements were made of a contemplated fusion of Lloyd's Bank and the Manchester and Liverpool District Bank, which would have resulted in the formation of a bank with deposits amounting to the enormous sum of seventy millions; the project was however abandoned.

Fears have sometimes been expressed that this tendency to concentration may lead to monopoly and that the public may suffer. It is of course rash to prophecy, but there is nothing in recent events to justify this fear. What combination there has yet been between banks has been for the public good. Greater uniformity of practice now prevails than was once the case, and this has led to sounder methods of banking, and so to greater security. Even more

important than this, the evolution of a comparatively small number of powerful banks leads to the attainment of that decisive and concerted action in times of emergency and grave financial peril, which the delicacy of our mechanism of credit renders a necessity to the national well-being, and of which the events of the Baring crisis in 1890 are an excellent example.

CHAPTER XII.

CLEARING HOUSES.

When we consider what an overwhelming proportion of the monetary payments in this country are made by means of cheques and bills, it becomes evident that the presentation and payment of these documents is a task of no small difficulty. Obviously it has long been impossible to present them at the counter of the bank upon which they are drawn, and demand coin and notes. The proportion of cheques so presented is insignificant; the remainder are paid, directly or indirectly, by means of one of the Clearing Houses, chief among which of course is the London Clearing House in Post Office Court, Lombard Street.

The exact origin of this institution is uncertain. Gilbart in his "Principles and Practice of Banking," says it was founded in 1775, but we find references to a clearing house in London before that date. It is fairly certain that it had a small beginning and was probably at first a voluntary and informal meeting of clerks sent out to collect cheques drawn upon other banks. Some of the London bankers for a time held aloof, but it eventually became rather an exclusive body, slow to admit fresh members. The early joint stock banks were refused member-

ship, and it was not until 1854 that they obtained admittance.

In 1858 the Country Clearing was established. Before that date country cheques were presented directly through the post and a draft on a clearing banker sent in return, but since 1858 the cheques have passed through the Clearing House by means of the clearing agent, of whom every country banker now makes use.

Four years previous to this, in 1854, a great improvement in the mechanism of the House was effected. The differences between the various members of the House had hitherto been paid in Bank of England notes and coin, but since 1854 each member of the Clearing House has had to keep an account with the Bank of England, and the differences are now paid by transfers between such accounts.

Each clearing bank sends round to the Clearing House at the times fixed for the clearing, bundles of "articles" called "charges," each "charge" consisting of cheques drawn upon another member of the House, or in the case of the country clearing, drawn upon the country correspondents of another member.

These are exchanged, entered and added by means of automatic machines, and so far as possible the totals are verified. The "charges" received by each bank are then taken round to the bank and examined and paid, or in the case of the country clearing, sorted and posted at the end of the day to the various country correspondents. There are three clearings during the day. The morning clearing,

commencing on ordinary days at 10.30 a.m., consists chiefly of drafts on the clearing banks which have been received from the branches and country correspondents of each clearing bank by the morning post, together with a certain number of drafts received on the previous afternoon too late for that day's clearing.

Then there is the country clearing, which commences at the same time. All the drafts which go through the country clearing are drawn upon country bankers, and are sorted according to the clearing agents; each charge is therefore a bundle of miscellaneous cheques which, after they have been exchanged, are taken back, sorted according to the bankers upon whom they are drawn, and despatched by the evening post for payment. The afternoon clearing, which commences at 2.30 p.m., is the busiest of the day. The cheques cleared are those drawn upon members of the Clearing House which have been paid in by customers of other clearing banks during the same day, or have been remitted by such suburban banks or West End banks as are in a position to send a midday remittance to their clearing agent. During the afternoon, fresh "charges" are continually being brought to the House right up to its close at five minutes past four.

As soon as all the charges are entered and agreed, the work of settlement commences. First of all the clearing clerk of each bank strikes a balance between the amounts of his in-clearing and his out-clearing with each other bank; the result is the

amount which on the day's working he owes to that other bank, or, as the case may be, the amount which that other bank owes to him.

It must not be supposed that each bank then settles the amount owing to or from each other bank by direct payment. The method pursued is much simpler and more economical than this.

Each bank takes its "summary sheet," which has a column of the names of all the clearing bankers with a column on each side for the amounts owing to or from these banks. These two columns are added up, and the difference between the two represents the total sum owing to or by the bank in question, "on general balance." Each bank keeps an account at the Bank of England, and there is also an account called the Clearing Banker's Account, and the differences are settled by transfers between these accounts. If the X. Bank owes £7,215 on general balance, it authorises the Bank of England to transfer this amount from the account of the X. Bank to that of the Clearing Banker's Account. If, on the other hand, the day's work ends in a balance of £745 owing to the X. Bank, it hands to the Bank of England a request signed by an official of the X. Bank and by a Clearing House inspector, to transfer £745 from the Clearing Bankers' Account to the credit of the X. Bank.

The country clearing is settled in a similar manner, except that the balances are not transferred until the third day, owing to the necessity of sending the cheques into the country to be paid.

We have hitherto supposed that all cheques presented through the clearing have been paid, but

there are usually a number of cheques unpaid, either through want of funds or because of some irregularity in the drawing or endorsement; "returns" as they are called.

All returns must in the case of the town clearing be received back at the Clearing House by 5 o'clock on the day of presentation, though this hour is slightly extended on certain days when the work is especially heavy, and they must bear a written answer upon them stating the reason of non-payment.

In the case of the country clearing, each country banker must, by return of post on the day of receipt, advise its London agents of the amount of the cheques received and paid, enumerating the returns deducted, if any. All cheques presented through the clearing must bear across their face the name of the presenting bank, and in the country clearing the name of the London agent also, and, according to the rules of the House, it is the duty of "any country bank not intending to pay a cheque sent to it for collection, to return it direct to the country or *branch bank*, if any, whose name and address is across it." Such returns must in every case be sent back on the same day on which they are received.

In the case of the town clearing it may be mentioned, bills and various orders to pay which are not cheques are presented through the Clearing House; but in the country clearing, bills, promissory notes and cheques with documents attached are not received, and must be presented through other channels.

When returns are received at the Clearing House they are treated just as if they were cheques drawn upon the bank by whom they were presented, and are entered at the end of the summary sheet before the general balance is struck.

The following bankers are members of the London Clearing House:

Bank of England.
Barclay and Company.
Capital and Counties Bank.
Glyn, Mills and Company.
Lloyd's Bank.
London and County Bank.
London and South Western Bank.
London and Westminster Bank.
London, City and Midland Bank.
London Joint Stock Bank.
Martin's Bank.
Metropolitan Bank.
National Bank.
National Provincial Bank of England.
Parr's Bank.
Robarts and Company.
Union of London and Smiths Bank.
Williams Deacon's Bank.

Besides this several of the more important city branches of the above banks clear direct without the intervention of their head office.

The total amounts cleared are enormous, exceeding in 1902 the sum of ten thousand millions. Certain days are always busier than usual, and on some of these days some extension of hours is allowed. Such days are the first of January, April, July, and

October, on which many dividends are payable, Stock Exchange settling days, and the fourth day of each month. The reason for the pressure on these last-mentioned days is that in those trades in which the retailer pays the wholesale dealer by means of bills of exchange, it is generally customary to draw on the first of the month, and these bills, drawn at one, two, or three months after date, mature, when the three days' grace is added, upon the fourth day of the month.

The London Bankers' Clearing House is by far the most important of the English clearing houses. There are, however, local houses at several of the more important provincial towns, notably Manchester, Liverpool, Birmingham, Newcastle, and Bristol. These, however, are not in any way rivals of the central Clearing House. They are used for the collection of purely local cheques, which in smaller towns would not be sent to London for collection, but presented directly over the counter of the local banks, and be paid by a draft on a London clearing banker. Instead of this, in the towns above mentioned and a few others, these local cheques are presented through the local clearing house, usually conducted on a similar plan to the London House, and the balances are transferred through the local branch of the Bank of England. Cheques drawn upon banks in towns other than that in which the collecting banker resides would, however, be collected through the London Clearing House in the usual way.

Cheques drawn upon the numerous West End and suburban banks in London are not collected directly

through the Clearing House, but their totals nevertheless eventually appear in the Clearing House returns. These cheques are presented at the counter of the banks upon which they are drawn by "walk clerks" and messengers, who are paid by drafts upon a clearing banker, and these drafts are in turn collected through the London Clearing House.

Although our system of clearing cheques is complete and far-reaching as regards each of the three kingdoms, it is to be regretted that there is no central institution for international clearings between England, Scotland and Ireland.

Dublin, Edinburgh and Glasgow each have their own Clearing House, but to none of the central clearing houses do the banks of any of the other kingdoms belong. Thus, if a banker in, say, Nottingham receives for collection a cheque drawn upon a banker in, say, Inverness, he must present it directly through the post with a request for a draft on London in return, which is usually sent, less a small charge for commission. Some of the larger banks have, however, made mutual arrangements to collect each other's cheques through their London offices, but this is, of course, simply a private arrangement. Attempts have been made to admit the Scotch and Irish banks to the London Clearing House, but there are many difficulties in the way, and such attempts have hitherto been unsuccessful.

CHAPTER XIII.

THE FUNCTIONS OF A BANKER.

THE old definition of a banker as a man who took care of other people's money and let them have some of it when required, is a very incomplete one. A banker's function is not to take care of other people's money; he buys other people's debts and collects them; he is, in short, a dealer in money and credit.

If a man pays into his banking account a cheque drawn upon the X. Bank, he thereby sells to his banker a right to demand money from the X. Bank, and he acquires in return a right to demand the money from his own banker; the transaction has been an exchange of rights.

Before we can get a clear idea of the duties which a banker owes to the community and of the steps which he should take to make his position a secure one, it is necessary to grasp thoroughly the fact that the main function of a banker is to buy and sell rights to the possession of money. It must always be borne in mind that every right implies necessarily an obligation. If a customer gains the right to obtain coin of the realm from a banker on demand, the banker necessarily incurs an obligation or liability to pay this money whenever it is demanded

of him. Let us see what are the principal functions of a banker and what is the nature of the obligations he incurs.

These functions can be conveniently divided into four groups:

(1) The issue of notes.

(2) The receipt of deposits.

(3) The discounting of bills and promissory notes.

(4) The granting of loans.

(1) The issue of notes was the function of a banker which was at one time deemed of paramount importance, but which, except in the case of the Bank of England, is now in England of small significance.

Every note issued by a banker increases his liabilities to pay money on demand. If a note is issued in exchange for gold, the banker buys the gold and gives in return to the seller a right to demand gold at his will—not the same gold, but gold of an equal amount. The banker gains the use of this gold for an uncertain period, for the note costs him practically nothing. If the note is issued in the form of a loan to a customer, there is an exchange of rights to gold on demand, but the customer has to pay interest on the amount of the rights he buys; the banker does not.

(2) The receipt of deposits on "current account" by a banker is an almost identical function with that of the issue of notes. In each case the customer acquires a right to money on demand, and a banker incurs a similar obligation. In the one case this

right is evidenced by a piece of paper by which the holder can transfer the right by mere delivery; in the other case, the customer's right rests upon the implied contract made with the banker at the time the account is opened, and the customer can transfer his rights by drawing and negotiating cheques.

But in opening what is called a "deposit account"—that is, an account upon which interest is allowed, and the right of drawing cheques is not usually conferred—there is a slight difference in the nature of the banker's obligations. Such accounts are repayable only upon certain stipulated notice being given, usually seven days, though in some cases as much as two or three years. Therefore the banker's obligations are not to pay gold on demand as in the two preceding instances, and, as we shall see, this difference is a most important one from a banker's point of view.

(3) In discounting bills and promissory notes, a banker buys a right due at a certain fixed future time, and he gives in return to the customer an immediate right to demand money; he charges interest, called bankers' discount, on the transaction in return for which the customer gets the immediate use of the money.

A. has a bill, accepted by B., payable in three months for £100. He wishes to realise the amount at once, and therefore takes the bill to his banker, who credits his account with £100 less £1 for interest. A. acquires an immediate right against the banker, who obtains a right against B. payable in three months time.

It will be seen that in this case, as in two of the three preceding instances, the banker incurs obligations to pay gold on demand.

(4) The function of granting loans is similar to that of discounting bills; in each case the banker gives to the customer an immediate right in return for a future one.

A. applies for a loan of £1,000 to his banker. The latter opens a "loan account" in A.'s name, and debits this with £1,000 which he credits to A.'s current account. The customer therefore acquires an immediate right to £1,000 as against the banker, while the latter obtains, by means of the loan account, the right to demand the repayment of the sum at some future time, either at a fixed period agreed beforehand, or, as is more usual, at such future time as shall be convenient to the banker, due and reasonable notice being given to A.

These are the four principal functions of a banker, and it will be noticed that in every instance, except in the case of "deposit accounts" repayable with notice, the obligation incurred by the banker is to pay *on demand* gold or Bank of England notes, the latter being legal tender except by the Bank of England and its branches.

It may be thought that this insistence upon the nature of the rights and obligations in which a banker deals is pedantic and useless, but the key to the proper appreciation of the position of a banker towards the public lies in the proper understanding of this fact, that the majority of his obligations are payable on demand. The fact is hardly realised in

many quarters that a banker's deposits may be an actual source of weakness to him instead of strength, and that in cases of panic or of temporary lapse of confidence, his danger may be commensurate with the amount of such obligations.

Our modern banking system rests upon the assumption, based upon experience, that the whole of these demands, or even a majority of them, will not be made at the same time. Should a general distrust of credit ever take place, our banking system would collapse, for it would be quite impossible to find the gold to pay even the majority of our banking obligations. Fortunately we are justified in assuming that such a demand for gold is outside the range of probabilities, except in very abnormal political circumstances.

But even an unusually large demand for gold or notes, a demand slightly greater than the season of the year and the existing financial conditions warrant, is sufficient to cause bankers considerable anxiety and inconvenience.

A banker is by force of circumstances divided between two conflicting aims. On the one hand, the desire to earn a good dividend prompts him to use as much of the money under his control as he safely can. All money lying idle means loss of profit, and all money kept as a reserve against an unusual demand must lie idle. Money employed so as to earn a profit cannot be truly said to be a reserve, because if such circumstances should arise that a banker wished to get immediate control of the

money, it is extremely probable that the same circumstances would prevent his doing so. A banker most needs his reserve when there is a stringency in the market for money and when credit is temporarily straitened, and if he has lent his reserve this is just the period when his debtor would find it most inconvenient to repay the amount.

On the one hand then a banker wishes to maintain a high rate of profit, on the other hand he wishes to make his position as secure as possible against a sudden call to pay an unusual proportion of his obligations.

To maintain this happy medium and to forestall such demands, calls for the exercise of those qualities which make a successful banker.

We can now see why a banker is in a position to pay interest on deposit accounts repayable at a fixed notice, though he, as a rule, refuses to do so in the case of current accounts repayable on demand. In the former case the banker can use the money so deposited with him without endangering his position, and can therefore earn interest with it. The seven days' notice, or whatever is the agreed term, although it may not always be enforced, yet in an emergency will give him time to realise some of the debts owing to him. But in the case of the current account a certain proportion must be kept idle to meet possible demands for repayment, and this curtailment of their earning power prevents most bankers from allowing their customers interest on such accounts except in special circumstances.

Let us look now for a moment at the assets of a banker available to meet his customers' demands. As has been shown, all these assets should be, to a greater or less extent, "liquid," that is, they should be of such a character that they can be promptly turned into gold. Of course a banker's assets do not all possess this quality to the same extent. They can be divided into several lines of defence against the attack of the bankers' creditors.

First of all, there is the "Cash on hand." This is chiefly the gold and silver held in the tills of his head office and branches, with a small reserve at his head office for filling up gaps at the various branches. Classed with this cash on hand we have, in the case of the larger banks, "Cash at the Bank of England," represented on the balance sheets of the smaller bankers by "Cash with London agent." This "Cash at the Bank of England" represents the surplus unemployed funds of the banker, kept to meet demands from other bankers through the Clearing House. I have called it "unemployed," although we shall see in a later chapter that though not employed by the banker yet a proportion of it is employed by the Bank of England. However, this money is always reckoned as equivalent to cash on hand, and, except in such circumstances as would infallibly compel the suspension of all of our banks, bankers are justified in so regarding it.

Next to cash on hand and at the Bank of England there is "Money lent at call and short notice." This money is lent on the money market

to bill brokers and others, and can be, and often is, called in at the shortest notice. The usual terms on which money is lent in this way are that it shall be repayable either on demand or at a fixed period up to seven days. It is the money which the banker finds it unnecessary to keep lying quite idle, but which must be almost immediately available if necessary.

Thirdly, there are "Stock Exchange investments"; these are usually either English, Colonial or foreign government stocks, corporation stocks, and railway and other first-class debentures. They can in normal circumstances be readily sold on the Stock Exchange, and, if necessary, many of them will find a market on foreign "bourses." They have this disadvantage however from a banker's standpoint, that in such circumstances as would compel a general sale of investments by bankers it would be difficult and often impossible to find a purchaser. In acute financial crisis even English Consols can only be realised at a tremendous sacrifice. At such times the demand is for notes or gold. A bank may be perfectly solvent and its securities be of great value, but should a scramble for notes and gold ensue, this may not save the bank from suspension.

Next to Stock Exchange securities come bills of exchange. Bills form an excellent class of bankers' asset in one sense, because the date of their maturity is fixed, and if a banker chooses to limit or cease his discounts the amount of his liabilities in this respect will automatically decrease. But bills

are of no use in an emergency. The date of their maturity cannot be hastened, and they cannot easily be sold. In some countries it is the custom for bankers to rediscount their bills with other bankers, but in England, at all events in London, this is contrary to tradition, and is a course but seldom pursued. If English bankers held foreign bills, that is, bills which are payable in another country, it might be possible in emergency to sell such bills abroad and import gold to pay for them, but such bills usually find their way into the hands of the bill brokers, and the ordinary English banker prefers to leave alone this branch of banking.

Last of all of a banker's assets as regards their convertibility into money, come his loans to his customers, whether secured or not.

Such assets are practically useless in a crisis. For one thing, reasonable notice of any intention to call in such loans must be given, and securities deposited to cover such advances can only be realized after considerable delay has ensued. Then again, the customer can only repay the amount, in the majority of cases, by means of a draft upon another banker, and the process of calling in loans will therefore often only result in a mutual exchange between bankers, which benefits no one, and is apt to recoil upon the head of the originator.

Thirdly, any attempt to enforce the repayment of loans in a crisis is a suicidal policy, because it only intensifies the feeling of nervousness and unrest which is the root of the evil.

It is easy to see, therefore, that the essential characteristic of a banker's assets, or at least of a certain proportion of them, is convertibility into money, not merely ultimate safety. A banker's obligations are to pay gold or notes on demand, and he must have access to a reserve which is available for use in any circumstances and without any delay.

CHAPTER XIV.

THE RELATIONS OF A BANKER TO HIS CUSTOMER.

We have seen that the general relation between the banker and his customer is that of debtor and creditor, but the minor duties usually undertaken by the former are manifold and manysided, and the legal relations between the two are consequently complex.

When a banker accepts a deposit from a customer with which to open a current account on the terms usually adopted by bankers, he enters into an implied contract to repay the amount in the manner directed by the customer. He engages to honour cheques drawn upon the account, and if he pays away any of the money against the wishes of his customer, whether through fraud or misrepresentation or through an error, he is, speaking generally, liable to the customer for wrongful conversion, except in those cases where he is protected by statute.

But the drawee banker, that is to say, the banker paying a cheque drawn upon himself, is only liable to his customer and not to any third party. If a banker wrongfully dishonours a customer's cheque, he is not directly liable to the holder of the cheque, but only to his customer, and the holder

can only compel payment of the cheque or obtain damages for the error through the drawer of the cheque.

The banker's authority for parting with money held at the disposal of his customer, is the latter's cheque, and he must, except where specially protected, take the consequences of acting upon an irregular document. For instance, if the drawer's signature is forged and the banker fails to detect the forgery he cannot debit the customer with the amount. If he pays a cheque before the date which it bears, or pays a bill before the date of maturity, he can only debit his customer on or after the date of the document, not before. He must pay the cheque or bill to the person named in the document, or to some other person to whom the document has been negotiated by endorsement and delivery, except in the case of instruments payable to bearer. The evidence of such proper payment is the endorsement of the payee or endorsee. But special protection is afforded to the banker paying cheques drawn upon himself, by s. 60 of the Bills of Exchange Act, 1882, which is as follows: "When a bill payable to order on demand is drawn on a banker, and the banker on whom it is drawn pays the bill in good faith and in the ordinary course of business, it is not incumbent on the banker to show that the indorsement of the payee or any subsequent indorsement was made by or under the authority of the person whose indorsement it purports to be, and the banker is deemed to have paid the bill in due course, although such indorsement has been forged or made without authority."

This section is of the utmost importance to the paying banker, as it protects him from the legal consequences of paying a cheque with a forged or unauthorised endorsement. It must be noted, however, that the endorsement must at least "purport" to be that of the payee or endorsee, that is to say, it must be on the face of it correct, and the section does not protect a banker paying on an endorsement differing in spelling from that of the person named in the instrument, or otherwise manifestly irregular.

Secondly, it must be noted that the section applies only to bills drawn on a banker payable to order on demand, that is to say, cheques. Under the terms of the Finance Act of 1853, the protection probably applies also to drafts or orders upon a banker, which are, technically speaking, not cheques according to the definition in the Bills of Exchange Act, but it certainly does not apply to bills of exchange accepted payable at a bankers, and the banker paying such bills with a forged or unauthorised endorsement will be liable to the acceptor for wrongful conversion.

The position of a paying banker is well defined and fairly comfortable, but that of the banker who collects a cheque drawn upon another banker either for a customer or for a third party is both complex and full of responsibility. In the absence of statutory protection, the collecting banker is in the same position as any other individual who changes a cheque to oblige a friend or in the course of business. He may be a "*bonâ fide* holder for value," or he may be a mere agent for collection, but he cannot be both.

A *bonâ fide* holder for value or holder in due course is defined by s. 29 (1) of the Bills of Exchange Act, 1882, as "A holder . . . who has taken a bill (*a*), complete and regular on the face of it, under the following conditions; namely,

"(a) That he became the holder of it before it was overdue, and without notice that it had been previously dishonoured, if such was the fact:

"(b) That he took the bill in good faith and for value, and that at the time the bill was negotiated to him he had no notice of any defect in the title of the person who negotiated it."

The position of a holder in due course is a strong one. He holds the bill "free from any defect of title of prior parties," and he can "enforce payment against all parties liable on the bill."

But if the collecting banker relies on his position as a holder for value, there is a weak spot which often invalidates his position. No one can acquire the rights of a holder in due course of a bill (which term includes a cheque) on which a previous endorsement is forged or unauthorised. No title whatever can be acquired through a forgery. In most cases, however, in which a banker collects a bill or cheque with a forged endorsement, his right against his customer is practically worthless, and he may therefore be accountable to the true owner for the amount.

Suppose a banker opens an account with a man who is practically a stranger to him, and collects

(*a*) The word "bill" as used here includes a cheque.

for him a cheque on which the customer has forged the endorsement. The customer withdraws his balance and decamps. The banker cannot, because of the forgery, rely upon his position as a holder in due course, and in the absence of any other defence he is liable to the true owner of the cheque.

But if the banker is not a *bonâ fide* holder for value he may rely upon the protection given to him as a mere agent for collection by s. 82 of the Bills of Exchange Act, 1882, which runs as follows:

"Where a banker in good faith and without negligence receives payment *for a customer* of a cheque crossed generally or specially to himself, and the customer has no title or a defective title thereto, the banker shall not incur any liability to the true owner of the cheque by reason only of having received such payment."

The Revenue Act of 1883, s. 17, extends the operation of this clause to "any document issued by a customer of any banker, and intended to enable any person or body corporate to obtain payment from such banker of the sum mentioned in such document" provided it is crossed, but, with this exception, this section applies only to *crossed cheques*, and it has recently been held that the crossing must be placed on the cheque before it reaches the collecting banker's hands. Bills other than cheques, and open cheques are excluded altogether from the operation of this clause.

Secondly, the crossed cheque must be collected *for a customer*. In the recent case of *Capital and*

Counties Bank v. *Gordon*, [1903] A. C. 240, it was decided that if a banker credits his customer's account with the amount of the cheque as cash immediately upon receipt of it, and then proceeds to collect it, he collects it not for his customer but for himself, his own position being that not of an agent for collection, but of a holder for value. Since it is the almost universal practice of bankers to treat, at all events, cheques payable in London in this manner, and in many cases also cheques payable in the country, it will be seen that this decision deprives the collecting banker in the majority of cases of the protection ostensibly afforded by the section quoted above (p. 128), the banker is forced to stand or fall by the validity of his position as a holder in due course.

There is a further limitation to the position of a holder in due course, that is, in the case of crossed cheques which are marked "not negotiable." This addition to the crossing of a cheque does not prevent the cheque from being negotiated, but the person taking such a cheque "shall not have and shall not be capable of giving a better title to the cheque than that which the person from whom he took it had."

The position of the collecting banker is therefore as follows:

(1) He may be a *bonâ fide* holder for value of the cheque or bill which he is collecting, having given his customer value for the cheque or bill by crediting his account with the amount previous to collection. The banker cannot claim to be a *bonâ fide* holder for value unless he has given value for the cheque

and his claim is defeated by the existence of a forged or unauthorised endorsement of any previous party, or by the existence of the words "not negotiable," if the document is a crossed cheque.

(2) If he is not a holder in due course, he can, in the case of crossed cheques only, plead the protection afforded to the banker collecting such cheques for his customer by s. 82 of the Bills of Exchange Act, 1882, but a cheque is collected for a customer within the meaning of the Act, only when it is collected before the customer's account is credited with the amount.

(3) If the collecting banker is neither a holder in due course nor protected by s. 82, he must stand or fall by the validity of his customer's title. If his customer has no title or a bad title to the bill or cheque, the banker cannot acquire a good title, and will be liable to the true owner of the cheque or bill; his only recourse will be, in the majority of cases, against his own customer.

So much for the relations of banker and customer in the ordinary operations of paying and collecting bills and cheques: the relationship is partly that of agent and principal, partly of debtor and creditor. But this is not the only form of relation between banker and customer. In a bank advertisement a paragraph in something like the following terms will often be noticed: "The Lombard Bank will take charge of Foreign and Colonial Bonds, etc., and will detach and collect the coupons as they fall due, passing the interest to the credit of customers as received."

In this case the banker stands in the relation of trustee as well as agent for his customer. He acquires no property in the securities so lodged with him for safe custody. Where a banker discounts a bill for a customer, he becomes the legal owner of the bill; he buys it, and only has a possible right of recourse against his customer through the latter's endorsement, should the other parties to the bill fail to meet it. But in the case of securities lodged for safe custody, the position of the banker is different; he must neither sell nor pledge them, and must be prepared at any time to hand back the identical securities deposited. Should he convert them to his own use, he becomes criminally liable.

The only right which a banker may acquire over such securities is what is called a banker's lien. A lien is a right to retain valuables until all debts due by the owner to the holder have been discharged; a right of sale is not given by a lien. Bankers have, "by implication of law," a general lien over all securities deposited with them in their capacity *as bankers*, unless there is a special contract over-riding the general lien. This general lien attaches to all bills, cheques and other negotiable instruments deposited with a banker for collection. It probably does not attach to securities deposited simply for safe custody, but if the customer instructs the banker to cut off and collect coupons on bonds, this is generally thought sufficient to bring the bonds under the banker's lien, since it then becomes the banker's duty so to collect the coupons, and the bonds may therefore be held to be in his possession for that purpose. If, however, a customer deposits share

warrants or certificates with his banker for safe custody, and at the same time gives an authority for the dividends to be paid direct to the bank for the credit of his account, it is doubtful whether the general lien attaches, as such certificates are not in the possession of the banker as a banker: he incurs no obligation with respect to them, and holds them not because it is part of his duty towards his customer, but because it is the usual custom to do so.

Another point to be noticed with regard to the general lien of a banker is, that it is defeated by the existence of a special lien. If securities to the value of £5,000 are lodged with a banker under a written agreement to secure a debt of £3,000, the banker acquires a special or conventional lien to the extent of the latter amount, but he cannot claim a general lien on the remaining £2,000.

A banker enters into another relation to his customer when he consents to take charge of plate, jewellery, or other similar articles. These are almost invariably deposited in a locked or sealed box or plate chest, and the banker takes no cognizance of the contents of such boxes, and makes no charge for thus taking charge of them. He is what is called a "gratuitous bailee" for his customer, and provided he acts in good faith and takes all reasonable precautions, that is such precautions as a business man would usually take in respect of his own property, he is not liable for any loss or damage to the articles. If, however, the banker delivers them to a third party without the consent of the owner, as, for instance, when he acts upon an order purporting to be written by his customer, but which is

in reality forged, it has been argued that he is liable to his customer for any loss accruing from his acts. The only case bearing directly upon the subject, that of *Langtry* v. *Union Bank of London* in 1896, was settled by a compromise, so that the state of the law upon the point is uncertain.

Apart from these general relations of banker and customer, there are occasions in which a banker incurs special liabilities in his dealings with the latter. In dealing with a bankrupt, for instance, special care is necessary on the part of a banker. Immediately the latter has notice of an act of bankruptcy committed by his customer, he should stop the account and refuse to pay any further cheques. The property in the balance standing to such a customer is vested in the trustee in bankruptcy, and if a banker pays a cheque after the receipt of such notice, or after a receiving order has been made, with or without notice, he is liable to refund such amount to the trustee. It must, however, be borne in mind that the mere calling together of a debtor's creditors and the offer to them of a composition, does not in itself constitute an "act of bankruptcy."

A banker should not open or carry on an account with an undischarged bankrupt, or he may find himself liable to refund all payments made by him on the account; neither should he open an account with the wife of an undischarged bankrupt who is carrying on the business formerly belonging to her husband.

Another special relation is that of a banker to a customer who is a minor. It has in some quarters

been held that a minor, being unable to give a valid discharge for a debt, can, when he comes of age repudiate, as against his banker, cheques drawn by himself upon the latter, but the better opinion seems to be against such a strained interpretation of the protection afforded by law to minors. But although a banker can, perhaps, safely open a current account with a minor, he should certainly not allow the account to be overdrawn, as money lent to a minor cannot be recovered in a court of law.

Another case in which a banker should exercise great care is in his dealings with trustees. The English courts always extend the utmost protection to the beneficiaries of a trust, and a banker may, through imprudent action on his part, find himself held to be technically privy to a breach of trust. For instance, suppose a customer keeps two accounts, one a trust account with a credit balance, the other a private account with an overdrawn balance; the banker presses his customer to reduce the overdraft upon his private account, and he thereupon transfers part of the balance standing to his trust account, in satisfaction of the overdraft upon his private account. If the customer proves to have fraudulently misapplied the trust funds to his own use, it is probable that the banker would be held privy to such fraud and would be liable to refund the money so transferred. Again, a banker should be very careful of acting upon the authority of a single trustee, or of the majority. It is best to obtain the signature of all the trustees in every case, and if he is prudent a banker will hesitate to accept an authority signed by all the trustees granting to one of them the

power to act for the whole body, as such an authority may be held to be *ultra vires*.

Lastly, a banker should act with care in his dealings with employees and other agents. Especially is this true as regards the collecting banker. Section 82 of the Bills of Exchange Act, 1882, which we saw to be the chief protection of the collecting banker, stipulates that a banker must act "without negligence," and it has been held that a banker who collects for an agent cheques payable to his principal may be held guilty of negligence. In the case of *Bissell* v. *Fox* (1885), 53 L. T. (N.S.) 193, a commercial traveller opened an account with a bank in his own name and paid in to his credit cheques payable to his principal which he had endorsed "per procuration." A "per procuration" signature "operates as notice that the agent has but a limited authority to sign," and it was held that the circumstances were sufficient to put the banker upon enquiry as to the validity of his customer's power to endorse in this way, and that therefore the bank did not act "without negligence." In a similar case, *Hannan's Lake View Central* v. *Armstrong* (1900), 15 T. L. R. 236, the secretary of a company endorsed a cheque payable to the company and then fraudulently paid it to his own credit, and the collecting bankers were similarly held not to have acted "without negligence."

It therefore behoves a banker to act with extreme caution in his transactions with a customer who is known to be the agent or employee of another person.

CHAPTER XV.

BANKERS AND BORROWERS.—I.

It is very difficult and somewhat dangerous to attempt to lay down on paper the rules which should guide a banker in lending money. This is above all the function which a practical business man can alone fulfil with complete success. It may be easy to formulate rules, but in practice such rules are apt to be rather rudely brushed aside. In order to lend money with success, theoretical knowledge is of less importance than those business virtues, such as judgment and knowledge of character, combined with the possession of thoroughly reliable local information such as every bank manager should endeavour to acquire. But although in individual cases theory is subordinate to practice, yet in dealing with transactions in the mass some rule of conduct is necessary, or a large bank will soon find itself in difficulties. The branch manager will often find that local conditions render necessary the lending of money in a direction or by a method which runs counter to the line of policy pursued by his directors. It may be that the representations of the manager will carry the day, but he is often rather galled to find that what he regards as a golden opportunity for making money is heedlessly thrown away by his directors. Probably the branch

manager has not sufficiently realised that in dealing with the advances of the bank as a whole, certain rules must be for safety's sake laid down, and more or less closely adhered to.

It is intended here to give some idea of the general principles which should guide a banker in lending money, though with this proviso, that circumstances may often arise which necessitate the breaking of the rules laid down. A banker, like most business men, is often constrained to act against his better judgment. He may be influenced in his loans by the fear of offending wealthy connections of his customer by a refusal, or, having made a loan without security, he may find it better to accept later on an unsatisfactory form of security rather than face a heavy risk of loss.

First of all then it will be convenient to consider the classes of borrowers with which a banker usually has to deal. These can be divided into three :

(1) Private individuals, *i.e.*, those not engaged in trade or business.

(2) Commercial firms or individuals.

(3) Companies registered under the Companies Acts.

This is not a complete list, for it excludes such borrowers as municipal and educational authorities, but it includes all we have room to discuss here.

First then, in dealing with private individuals it should be noted that such people should not, as a general rule, offer bills for discount. Bills arise out of commercial transactions, and private individuals

neither pay their debts nor are they paid by means of bills. Sometimes they may offer bank bills for discount, and this may be quite in accordance with expectation. The customer may have, for instance, property in one of the Colonies, and may have money remitted to him by means of sixty days' sight bank bills, which is the usual method of remitting money from Australia; in this case, the customer will often wish to discount the bill with his banker. Nevertheless, as a general rule, bills offered for discount by a private individual should be regarded with suspicion; they may probably turn out to be "accommodation" bills. An accommodation bill is one which an obliging friend or other person has accepted in order to enable the holder to borrow money upon it, but without being a party to any monetary transaction upon which the bill has been based. It is always doubtful whether an accommodation bill will be met at maturity. The obliging friend has probably been informed that the bill will be "taken up" or "retired" before maturity, and he has therefore taken no steps to meet the bill. Borrowers are however proverbially sanguine, and it often happens that the drawer or endorser of the bill is unable to take it up before maturity, and the bill is consequently dishonoured, in which case the banker may find that his only resource is to renew the bill, and hope that time will improve matters.

Secondly, in advancing money to a private individual, remember that however large his income may be, it may cease at his death. Supposing the customer is a barrister or doctor earning several thousands a year, but living right up to his income and saving no

money. His banker may feel tempted to grant him a temporary loan without security, relying on the extent of his "turnover," that is, the amount of money passing through his account. But in case of the customer's death, what is the banker's position? If the customer has spent all his income and has no capital, the debt will be worthless. It is an error to suppose that because a man lives in good style and keeps up appearances, he is necessarily a wealthy man. Of course, a glance at the customer's account in the ledger will usually show whether he has money invested. If he has bought Stock Exchange securities, the dividends will be periodically credited. If, on the other hand, he has invested his money in landed or other property, it may not be easy to distinguish between the income from these sources and other receipts.

In lending money to the second class of customers, commercial men or firms, the banker has different considerations forced upon his notice. In dealing with such men, a banker is often asked to make temporary advances without security. A business man may often have sudden and unexpected calls for payment which he cannot easily meet, but which must not be disregarded. A commercial man's credit, his reputation as a man of means, is a tender thing, a part of his capital, and in order to protect it he may have to make a sudden call upon his banker.

Something can be told from the amount of a business man's "turnover," but this knowledge must be used with caution. He may be buying on

long credit and selling for cash, or he may be speculating, and the appearance of his account be deceptive. Some banks ask their customer to give them in confidence a rough balance-sheet showing the state of his finances. It may be asked what is the use of a balance-sheet which only possesses the authority of the customer's written statement, and which the banker is unable to verify? It may be entirely fraudulent. The answer is, that it is almost impossible in this matter for a banker to protect himself against deliberate fraud on the part of a customer. Very few men would go so far as to sign a fraudulent balance-sheet, knowing that they would by so doing render themselves criminally liable. The risk of fraudulent dealing is an ordinary business risk which a banker is at times compelled to run. If the customer is such a one that his written statement cannot be trusted, it will be advisable not to lend to him except upon good security. But in considering a balance-sheet with a view to lending money, although the possibility of fraud can in most cases be disregarded, yet the banker, if he is wise, will make a liberal allowance for the exaggerated optimism which nearly always characterises a borrower, however honest he may be.

In dealing with trading firms, it is well to remember that the act of one partner binds the firm. When possible, it is better, in making a loan, to obtain the consent or authority of all the partners, but it is not a legal necessity. Not only is this so, but a banker need not take special steps to

prove that an individual is a legal partner in a business firm. Provided the firm act in such a manner as to induce the public to believe that an individual is a partner, they are bound by the acts of such a man, and cannot repudiate them on the ground of lack of authority, although no deed of partnership may exist.

In dealing with the third class of borrowers, viz., companies registered under the Companies Acts, there are one or two important points to remember.

First of all, a company may have no power to borrow money at all, or may only have a limited power to borrow to a restricted amount, or under certain conditions.

A company's powers of borrowing are determined by its memorandum and articles of association, and it is advisable to see a copy of these before lending money to the company. Otherwise it may be discovered that the directors have acted *ultra vires* by so borrowing, the effect being that the shareholders of the company are not bound by the acts of its directors, and the only remedy of the bank is against the directors personally.

Secondly, caution is necessary in lending money to a newly registered company. Bankers have often to help to finance new companies floated under their auspices; but the Companies Act of 1900 says that no contracts entered into by a company shall be binding until such company is entitled to commence business; and in order to do this the company must first obtain from the Registrar of Public Companies

a certificate stating that certain formalities have been carried out and that a certain proportion of the capital has been allotted. In lending money to newly formed companies it is advisable for the banker to ask to see a copy not only of the articles of association but also of the registrar's certificate that the company is entitled to commence business.

The third point to remember is the obvious one that if the liability of the company is registered as "limited" the shareholders of the company are not responsible for its debts beyond the nominal amount of their shares. The debts of a common law partnership can be recovered against the private estate of any or all of the parties; but the creditor of a limited company is denied this privilege. A banker will therefore usually hesitate before lending money to a limited company unless security be deposited; but in cases where a temporary loan is required, and it is not convenient to deposit Stock Exchange securities or title deeds, it is very usual for the banker to accept a joint and several promissory note signed by two or more of the directors personally. This is discounted, and the proceeds placed to the credit of the company. At maturity the company will probably be in the position to pay the amount; but if not, the banker has a remedy against the private estate of each or all of the directors who signed the note.

Now that we have gained some idea of the chief classes of borrowers, it will be advisable to examine the different methods of borrowing from a banker,

and these can again be conveniently divided into three heads:

(1) By the discount of bills and promissory notes.

(2) By overdraft upon current account.

(3) By loan account.

(1) When a bill or a batch of bills is offered to a banker by a customer for discount, the first thing the banker has to decide is whether the customer's account is a sufficiently good one to justify the transaction. A banker will naturally hesitate to discount bills for a customer whose cheques he is sometimes forced to dishonour, for it is very probable that the bills offered by such a man will not be reliable. He will also probably refuse to discount for a customer whom he does not know to be thoroughly respectable, for a banker is, as a rule, ignorant of the signature of the acceptor to a bill offered for discount, and relies upon the honesty of his customer.

Having decided that the customer's account warrants the transaction, the banker will see that the bill is correct in form, drawn upon properly stamped paper and duly accepted. He will see that the customer endorses the bill, whether it be payable to his order or not, for in case of dishonour the banker's remedy against his customer lies through the latter's signature either as drawer or endorser. As a rule a banker will not discount bills having more than six months to run, nor do English bankers often discount bills payable abroad, this branch of the business being usually left to the bill brokers.

Nearly all bills offered for discount are accepted payable at a bank. The discounting banker will then make a confidential inquiry of the acceptor's banker, asking for the latter's opinion in strict confidence of the standing and respectability of the acceptor. This opinion he will record for future use in his acceptor's register, in which book it will be found convenient to make a note of any dishonoured bills, in order that if necessary he can avoid similar bills in the future. If the opinion is satisfactory the customer will be credited with the full amount of the bill, which will be debited to the "bills discounted" account. Interest on the unexpired term of the bill, at a rate to be agreed upon, and usually bearing a fixed relation to the current Bank of England discount rate, will then be debited to the customer and credited to the banker's discount account.

This operation, which is the ordinary routine of discounting a bill, is now complete. It only remains to make a note of the due date of the bill in the bill diary in order that the bill may be duly presented, for if through inadvertence presentation be neglected the consequences may be serious to the banker, since the drawer's and endorser's liability will be terminated by the omission, and the banker's only recourse will be against the acceptor. If on due presentation the bill is dishonoured, notice must be given to the customer not later than the day following such dishonour.

In discounting promissory notes, the proceeding is similar, except that the maker of the note stands in the position of the acceptor of the bill. A banker will sometimes advance money to a customer

of good standing by discounting the customer's own promissory note; if he wishes an additional safeguard, he will ask the customer to get a friend to join with him in a "joint and several" promissory note, in which case each of the parties is liable for the full amount of the note.

(2) and (3). The difference between lending money by an overdraft upon current account and by loan account is as follows:—In the former case, the customer pays interest on the daily balance standing to his debit, this being charged either quarterly or half-yearly. In the latter case, the customer opens a loan account and transfers from this account to his current account either the whole stipulated sum or such a portion of it as he is likely to require in the immediate future. He will be expected to keep a credit balance on his current account of such an amount as a banker thinks sufficient, according to the character of the account. He will pay interest on the sum standing to the debit of his loan account.

At first sight it may seem as though every customer would prefer to borrow by the former method, that is, by overdraft, because in this case he only pays interest on the sum he actually uses, whereas in the latter case, part of the sum for which he pays interest is standing to his credit on current account. But to counterbalance this, a banker is usually willing to grant a loan at a slightly lower rate of interest than he will charge on an overdraft, while in the latter case he also usually charges a small commission to recoup himself for the trouble and expense of keeping the customer's account, an

expense which is covered in the case of a loan account by the credit balance kept on the current account.

The next chapter will treat of the various forms of security which are deposited with a banker to cover loans made by him. Before passing on to this, I should like to reiterate what I have previously mentioned as to the character of a banker's loans. It is not a banker's function to lend money permanently.

Fortunately we have not had to face the failure of one of our larger banks for many years, but minor failures have been frequent, and it is no exaggeration to say that by far the larger proportion of these have resulted from assets being locked up in large loans to a few individuals—loans which have gradually acquired a permanent character, and ended by becoming bad debts. The province of a banker is to tide over temporary lack of ready money, not to provide capital on which the customer carries on his business.

No doubt a banker in this as in other directions has often to run counter to his general policy, but he should never lose sight of the fact that his obligations are to pay on demand, and keeping this ever in mind, he should always hesitate to lock up his money in permanent loans.

CHAPTER XVI.

BANKERS AND BORROWERS.—II.

As we have seen, a banker in some cases is willing to lend money to a good customer for a short period without security, but in most cases a banker requires the deposit of some form of security as cover to the loan.

Perhaps the most usual form is the deposit of Stock Exchange securities. The character of the greater part of a banker's security depends upon the character of his business. In a neighbourhood like the West End of London, Stock Exchange securities will perhaps greatly outnumber the remaining forms. In a country town, it may be that deeds of title to land form a large proportion; in a seaport town very likely a considerable amount of money will be lent on bills of lading and other shipping documents.

Government stocks, good debentures and other "gilt-edged" securities, form excellent cover for a banker against advances. He can either acquire a general lien against such securities, an equitable title or a legal title. The application of the banker's lien has been considered in a former chapter. If the securities are deposited under a memorandum or deed of deposit, the banker, in the case of negotiable securities, such as bearer bonds and scrip, acquires

upon the default of his customer, a full legal title. Provided he took the securities without legal "notice" of any defect in his customer's title, he can maintain his right to them against all comers, notwithstanding any such possible defects. The banker must however be careful that circumstances do not occur which can be held to affect him with "notice." The Courts are in many cases, especially where a trust is concerned, strict in their interpretation of the term notice, and if anything should occur to make the banker suspect that the securities are held by his customer in trust, he should either obtain a clear explanation or refuse to accept the security.

In the case of shares of companies registered under the Companies Acts, the deposit of the share certificates only gives the banker an equitable title. The difference between the two is this: a legal title always has the priority over a mere equitable title. The danger of an equitable title is that, unknown to the banker, some one else may have either a prior equitable title or a legal title, in which case the former will have to surrender the securities. In order that a banker may obtain a legal title to shares in a company, it is necessary in nearly all companies to have the shares transferred into the name of the banker, or, as is usually done, into the names of some nominees of the banker, and also to have this transfer registered in the books of the company. Until the transfer has been so registered, the banker will have but an equitable title, which will be liable to be postponed to a prior equitable title, either of the company or perhaps in favour of some trust of which the banker was unaware.

Practice varies among bankers, but it is certain wiser in the majority of cases to have the shares transferred and registered. At one time the custom prevailed of obtaining the customer's signature to a blank transfer deed, which could be filled up and registered when the occasion demanded, but it has been decided by the Court of Appeal that a transfer so drawn up is not a legal or effective document.

Cases may arise where it is inexpedient to obtain a legal title to shares, as for instance when the shares are not fully paid. Bankers will not willingly accept as security shares on which there is a balance of uncalled capital. Mining shares and certain classes of industrial shares are avoided by the average banker, not only on account of their speculative character, but also by reason of the fact that they are seldom fully paid, but if a banker is compelled to accept such shares for want of a better security, it is wiser not to transfer the shares, in order that the banker may not be saddled with the responsibility for the uncalled balance.

Another very general form of security offered to a banker consists of title deeds to landed property. This forms a very fair class of banker's security, though it suffers from the disadvantage that such property is not always easily marketable, and a forced sale is apt to result in a price very much below the normal one.

As in the case of Stock Exchange securities, a banker may either obtain a legal mortgage or an equitable mortgage. Speaking generally, bankers do not lend on legal mortgages. If a customer

wishes to execute a legal mortgage he usually consults his solicitor, not his banker, for the solicitor can usually find someone willing to lend money for a longer period than is expedient to a banker, someone who has not the banker's responsibilities, and who is willing to regard the transaction as a more or less permanent investment of capital.

Bankers usually obtain the deposit of the title deeds under a memorandum, which constitutes an equitable mortgage. The only drawback to this is, as in the former case, the possibility of its being postponed to a prior equitable mortgage or a later legal mortgage, but the latter danger can be guarded against if the banker keeps the title deeds continually in his possession, and does not part with them even for a short interval, as without the possession of the deeds it is not possible to execute a legal mortgage.

In dealing with title deeds there are several points to remember:

(1) The deeds should be immediately submitted to a competent solicitor for a report as to their genuineness and correctness.

(2) The property should be valued at frequent intervals. Certain classes of house property rapidly deteriorate in value if they are not kept in a proper condition of repair.

(3) In dealing with leasehold properties, allowance must be made for the fact that their value declines as the term of expiry approaches.

(4) The customer should be required to produce the receipt for the ground rent of leasehold properties

as soon as the period for payment has passed, since, if this be not paid, the lease may be forfeited.

(5) All house property should be insured against fire, and the customer should produce for the banker's inspection the receipt for each annual premium as it falls due.

(6) Second mortgages of all kinds should be avoided. The holder of a second mortgage is practically powerless without the co-operation of the first mortgagee, and, what is worse, he may find that by the process called "tacking," the holder of a third mortgage may join his charge to that of the first mortgagee, and both may take precedence of the second mortgage.

Another form of security sometimes offered to a banker is a life insurance policy. The amount a banker can safely lend on a life policy will not exceed its "surrender value." This is the amount, fixed by the company issuing the policy, which they are willing to pay for its surrender, and is a proportion of the actual amount of the premiums already paid. There is a general opinion that a banker can acquire no right to retain a life policy unless it has been deposited under a memorandum, but this opinion is apparently unwarranted, and if the policy has been left with the banker for the purpose of securing an advance, the banker probably has a lien upon it, although no memorandum of deposit may exist.

The next form of security which we have to notice is the guarantee of a third party, which may be

either under hand or seal, though the former is the method more usually adopted.

The weak point of a guarantee is that the banker is not always in a position to judge whether the guarantor is thoroughly reliable. In most cases he will have to rely upon the confidential opinion of another banker, and in giving such opinions all bankers are naturally prone to take the most favourable view of their own customer's position.

Most banks have their own form of guarantee drawn up by an expert solicitor, but it may be mentioned that a guarantee should be expressed to be a "continuing" guarantee, covering not only existing debts due from the person guaranteed, but all future debts incurred by him until the guarantee is terminated, either by notice or by the death or bankruptcy of the guarantor.

If a guarantor dies or gives notice that he wishes the guarantee to cease, the banker upon hearing of the death, or at the expiration of the notice, should at once stop the account of his customer and refuse all further transactions on it. This is imperative. If the account is continued after the expiration of the notice or the death of the guarantor, every amount paid to the credit of the account reduces the debt, but every cheque paid creates a fresh debt. This principle is called the general rule of the appropriation of payments, or "the rule in Clayton's case."

An illustration will perhaps explain the meaning of this more clearly. Suppose John Smith has an overdrawn balance of £100 on his account. He

calls in at the bank, pays in a cheque for £100, and draws out £100 to pay his week's wages. From a legal point of view he has extinguished his original debt and created a new one.

Now let us suppose that the overdraft is secured by a continuing guarantee of John Brown for £100. John Brown gives notice that he wishes to terminate the guarantee, and at the expiration of the notice Smith's overdraft is £95. Smith's banker neglects to stop the account, and Smith comes to the bank next day, pays in £50 to his credit and draws out £25, leaving his balance £70. Brown's liability is, however, reduced to £45. The cheque for £25 constituted a new advance from the banker to Smith, and was not therefore covered by Brown's guarantee, although the £50 paid in is deemed to have paid off part of the old debt.

One of the chief advantages of a guarantee is experienced in the case of the bankruptcy of the customer whose account is guaranteed. If the account is secured by the deposit of bonds, title deeds or similar securities belonging to the customer, the banker will have to realise them before proving against the estate in bankruptcy. But with a properly drawn guarantee, he can, if he think proper, prove against the estate for the full amount of his debt, and then require the guarantor to pay the balance, or so much of the balance as the full amount of the guarantee will cover.

In many cases there will be an important difference between these two methods of realising the securities. Suppose the overdraft of the bankrupt is £150, secured

by the deposit of bonds worth £100 in the one case, and a guarantee for £100 in the other. In the first case the banker will be able to prove for £50 only, and if the dividend is 10*s.* in the pound, he loses £25. In the second case he proves for £150, which, with the same dividend, will leave a debt of £75, and he can then claim the repayment of the whole of this balance by the guarantor.

One other form of security may be mentioned—that is, documents of title to goods. The most important of these is a bill of lading, which is in effect a certificate given by the master of a ship that certain goods have been entrusted to his possession, and that he undertakes to deliver them at the end of the voyage, subject to certain conditions mentioned in the bill. While the goods are at sea the bill of lading is evidence of ownership, and the right to obtain delivery of the goods can be transferred by the negotiation of the bill of lading.

A bill of lading is almost always drawn in a "sett"; that is, there are two or three identical parts, numbered one, two and three, and care must be taken to gain possession of all the parts. The master of the ship or warehouseman will deliver the goods on the presentation of any one part of the bill, and the law justifies him in this course. If the holder of a bill of lading fraudulently negotiates each part to a separate individual, the man to whom the transfer is made first in point of time has a better title than the later ones, but the man who

first presents the part in his possession will probably obtain possession of the goods. The only safe method, therefore, is to obtain possession of all the parts of the bill.

A bill of lading usually states that so many packages, boxes, bales of merchandise, have been shipped, but it does not guarantee the contents of the packages, and the shipowner is not responsible for the genuineness of the goods. A policy of insurance should, however, always be attached to the bill, and an invoice, and these will afford a fair criterion of the value of the goods, though they will not always be a protection against fraud on the part of the shipper.

It must be remembered that a bill of lading confers a right to obtain possession of the goods mentioned in it, but it does not necessarily confer a valid title to the goods. The banker may find, after he has obtained the goods, that the man to whom he lent the money had no right to pledge the goods, and he may, therefore, have to surrender them to the true owner. In this connection the Factors Act, 1889, is a great protection to bankers. It enacts that if goods are entrusted to a mercantile agent, factor or broker in the usual course of his business, and the mercantile agent wrongfully pledges them, yet a man who innocently advances money on the goods or the documents of title to them shall be able to enforce the contract against the true owner, although the latter had not sanctioned the pledge.

Finally, to return to the topic of lending generally, there are two points which a banker should always bear in mind.

First, the mistake of optimism should be avoided. Do not be over sanguine. It is advisable to allow a liberal margin between the value of the securities and the amount of money advanced against them, as provision against possible depreciation. Do not be too ready to accept a customer's valuation of his assets or of his probable profits in the future. Without imputing any fraudulent intention, it is safe to say that such estimates usually prove too sanguine.

Secondly, if a bank manager has a sudden doubt of the position of the customer to whom he has granted an overdraft, he must not therefore dishonour his cheques without reasonable notice. Of course, if a limit has been agreed upon, beyond which the customer must not draw, and cheques are presented which will exceed this limit, they may be returned unpaid without notice and without scruple. But if a banker has been in the habit of allowing his customer to overdraw to an agreed amount, he must act with caution in refusing to pay up to this amount; if he should attempt to dishonour cheques in such circumstances without what the law considers "reasonable notice," he may find himself mulcted in heavy damages.

Another similar point to remember is that a banker should not dishonour his customer's cheque solely for the reason that the debit of his quarterly

or half-yearly charges for interest and commission has brought the overdraft up to or beyond the agreed limit, unless the customer has had notice of such charge. It is advisable, if the banker's charges bring the account somewhere near the limit, to send the customer his pass-book with the entries made, which in all probability will constitute notice of such charges.

CHAPTER XVII.

THE MONEY MARKET.

THE Money Market is a general name for the sphere of operations of certain classes of men who wish to borrow or lend money, and is grouped around the Bank of England and those streets in the immediate neighbourhood where for centuries the City bankers have congregated.

The Money Market deals more especially in loans for very short periods. The fund which is dealt in is called the "short loan fund of the London Money Market." This short loan fund consists for the most part of the unemployed money of the banks. By "unemployed" is meant that money which is not permanently invested by the banks, but which it is thought advisable to have ready at hand. It is described in the balance sheets of the various banks as "money lent at call or on short notice."

On the one hand, we have the banks who have money to lend; on the other hand, there is a group of men who carry on their business partly by means of borrowed capital. These are the bill brokers and the operators on the Stock Exchange. Added to these are the British Government, which borrows money from the market from time to time, and the

Indian Government, which lends money. Foreign governments and foreign banks also take advantage of London's position as a free gold market, and there is, as a general rule, a very large amount of foreign capital invested in the London Money Market.

London occupies quite a peculiar financial position compared with the other capitals of Europe. The Bank of England is compelled by its charter, as we saw in a previous chapter, to buy all gold offered to it, and it never attempts to place any obstacle in the way of those who wish to export gold, beyond the legitimate method of raising the rate of interest. In this way London has acquired the reputation of being the only perfectly free market for gold.

Of course the Bank of England is intimately connected with the Money Market; in fact it is the pivot of the Market, but the Bank is generally spoken of as apart from the Market, which is, as we shall see later, often slightly antagonistic to the Bank.

The position of the bill brokers demands a few words of explanation. In most, if not all, of the European capitals the business of bill discounting is carried on by the banks, but in London there is a class of middlemen between the banker and the holders of bills. These are the bill brokers, who have acquired the greater part of the business of discounting bills in London. A great part of this business is conducted with money borrowed from the banks, either in the form of seven-day loans or day-to-day money, or even such short loans as

"overnight" money, lent from one afternoon to the next morning.

Two things are of especial interest to all who study the Money Market; these are, the Bank of England Reserve of coin and bullion, and the Rates of Interest prevailing in the Market. Owing to the unique position occupied by the Bank of England in our banking system—a position which has been explained in a former chapter—the Reserve of the Bank of England has come to be regarded as the National Reserve. All of the London Clearing bankers are compelled to keep an account at the Bank of England, and as the other bankers all appoint London agents with whom they keep a balance and upon whom they draw, it follows that the Bank of England is open to be drawn upon directly or indirectly by the whole of the English banks. With the exception of the balances kept at the Bank of England or the London agent, no banks keep a gold reserve of any great extent beyond the money held as till money, and which is required for day-to-day purposes. It is easy to see, therefore, the importance which attaches to the Bank of England Reserve. Not only is this Reserve open to be drawn upon for the purposes of our English banking system, but it may also be diminished at any moment by a drain of money for export purposes, a danger which is accentuated by the international position occupied by London as the financial centre of the world.

During the eighteenth century, if gold was being drained from the country, and the Bank of England's reserve was abnormally diminished, the remedy was

found in a contraction of the paper currency, which caused gold to flow into the country to fill the vacancy so caused. But since the passing of the Act of 1844 the note circulation varies automatically with the influx and efflux of gold to and from the Bank of England. Another method is now used to attract gold to the country—a method much more certain and rapid in its action; that is, the raising of the prevailing rates of interest in the Money Market. If the general level of interest in the Market rises, the prospect of increased profit induces foreigners to remit money to the London Market and to buy bills on London, both of which tend to make the foreign exchanges more favourable to this country, and so bring about an import of gold from other financial centres.

It can now be seen why the Bank of England is often antagonistic to the Money Market. The Market, that is to say, the borrowing portion of the Market, is always anxious to keep the rate of interest low. "Cheap money," that is, money which can be borrowed at a low rate of interest, is a necessity to those classes who trade in part with borrowed capital. The Bank of England, on the other hand, must always keep one eye upon its Reserve, and it often is compelled to use every effort to force up the prevailing rates of interest against the inclination of the Market. The Bank of England cannot altogether control these prevailing rates, but they are able to influence them powerfully through their own official rate of discount, commonly called the Bank Rate.

There is consequently a see-saw tendency in the Money Market—one set of forces at work endeavouring to raise the rate of interest in order to protect the Reserve, another set of forces working to lower rates in order to obtain cheap loanable capital; and this forms the chief point of interest to those who are concerned with Money Market operations.

Let us see for a moment what are the various rates of interest prevailing in London.

First, there is the Bank Rate—that is, the advertised minimum rate at which the Bank of England will discount bills. This rate is fixed by the Bank Court at their weekly meeting each Thursday, though in times of emergency alterations are made at other times.

Secondly, there is the Bank of England Loan Rate, usually a trifle higher than their Discount Rate.

Thirdly, there is the Market Rate of Discount, that is to say, the rate charged by the bill brokers and bankers for discounting bills. There are usually two quotations of this rate—the lower one for first-class bills, that is to say, bills drawn upon bankers and certain other houses of well-known standing in the City; the higher rate for the better class of trade bills.

Fourthly, there is the Other Bankers' Deposit Rate. The Bank of England do not allow interest on money deposited with them, but most of the joint stock and private banks, called the "Other Banks" in contradistinction to the Bank of England,

allow a rate which bears a fixed relation to Bank Rate, usually 1½ per cent. below, though when the Bank Rate is as low as 2 per cent. the Deposit Rate does not often fall below 1 per cent.

The bill-broking houses also allow interest on deposits, usually slightly higher than the Other Bankers' Rate.

Fifthly, there is the Bankers' Call Rate and Seven-Day Rate, that is, the rate charged for lending money to the bill brokers and others. Besides these five rates, there is the rate of interest charged by banks to their customers for loans or overdrafts. This is not strictly a Money Market rate, but it often bears a fixed relation to Bank Rate.

All these rates of interest are related to and dependent upon one another.

Take the first and third, the Bank of England official rate of discount and the market rate of discount. As a general rule the latter is slightly lower than the Bank rate. The bill brokers have no responsibility in the shape of a Reserve to hamper them, and can afford to discount at a fractionally lower rate, though it must be noted that the Bank of England will usually discount for regular customers at the market rate, in spite of the fact that their own published rate is higher.

We will suppose that the Bank of England, who are usually well informed as to the probable trend of the movements of specie, anticipate a strong demand from America for gold, and therefore think it advisable to raise the rate of discount. It is not sufficient if they merely raise their own rate of

discount; they must carry the market rate with them, or the only result will be that they will get no bills offered to them, and their rate will be merely nominal.

The result of raising the Bank Rate will be that the Other Bankers will raise the rate which they allow on deposits. This will compel them, or at least will offer them a strong inducement, to raise the rate which they charge the bill brokers for money lent at call and short notice, otherwise their rate of profit will be seriously diminished. But if the bill brokers have to pay more for their borrowed capital, they will be forced, in self-defence, to raise the discount rate which they charge the public. Thus it will be seen the rise in the Bank Rate has brought about a rise in the Market Rate of discount.

There is another method in which the Bank of England are enabled to powerfully influence the ruling rates of interest. The amount of money which the banks are disposed to lend to the market at any particular period is a limited amount, and if it should prove insufficient, the only recourse of the bill brokers is to borrow from the Bank of England, which, since it has the monopoly of the note issue and the custody of a large reserve, is usually disposed to lend, if necessary, but of course at its own rate.

Speaking generally, the Market will not borrow from the Bank of England if it can get the money elsewhere, not only because the terms which the Bank gives are less favourable than those of the Other Banks, but also because the Bank is not so

accommodating as regards the period of the loan. But if they cannot borrow the money from the banks, the bill brokers must go to the Bank of England, and this gives the latter the opportunity of raising the market rate, because the bill brokers have to pay a higher rate on their borrowed capital, and must therefore charge their customers higher. This is the meaning of the phrase which constantly occurs in the daily money article in the morning paper, somewhat as follows: "A considerable amount being locked up in the instalments of the X. loan, the Market was driven to the Bank." Occasionally the Bank of England is compelled to use various makeshift expedients in order to gain the control of the Market. For instance, they "borrow money from the Market on Consols." That is, they sell large amounts of Consols for cash; in order to provide the money to pay for these Consols, the Other Banks have to call in from the bill-brokers some of their loans at call, and the brokers therefore are driven to the Bank.

As a rule, the greater the stringency in the Money Market, the greater the power of the Bank of England. At times when the financial horizon is clear and money is cheap and plentiful, the influence of the Bank of England is small, but if the outlook becomes really threatening, the Bank obtain practical control of the market. In such circumstances, the Other Banks, wishing to strengthen their position, call in a large proportion of their loans to the Market, which is thus forced into the hands of the Bank of England, and the Bank are enabled to raise rates to such a height as they think necessary to prevent

the further export of gold from the country, and attract fresh supplies.

The amount of money available for lending in the Money Market depends upon a variety of circumstances which cannot be accurately gauged. Trade conditions, the political outlook, especially the prospect of peace or war, the state of the foreign exchanges, the condition of credit—that is to say, whether there is general confidence in the financial outlook, or whether distrust is more prevalent—all these things affect the short loan fund of the Money Market. If trade be brisk and more money be required for commercial undertakings, there will usually be less to lend on the Market. Conversely, in periods of trade depression, money is usually plentiful and cheap in the Money Market, because there are few openings for its profitable employment in other directions. A great war always has the effect of "hardening" rates, in other words, of raising the rate of interest, because it is always anticipated that a war will lock up large sums of money in the shape of war loans, and that governments will strengthen their position by increasing their stock of gold, some of which is sure to be drawn from London. An adverse condition of the foreign exchanges will probably mean the export of gold, which will make bankers cautious in lending money.

But besides these general causes, which are uncertain and often unexpected, there are certain special recurrent forces at work whose action is known and looked for each year.

First of all, money is always more plentiful at those periods when the Government dividends are

paid—the four quarterly periods. At these periods, money is liberated from the Government accounts at the Bank of England, and finds its way to the deposits of the Other Banks. The warrants are sent to the proprietors, who pay them into their banking accounts, and so increase the deposits of the joint stock and private banks, which are enabled to lend more freely.

Secondly, during the first three months of the year money is generally scarcer in the Market owing to the payment of taxes. The payments on account of Income Tax and other taxes transfer money from the other banks to the Government accounts at the Bank of England, and, as we saw just now, the Market will not borrow from the latter if it can avoid doing so. The Other Banks have less to lend, and the Market is more dependent on the Bank of England.

Thirdly, experience shows that trade is usually brisker in the autumn of the year, and that there is not only more demand for borrowed capital, but also for notes and gold, which reduces the Bank Reserve and so tends to harden rates. What is called the "autumn drain" is anticipated each year, and can be explained in various ways. We have to pay for our imports of corn from America at this season, besides paying for our own harvest. Money which is sent down into the country to pay for agricultural operations does not so easily find its way back to the London Money Market as money sent by cheque to pay the usual business debt; the latter soon returns to London through the medium of the Clearing House.

A similar condition of affairs happens in Scotland and Ireland about May and November each year. In Scotland, rents and interest on mortgages are not payable quarterly as in England, but at the half-yearly periods of Whitsuntide and Martinmas. Both in Scotland and Ireland many such payments are made, not by cheque as in England, but by bank notes, which circulate much more freely than in this country, one pound notes being in common use. Now the Scotch and Irish note circulations are governed by the Bank Acts of 1845, under the terms of which all notes issued beyond a certain fixed sum must be secured by the deposit of gold to an equal amount. The consequence of this autumnal increase in the demand for notes is that the Irish and Scotch banks require more gold, and the only place they can easily obtain this from is the Bank of England. Every autumn, therefore, gold is sent from the Bank to Scotland and Ireland, and this means that the Bank Reserve is diminished, and that the rate of interest tends to become higher.

Mr. Palgrave(*a*) has worked out the average monthly Bank Rate over the period 1845—1900, and compared it with the average monthly note circulation in Scotland and Ireland, and his tables show that all three of these are higher in the month of November than at any time of the year.

There is one other periodic movement which is supposed to influence the amount of the short loan fund of the Money Market, and that is the operation

(*a*) R. H. Inglis Palgrave, The Bank Rate and the Money Market, pp. 130, 131.

spoken of in the Money Articles of the daily paper as "window dressing," or "shop buying for decoration purposes." According to some writers, at the seasons when the joint stock banks issue their monthly statements or half-yearly balance sheets to their shareholders, they call in a proportion of their loans to the Market in order to increase the asset, "Cash on hand and at the Bank of England," and thus make their position appear stronger, and this operation is supposed to materially reduce the available loanable funds at certain periods. It is, however, very doubtful whether this practice is indulged in to the extent which these critics imagine.

CHAPTER XVIII.

THE BANK RETURN.

THE weekly return of assets and liabilities issued by the Bank of England which appears in each Friday morning's paper has a significance far above that of the balance sheets of any other bank. The Bank Return is the barometer of the Money Market. It enables the financial man to forecast the probable "dearness" or "cheapness" of money, not always with exactitude, for, like all barometers, its accuracy is not always unimpeachable, but with approximate correctness.

Subjoined is the Return for the week ending August 17th, 1904:

BANK OF ENGLAND.

An account, pursuant to the Act 7 & 8 Vict. c. 32, for the week ending on Wednesday, August 17th, 1904.

Issue Department.

	£		£
Notes issued -	- 52,196,935	Government debt -	11,015,100
		Other securities -	7,434,900
		Gold coin and bullion -	- 33,746,935
	£52,196,935		£52,196,935

Banking Department.

	£		£
Proprietors' capital	14,553,000	Government securities	14,234,402
Rest	3,503,418	Other securities	25,049,787
Public deposits*	6,528,913	Notes	23,607,925
Other deposits	40,231,792	Gold and silver coin	2,024,260
Seven-day and other bills	99,251		
	£64,916,374		£64,916,374

* Including Exchequer, Savings Banks, Commissioners of National Debt, and Dividend Accounts.

(Signed) J. G. NAIRNE,
Chief cashier.

Aug. 18th.

It will be noticed that the Return is divided into two parts, the Issue Department and the Banking Department, according to the terms of the Act of 1844. It is an arrangement peculiar to the Bank of England, and has been copied by none of the continental State banks.

The sole function of the Issue Department is to issue notes; of the total of £52,196,935 in the Return before us, £18,450,000 is issued against securities, the "fiduciary issue" as it is called; the remainder is represented on the asset side by gold coin and bullion. The amount of securities in the Issue Department was fixed by the Act of 1844 at £14,000,000, but it has since been periodically increased owing to the lapse of country bank issues, the Bank of England being permitted to increase their issue against securities to the extent of two-thirds of such lapsed amounts. Of this amount of £18,450,000, the sum of £11,015,100 is the debt

due to the Bank by the Government, money lent to the State from time to time in return for the privileges of "exclusive banking," which were granted to the Governor and Company. This amount has not been increased since 1833.

The total amount of notes which appears on the liability side of the Issue Department is by no means the amount actually in active circulation. The action of the Issue Department is quite automatic, and it is compelled to issue notes to anyone offering gold, at the rate of £3 17*s.* 9*d.* per ounce of standard gold. These notes are transferred to the Banking Department, and the surplus not required by the public forms part of the Bank Reserve. If it is desired to ascertain the amount of the active circulation, that is to say, the circulation in the hands of the public and the Other Banks, the amount of notes in the Banking Department must be subtracted from the total issued by the Issue Department; in this case it will be £28,589,010, which is about the average amount, the total varying surprisingly little from day to day.

The asset in the Issue Department, "£33,746,935, gold coin and bullion," comprises practically the whole stock of gold in the Bank. A certain amount of gold and silver coin is kept in the Banking Department and at the branches for immediate use, but beyond this amount, generally about two millions, all gold is transferred to the Issue Department. The Bank is allowed to hold silver in the Issue Department to an amount not exceeding a fifth part of the whole sum, but this privilege has not been exercised for many years.

It should be thoroughly understood, after what was said in the chapter on the Bank Act, that the above total of £52,196,935 can only be increased by adding a corresponding amount to the gold on the asset side, and that this gold can only be withdrawn from the Issue Department by cancelling a corresponding amount of notes, either by transferring them from the Reserve in the Banking Department, or withdrawing them from active circulation.

To turn now to the Banking Department, the first liability is Proprietors' Capital, £14,553,000. The amount of the capital stock was originally £1,200,000, but it has remained unchanged since 1833, and it will be observed that, compared with the paid-up capital of the leading joint stock banks, it is a very large amount. This, of course, adds to the security of the Bank, but it forbids the payment of a high rate of dividend, and the usual 9 or 10 per cent. paid by the Bank is, considering its age and reputation, and also the fact that it pays no interest on its deposits, a very modest one.

The next item, Rest, £3,503,418, is the amount of the undivided profits of the Bank, and in most bank balance sheets would take the form of a Reserve Fund and Profit and Loss Account. Most banks separate these two latter accounts, but the Bank of England combine them in one. As, however, it is the practice of the Bank of England never to reduce the Rest below three millions, this sum practically represents their Reserve Fund, and the surplus is the Profit and Loss account available for dividend purposes, so that it is possible to forecast the probable

dividend of the Bank with some degree of accuracy by a study of the amount of the Rest.

The Public Deposits are explained by the footnote to the Return; they are the balances standing to the credit of the various Government Accounts. The Other Deposits include not only the deposits of the Bank's ordinary customers, but also of the joint-stock and private banks who keep accounts at the Bank, including, of course, all the Clearing Bankers. At one time the Bankers' balances were published separately, but the practice was discontinued in 1877. The Bankers' balances naturally afford the best criterion of the amount of money available for lending to the Market, but in default of detailed information on this point, the amount of the Other Deposits is of the most importance in this respect.

Speaking generally, the Public Deposits and the Other Deposits vary inversely. When the Public Deposits are abnormally high, Other Deposits are usually low, and *vice versâ*. The reason is that when large amounts are paid to the Government credit, as, for instance, during February and March, when arrears of taxes are paid and the Government is preparing for the close of its financial year, or at times when instalments of a Government loan are payable, such amounts are paid to a very great extent by cheques on Other Banks, which, of course, reduce the Bankers' balances. On the other hand, when the Government pays the dividends on Consols and other stock, large sums are liberated from the Public Deposits and find their way to the deposits of the Other Banks.

In normal times a high total of "other deposits" is usually coincident with cheap money and plenty of loanable capital. For instance, in 1890 when the average Bank Rate was as high as £4 10*s.* 5*d.* per cent., the average of the Other Deposits was £27,526,000. But in 1896, when the average of the Other Deposits was £49,390,000, the Bank Rate only averaged £2 9*s.* 8*d.* (*a*)

In some circumstances, however, such as those which point to an impending monetary crisis, or any serious disturbance of the Money Market, the Other Deposits rise rapidly at the same time that the Bank Rate rises. The reason for this is that when anything threatens the peace of the Money Market, the London banks prepare for the worst and endeavour to strengthen their position. In order to do this they call in their loans to the Market and increase the amount of their balance at the Bank of England, which can be drawn upon at a moment's notice. In the crisis of 1857, when the Bank Act had to be suspended, the Bankers' balances stood on November 4th, at the beginning of the crisis, at £3,400,000. By November 25th they had risen to £5,400,000, an increase of £2,000,000. In 1890, the year of the Baring crisis, we have not the figures of the Bankers' balances, but the Other Deposits show a no less marked rise, from £29,171,968 on November 6th to £36,364,838 on November 20th. In both of these instances there is not the slightest doubt that the rise was due to the action of the bankers in calling in their short

(*a*) Palgrave, Bank Rate and the Money Market, pp. 12—15.

loans so as to strengthen their position in view of the impending crisis.

The final item we have to notice on the liability side of the return is "Seven-day and other bills," £99,251. This item is a very small one and of small importance, though at one time much greater in amount. It consists chiefly of "Bank Post Bills," which are in effect bills issued by the Bank of England drawn upon themselves at seven days' date. They are used for remitting money, and do not require three days' grace when calculating the date of their maturity.

The first item upon the asset side is Government Securities, £14,234,402. The Bank do not give the public any information about the details of the securities in which they invest their money, beyond thus dividing them into "Government" and "Other" securities. This total of fourteen millions includes the Bank's investments in British Government stocks, Exchequer Bills and Treasury Bills; it also sometimes includes what are called "deficiency bills." It may happen that the Government has not enough money to pay its dividends, and it will then offer to the Bank "deficiency bills" for discount. Other securities, £25,049,787, consist of all the other investments of the Bank, such as Indian and Colonial Government stocks, and corporation loans; also bills discounted and loans to customers and bill brokers.

It will be noticed that the term "securities" as used in the Bank Return has a wider application than that which it usually receives among bankers. It does not only mean Stock Exchange securities

and other documentary evidences of title; it includes also loans made by the Bank, apart from the question of anything being deposited to "secure" the loan in the ordinary sense. Any advance made by the Bank will therefore increase the amount of either Government Securities or Other Securities.

We have no means of learning the details of the Bank's holdings of bills, but it is generally understood that they do not buy foreign bills, that is, bills accepted payable abroad. Many of the Continental State banks, however, habitually invest part of their assets in bills maturing at some other financial centre, as, in case of emergency, this gives them the power of acquiring gold by discounting the bills in the place where they mature.

Reference was made in the last chapter to the meaning of the phrase that the Market was "in the Bank," that is, that it was driven to borrow money from the Bank of England. When this happens it often shows itself in the Other Securities and Other Deposits. If the Other Bankers either refuse to lend or call in a proportion of the loans they have already made, the total of the Other Deposits will rise owing to the increase in the bankers' balances. The Market being driven to the Bank, the Other Securities, which comprise the loans made by the Bank, will rise, so that a simultaneous rise in Other Deposits and Other Securities is often evidence of a desire on the part of the Other Bankers to strengthen their position.

The last two items on the asset side, notes £23,607,925 and gold and silver coin £2,024,260,

form the Reserve of the Bank, the reserve on which our whole banking and financial system may be said to rest. The total liabilities of the Banking Department, exclusive of those due to the proprietors of the Bank, are £46,859,956, so that the Reserve on the date in question was nearly 55 per cent. of the liabilities to the public, a percentage much higher than that kept by the joint stock banks, which is usually about 15 per cent. The notes which form part of the Reserve are the surplus not required by the public; they are represented by gold in the Issue Department, and should gold be required, as, for instance, for export purposes, the notes can be cancelled and gold withdrawn from the Issue Department, so long as the notes in active circulation do not fall below the limit of the fiduciary issue, viz., £18,450,000. Fortunately this latter event is not likely to happen. The amount of the active circulation is very steady, and even in times of panic shows no tendency to decrease, being at all times well above the limit of £18,450,000. Consequently there is always more than sufficient gold in the Issue Department to pay all the notes held in the Reserve of the Banking Department. Should the demand for gold ever prove so great that the Reserve is exhausted, there is therefore an ultimate reserve of gold in the Issue Department which can be used by temporarily suspending the clause of the Bank Charter Act of 1844 which compels gold to be deposited against every note issued beyond the limit of the fiduciary issue.

Mention is sometimes made in the Money Article of the price at which the Bank sells gold, and this demands a word of explanation. The price at which

the Bank buys gold is fixed by law at £3 17*s.* 9*d.* an ounce, but it may sell it at whatever price it can get. Of course if the individual who wants gold demands sovereigns or half-sovereigns, the Bank cannot alter the price; it must pay five sovereigns for every £5 note or cheque. But the Bank also keeps quantities not only of gold bullion, but also of foreign coin, and if a certain form of gold is in demand the Bank have the power of very slightly raising its price. If anyone requires gold for export and takes this gold in the form of sovereigns, he will find these sovereigns are not all of full weight owing to wear and tear, although they may not be sufficiently worn to prevent them being legally current. But for export purpose gold is current by weight, not by tale, and therefore the individual will probably be willing to pay slightly above the Mint price of £3 17*s.* 10½*d.* for gold bullion. Or it may be that he is exporting, say, to Germany and prefers German coin. In either case the Bank are often able to obtain ½*d.* or 1*d.* an ounce above the Mint price for gold bullion or foreign coin. It is not often that the price rises above £3 17*s.* 11½*d.*, because in that case there would be a strong inducement for exporters to pick out the heaviest coins from those in circulation, which would have a bad effect on the condition of the coinage.

CHAPTER XIX.

THE FOREIGN EXCHANGES.—I.

THE subject of the Foreign Exchanges is to the average man a complex one, and it is one which cannot be adequately treated within the limits at the author's disposal, but this chapter will help the student to understand the frequent allusions to the subject which constantly occur in most treatises on banking. The subject of the foreign exchanges treats of the international value of money, the value in one country of a debt payable in another, and the means of transmitting and settling such debts. It is obvious that to a man living in London ten sovereigns in India will not be worth so much as ten sovereigns in London. The cost of sending the sovereigns from India to London will detract from their value. Or, supposing a man living in New York owes a man living in London £100, and that by the terms of the contract the debt is payable in New York. In whatever way the debt is collected, the sum realised in England will be somewhat less than £100. In fixing a rate of exchange, besides the question of the cost of transmission, there is also the question of an equation between the two systems of coinage which are in use in the two countries, unless the systems

happen to be the same, as, for instance, in England and Australia. But in most cases a relation has to be established between the amount of pure metal contained in the standard coins of the various countries. This relation is called the Mint Par of Exchange. When we say that the Mint Par of Exchange between London and Paris is 25.2215, we mean that the value of the metal in one full-weight sovereign equals that in 25.2215 golden francs, apart from any idea of distance and supposing the coins to be in the same place. Of course, the golden franc is not coined in France, but for exchange purposes the twentieth part of a Napoleon or twenty-franc piece is the unit of exchange.

The following are a few of the principal Mint Pars with London:

Paris	25.22$\frac{1}{4}$ francs to £1.
Berlin	20.43 marks to £1.
New York	\$4.866 to £1 or 49$\frac{5}{16}$d. to \$1.
Vienna	24.02 kronen to £1.

It follows that there can only be a Mint Par of Exchange between countries which use the same metal as their standard of value. There is no Mint Par between a gold-using country and one in which silver is the standard of value, because the exchange value of silver to gold is constantly changing. The Mint Par between two gold-using countries or two silver-using countries is a fixed quantity, and can only be varied by an alteration in the coinage regulations of either country.

The Mint Par of Exchange is a merely nominal rate of Exchange. Owing to the various influences which affect the current rates, the Mint Par is never the existing rate, or, if it is so, it is merely a coincidence. But from the Mint Par what are called the Specie Points are deduced, and these form the limits beyond which the rate of exchange between any two countries does not often vary, if their currencies are in a healthy condition. The Specie Points are determined by the cost of transmitting gold between the two countries, supposing they are both gold-using countries. Speaking generally, a debtor will not remit gold if he can settle the debt in any other way; it is the most expensive way. But if other methods fail or become too expensive, gold can in most cases be obtained, and therefore the cost of shipping and insuring gold determines the limits outside which the rates of exchange seldom vary.

Take, for an instance, the Paris rate: at the Mint Par £100 = 2522½ francs. The cost of sending this amount of gold between London and Paris is, roughly, 10 francs. It will therefore cost a Parisian 2532½ francs to send £100 in gold to London, which gives a rate of 25.32½. This is one of the Specie Points. The other is the rate at which it will pay to send gold the reverse way, from London to Paris, and is about 25.12½.

The Berlin Specie Points are 20.52 and 20.33, while those between London and New York are 4.89 and 4.82. In theory the exchange rates cannot vary outside the Specie Points either way, because

no one will pay more for a bill than it would cost to send gold, and directly the exchanges touch either of these limits, a movement of gold between the two countries should follow. In practice, however, this is not always the case, and the rate sometimes does rise or fall beyond the usually accepted Specie Points.

There are two reasons for this: First, the published Specie Points are not exact, because the cost of shipping varies from time to time. Secondly, although gold can always be readily obtained in London for export, yet in other financial centres this is by no means always the case. The Bank of France, for instance, exact a premium on gold required for export if circumstances render an export of gold undesirable, and the Imperial Bank of Germany bring pressure to bear where possible, if they wish to discourage the shipment of gold.

International debts are not settled by the export and import of gold; it is only the balance of indebtedness which may be settled in this way. Bills and cheques are the chief medium by which international payments are made, more especially the former.

Let us consider a very simple example of payment by bills or cheques. A London draper buys goods from a Parisian costumier, and in payment he sends a bill for £100 accepted payable in London. But the Parisian costumier owes £100 to a Bradford woollen merchant. It is obviously not worth his while to collect the bill on London, have the

proceeds remitted to Paris, and then send them back to Bradford. He sends the London bill to his Bradford creditor, and the latter presents it through the Clearing House in the ordinary way through his banker. The whole transaction is settled without any movement of gold. Of course this is an illustration which would seldom occur in practice. Very probably the Parisian would sell the bill, and it would perhaps find its way to Berlin or New York before being presented for payment in London.

Bills drawn upon London, that is, bills which are payable in London, are accepted all the world over; they are an international currency. It is obviously advantageous to the commercial world that some centre should be chosen by mutual consent where bills can be made payable, and where debts can be settled. In mediæval times, bills were exchanged at certain of the great annual fairs. In modern times London has been chosen as this centre, and "sterling bills," that is, bills drawn in sterling on London, find a ready market in all parts of the globe. This is the meaning of the phrase that London is the financial centre of the world. It is the world's clearing house where international debts are settled. The reason why London has come to occupy this position is twofold. First, it has been for some time the most important commercial capital and distributing centre, and banking tends to follow commerce; and, secondly, it is a free gold market, and the foreigner knows that he can always obtain payment in gold for a sterling bill if necessary.

It must not be thought that all bills are drawn on London, but London draws comparatively few bills on other countries. If an Englishman owes money to a foreigner he can either ask the foreigner to draw upon London, or he can buy and remit to him a bill payable in the capital of his own country, and *vice versâ*. In practice London pays by accepting bills drawn upon herself, while other countries pay London by buying bills on London and remitting them by post. It can easily be seen, therefore, that the foreign exchanges are of greater interest to the foreigner than to the Englishman. The foreigner deals largely in sterling bills, which are to him foreign bills, and the rate of exchange is of great importance, because upon it depends the cost of the bill to him. But when they reach this side they cease to be foreign bills to the Englishman, being usually drawn in pounds, shillings and pence. In England foreign bills are, except for the purposes of the Stamp Act, bills payable in other countries, and the number of these dealt with in London is comparatively few.

Foreign bills are bought and sold at the various financial centres, and their value is determined like that of other commodities. If the demand for bills drawn on a particular centre is in excess of the supply, the price rises; if, on the other hand, there are more bills offered for sale than there are buyers, the price will decline.

The price of bills is varied, not by adding to or deducting from the total of the bill, but by

alterations in the rate at which the currencies are converted, and it is therefore in the rate of exchange that the chief interest is centred.

Rates are quoted in various ways. Foreign countries quote rates in their own coinage, but London in most cases quotes in the same way as she is quoted. For instance, Paris quotes London in francs to the £, and London quotes Paris in the same way. But in one or two instances rates are quoted in London in pence to the foreign unit; for instance, London quotes St. Petersburg in pence to the rouble, while St. Petersburg quotes London in roubles to the £10. We quote Madrid in pence to the peso, while Madrid quotes London in pesetas to the £. New York quotes us in dollars to the £, while we quote New York both in pence to the dollar and in dollars to the £.

The place where foreign bills are bought and sold in London is the Royal Exchange, where bankers, merchants, and bill brokers meet on Tuesday and Thursday in each week, and as the result of their dealings lists of rates are issued and published in the next morning's papers under the heading "Course of Exchange."

The following is a recent Course of Exchange as published in the "Times" (*a*). The fourth column is added here for the convenience of students:

(*a*) August 26th, 1904.

LONDON COURSE OF EXCHANGE.

Amsterdam, etc.	Cheques	12.1$\frac{3}{4}$—12.2$\frac{1}{4}$	Florins and stivers to £1.
Do. - -	3 months	12.3$\frac{3}{4}$—12.4$\frac{1}{4}$	Do. do.
Antwerp and Brussels.	Do.	25.38$\frac{3}{4}$—25.43$\frac{3}{4}$	Francs and centimes do.
Hamburg - -	Do.	20.62—20.66	Marks and pfennigs do.
Berlin, etc. -	Do.	20.62—20.66	Do. do.
Paris - - -	Cheques	25.25—25.30	Francs and centimes do.
Do. - - -	3 months	25.35—25.40	Do. do.
Marseilles - -	Do.	25.36$\frac{1}{4}$—25.41$\frac{1}{4}$	Do. do.
Switzerland -	Do.	25.45—25.50	Do. do.
Austria - -	Do.	24.21—24.26	Crowns and hellers do.
St. Petersburg and Moscow.	Do.	24$\frac{5}{8}$—24$\frac{7}{8}$	Pence to 1 rouble.
Genoa, etc. -	Do.	25.51$\frac{1}{4}$—25.56$\frac{1}{4}$	Lire to £1.
Madrid, Barcelona, etc.	Do.	33$\frac{1}{16}$—34$\frac{1}{16}$	Pence to 1 peso.
Lisbon - -	Do.	43$\frac{9}{16}$—43$\frac{13}{16}$	Do. to 1 milreis.
Oporto - -	Do.	43$\frac{9}{16}$—43$\frac{13}{16}$	Do. do.
Copenhagen -	Do.	18.39—18.43	Crowns and öre to £1.
Christiania -	Do.	18.40—18.44	Do. do.
Stockholm - -	Do.	18.40—18.44	Do. do.

The above are the rates quoted in London for bills or cheques payable at the places mentioned. This London Course of Exchange must not be confused with the table of Foreign Rates of Exchange on London which appears in each day's paper. These latter rates are the prevailing rates on the "bourses" of the centres named for bills or cheques on London, and are cabled from those centres to London each day.

Appended is a table of the cabled rates on London extracted from the "Times" of the same date as the above Course of Exchange. Explanations have been added where necessary.

EXCHANGE ON LONDON

at dates

	Aug. 24th.	Aug. 25th.	
Paris - - cheques	25f. 25½c.	25f. 25⅜c.	——
Brussels - do.	25f. 23½c.	25f. 23½c.	——
Berlin - - sight -	20m. 45½pf.	20m. 45½pf.	——
Do. - - 8 days -	20m. 43½pf.	20m. 44pf.	——
Vienna - sight -	23kr. 97¼h.	23kr. 97h.	——
Amsterdam- do. -	12fl. 10c.	12fl. 10¼c.	Florins and cents* to £1.
Italy - - do. -	25lire 25½	25lire 25	——
Madrid - do. -	34ps. 81	34ps. 80	——
Lisbon - do. -	44⅝*d.*	$44\frac{5}{16}$*d.*	Pence to 1 milreis.
St. Peters- 3months burg.	93r. 95	93r. 95	Roubles to £10.
Bombay { telegraphic transfer	1*s.* $3\frac{31}{32}$*d.*	—	Shillings and pence to 1 rupee.
Calcutta do. -	1*s.* 4*d.*	1*s.* 4*d.*	Do. do.
Hong-kong do. -	1*s.* 9½*d.*	1*s.* $9\frac{5}{16}$*d.*	Pence to 1 Hong-kong dollar.
Shanghai do. -	2*s.* 5⅞*d.*	2*s.* 6*d.*	Pence to 1 silver currency tael.
Yokohama do. -	2*s.* $0\frac{3}{16}$*d.*	—	Pence to 1 yen.
Rio de Janiero -	$12\frac{3}{32}$*d.*	—	Pence to 1 milreis.
Valparaiso 90 days	$16\frac{11}{32}$*d.*	—	Pence to 1 peso.
Buenos Ayres { gold premium	127 per cent.	—	——
Do. { paper dollar	20·97*d.*	—	——
New York sight -	$4 88·10c.	$4 87·95c.	Dollars and cents to £1.
Do. cable transfer	$4 88·60c.	$4 88·45c.	
Do. 60 days' sight	$4 85·45c.	$4 85·20c.	

* We quote Amsterdam in florins and stivers, but Amsterdam quotes London in florins and cents, 5 cents being equal to one stiver.

Turning, first of all, to the Course of Exchange, it will be noticed that two prices are quoted for each centre. One of these is for first-class paper, and the other for ordinary trade bills. In the case of those rates quoted in foreign units to the pound sterling,

the first or lower rate is the rate for first-class bills, the second for commercial bills. But, on the other hand, in the case of those quoted in pence to the foreign unit, the first or lower rate is that for commercial bills, while the higher is that for bank bills.

The reason why there is a difference between the rates for first-class and for commercial bills is this: Supposing an Englishman buys a bill on Paris at three months and remits it to his creditor there. The latter will very likely wish to realise the proceeds, and will therefore offer it to his banker for discount. But the banker will charge a higher rate for discounting trade bills than he will for bank bills, to cover the increased risk; for this reason, trade bills do not command such a good price on 'Change.

This, of course, only applies to the "long" or three months' rate quoted in the Course of Exchange. In the case of the "cheque" rates the reason for the existence of a double quotation is that this rate usually includes bills which have not more than ten days to run, and that cheques fetch a slightly better price than such bills.

Perhaps the greatest difficulty in understanding allusions to a Course of Exchange lies in the different meanings attached to the terms "rise" and "fall." This difference arises from the fact that owing to the anomalous system prevalent in England, London quotes some rates in sterling and others in the coinage of the place quoted. Thus a rise in the nominal rate of the former class means that the man who wishes to buy a bill will have to pay more for

it, while a rise in the rate of the latter class has the reverse meaning. For instance, a rise in the Paris rate of exchange quoted on the London Exchange means that the same sum of English money will purchase a bill on Paris for an increased sum in francs. On the other hand, a rise in the Russian rate means that the English remitter will have to pay a greater sterling amount for a bill of the same amount due in St. Petersburg.

Remember, therefore, that the terms rise or fall of the exchanges refer simply to the nominal amount of the rate quoted, and may mean either a more favourable or less favourable rate for the buyer of the bill.

The terms favourable or unfavourable apply to the debtor, that is, the buyer of the bill. When the exchanges with any particular centre are said to be favourable to this country, the rate is tending towards that point when gold will be imported. Conversely, the rate is unfavourable to this country when it tends towards the other specie point, when gold will be exported.

When the rates are quoted in foreign money to the pound sterling, *high* rates are *favourable* to this country; *low* rates, *unfavourable.*

When the rates are quoted in shillings and pence to the foreign units *high rates* are *unfavourable*, *low* rates are *favourable.*

These remarks apply both to the prices quoted in London for bills payable in other countries, and also to the rates quoted in foreign centres for sterling

bills. It will be observed that both in the London Course of Exchange and in the table of cabled rates there are, in the case of some of the more important centres, a "sight" or cheque rate and a three months' or "long" rate. Many papers in their list of cabled rates give a fuller list of long rates than that quoted in the "Times," but, given the short exchange with any centre and the market rates of discount prevailing *in that centre*, the long rate can be calculated with approximate certainty.

The long rate is the rate at which a certain sum will buy a bill to realise the same amount as the cheque which can be bought for that sum at the short rate, allowance being made for the fact that the bill will be subject to a charge for discount and for bill stamps, if the man to whom it is sent wishes to realise it.

For instance, take the rates on Paris quoted in our Course of Exchange. A London merchant wishes to remit to his Paris agent £100, and to do this buys a cheque on Paris at the short rate 25.25, getting, of course, one for 2,525 francs, which he sends to his agent, who presents it for payment at the bank on which it is drawn. Supposing he prefers to buy and remit a bank bill at three months. He will, at the rate quoted, get a bill for 2,535 francs. This bill is taken to the agent's banker in Paris for discount, and a reference to the "Times" shows us that the market rate of discount prevailing at the time in Paris was $1\frac{1}{8}$ to $1\frac{1}{4}$. The charge for discount at the higher rate will be about eight francs, and the cost of bill stamps will bring the charge to nearly ten

francs. Thus, the bill would realise practically the identical amount of the cheque, 2,525 francs, and the two methods of remitting are seen to have cost the same.

A great many bills are dealt in on 'Change which are neither sight bills nor three months' bills, but have, let us say, thirty or forty days to run before maturity. In these cases a rate called a "tel quel," or "t.q." rate, is calculated from the long rate to fit the bill in question.

Most countries draw bills in the currency of the country where they are payable. Paris, for instance, usually draws upon us in sterling, upon Berlin, in marks; upon New York, in dollars, and so on. In England, however, commercial bills are often drawn upon other centres in sterling, probably owing to the fact that, outside a limited circle, the foreign exchanges are but little understood by English business men. In this case, when the bill is sold in London, the market rate is specified in the endorsement on the bill: "Pay Blank & Co., or order, at the exchange of 25.27," and a memorandum of the amount in foreign currency is made on the face of the bill.

For the student who finds any difficulty in grasping the effect of a rise or fall in the rates upon the value of a foreign bill, the maxim quoted by Mr. George Clare, (*b*) in his excellent work on the Foreign Exchanges, will be found extremely useful:

(*b*) The A. B. C. of the Foreign Exchanges, G. Clare, p. 51.

"Buy high, sell low; the better the bill, the lower the rate."

A word of caution must, however, be added. This maxim only applies to those rates which are quoted in foreign units to the £1 sterling.

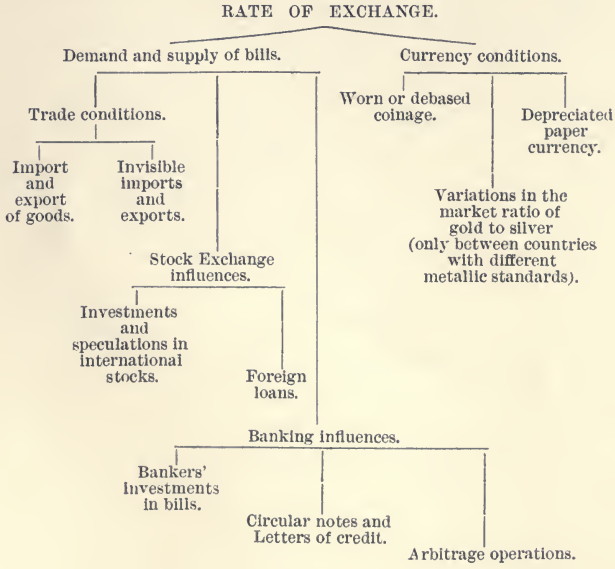
In dealing with bills drawn upon countries which London quotes in shillings and pence to the foreign unit, the exact reverse of this is true, and the rule to be remembered is the usual commercial rule for buying and selling commodities: "Buy low, sell high; the better the bill, the higher the rate."

CHAPTER XX.

THE FOREIGN EXCHANGES.—II.

FLUCTUATIONS in the Rates of Exchanges are the result of two sets of causes: (1) Those dependent upon the demand and supply of bills; (2) those dependent upon the condition of the currency of the countries.

The following diagram is intended to show the nature of these sets of causes:



It must be borne in mind that the rate of exchange is not dependent upon the indebtedness of the countries concerned. It is the debts which are in the process of being paid which affect the exchanges, but the total indebtedness of either country may not affect the exchanges in any way. Most nations are indebted to England owing to the investment of English capital abroad, and though, as we shall see, the payment of the interest on such investments has an important bearing on the rate of exchange, yet the capital sums do not affect the rates except at the time they are borrowed or repaid.

Turning to the trade conditions upon which depend the demand and supply of foreign bills, abnormal imports tend to turn the exchanges against a country, and abnormal exports tend the reverse way. Take the New York Exchange, for instance. In the autumn of each year we import enormous amounts of wheat and other food-stuffs and cotton from the United States, and therefore the price of bills on London falls in New York, and the rate of exchange is usually unfavourable to this country.

It is not, however, safe to expect that the trade conditions between this country and another will always act upon the rate of exchange with that particular country; it may affect exchange rates in quite a different quarter. Suppose, for instance, we have imported food-stuffs in great quantities from Denmark, and that Denmark has drawn upon London to pay herself for them. Germany may have heavy payments to make to London and may find it convenient to buy these bills from Denmark

in order to remit them to London. In this way the effect of such imports from Denmark may be, so far as this country is concerned, simply to steady the rates between London and Berlin, which would otherwise have been in our favour.

Bills on London find such a ready market in most financial centres that it must not be expected that they will be remitted direct from the country which draws them.

Under the second head of trade conditions affecting the rate of exchange we have what are called "invisible exports and imports." This is an expression used to include services rendered by one nation to another which have to be paid for, and which, therefore, exert just the same influence on the exchanges of the country which renders the service as would an export of goods by that country. The freight earned by our carrying fleet is an important item in our exports which does not appear in the Board of Trade Returns, and the amount of which cannot be easily estimated, though, as we own roughly half the mercantile marine of the world, it is by no means inconsiderable.

Brokerage and commission earned in London on business transacted for foreigners is also another important item, and we can perhaps best include under this head the earnings of British capital invested abroad.

Stock Exchange influences on the rates of exchange are divided into two heads: investments and speculations in international stocks, and the issue of foreign loans.

Paragraphs such as the following may often be observed in the daily money article: "Turkish Unified opened weak, but the receipt of heavy buying orders from Paris resulted in the price closing ½ up."

The prices of certain "international" stocks which find a ready market on all the chief European "bourses" are telegraphed continually from one financial centre to another, and variations in the prices quoted result in orders to buy or sell being sent from one centre to another. There is always an international account running between the chief investing centres. Parcels of bonds are sent from London to be sold at Wall Street and *vice versâ*, and the payment of the cheques drawn to settle the accounts turn the exchanges one way or the other.

A similar effect results from loans floated in a foreign centre. Most nations who wish to float a loan open a subscription list in London, and the money so borrowed has to be remitted in some shape. Sometimes the proceeds are exported from England in the shape of goods, and so influence the exchanges indirectly through trade channels. War indemnities have a similar effect upon the exchanges. For instance, at the end of the Chino-Japanese war, China paid a large part of the indemnity through London, where it remained a considerable time, part of the amount being remitted by us to Japan in the shape of ships and other manufactured articles, and part remitted by bills upon London.

Money is also borrowed in London for commercial undertakings abroad, and English capital is invested all over the world. Of late years, the reverse of this

is happening with respect to the United States, who are acquiring an increasing financial interest in English undertakings, while it is said that the holdings of Englishmen in American railways and other commercial concerns is on the decline. In some quarters fears are expressed that the heavy excess of imports from the United States over our exports to that country is being paid for by a decline in our capital invested there, and that the Americans are buying back their securities which we hold by this export of goods to us. This is nothing more than a surmise, however, and is not a necessary corollary from the facts before us. An import of goods from one country may be, and usually is, paid for by an export of goods or services rendered to some other country with, may be, no apparent trade relations with the first-named.

The third factor in determining the price of bills on the market is classified under the head of banking influences. Chief among these are the bankers' investments in bills as a means of influencing gold movements. Certain financial centres, London, Paris, New York, and Berlin, are known as "gold centres," because a more or less free market for gold exists there, as opposed to those other centres where gold cannot always be obtained for export. In each of these centres great interest is felt in the gold reserves, and every effort is made to attract gold when the state of these reserves is unsatisfactory. London bankers hold very few foreign bills, but Paris and Berlin habitually hold bills on other centres, which can, if necessary, be discounted

in the centre where payable, and the proceeds remitted in gold.

Besides the power of influencing gold movements which foreign bills possess, they afford a good investment to the banker, especially if the rate of interest rules higher in the centre upon which they are drawn than in the banker's own town. A banker can make a profit by buying "long" bills, keeping them till maturity, and then selling them at the "short" rate, or if the rate of interest in the foreign centre should fall in the meanwhile, he may make a quicker profit by selling them at once.

An illustration may make this somewhat clearer. As we saw previously, the difference between the long and the short rates is dependent upon the market rate of discount in the country upon which the bill is drawn. Supposing the sight rate of Paris on London is 25.25, and the rate of discount in London is 5 per cent., the three months' rate on London will be about 24.92. A Paris banker buys a three months' bill on London for £1,000, which will cost him 24,920 francs. If, at the end of the three months, the sight rate is unaltered, he can sell it for 25,250 francs, leaving 330 francs as his interest on capital invested. But, of course, it is very improbable that the sight rate will be unaltered; it may be higher or lower, but its ultimate figure is altogether problematical. The interest which the banker will gain if he keeps the bill till maturity is therefore uncertain. But we will suppose that on the day after he buys the bill the market rate of discount in London drops to 4 per cent. The long

rate, being dependent on the London discount rate, will rise, and the banker can make an immediate profit by selling the bill.

If the short rate remained the same, the long rate will rise to about 25·00, but probably the sight rate will fall owing to the sale of bills by those wishing to take their profit. Suppose then sight rate falls to 25.22 ; this brings the long rate to about 24.97, and the Paris banker can sell his bill at once for 24,970 francs, leaving an immediate profit of 50 francs.

The issue of Circular Notes and Letters of Credit also influences the rate of Exchange. They are chiefly used by travellers, and at certain seasons of the year Englishmen migrate to the continent in crowds, mostly armed with these documents, which are in effect and usually in form, bills upon London. They consequently help to turn the exchanges against this country. The Englishman usually gets a fixed price for them, but to the foreign banker who cashes them the rate of exchange is important, as upon it depends the amount of his profit.

The third of the Banking influences is to be found in arbitrage operations. This is the name given to the transactions of certain bankers and mercantile houses who can draw upon, or be drawn upon, by a foreign house or agent. Profits can be made by buying bills in one centre and selling them in another, if there is sufficient difference in the rates ruling at these centres. It is a form of speculation in differences. There are arbitrage transactions in bills, in bullion, in stocks and shares, but in each case the operations are similar and the profits are

made through the differences in price which may exist in various centres.

Take a very simple instance, one which from its very simplicity would never occur, but which will serve to illustrate the meaning of the term arbitrage. A London merchant, Smith, has an agent in Paris, Duval, upon whom he can draw; possibly he has made arrangements with a Paris house to carry on an arbitrage business and share the profits. The London cheque rate on Paris is 25.25, while the Paris rate on London is 25.30. Smith draws at sight on Duval for 25,250 francs, and sells the draft on 'Change for £1,000. He then wires to Duval to draw upon him in London for £1,000; this Duval does, and sells the draft on the Paris bourse for 25,300 francs. Smith has £1,000 with which to meet the draft for £1,000 drawn upon him by Duval, and therefore the account balances on the London side. But Duval has 25,300 francs to meet a draft for 25,250 francs which Smith has drawn, and therefore makes a profit of 50 francs, less the expenses of stamps and telegrams. This is an extreme instance which would not occur in practice, because, owing to the influence of such transactions, the sight rates between two centres vary but little. Paris quotes London for cheques at practically the same rate as London quotes Paris at the same time; any divergence is seized upon by the arbitrage operator and the difference quickly disappears. In long rates the reverse of this happens. The long rate quoted in Paris on London, or Berlin on London, is *lower* than the short rate, while the long rate of London on Paris or Berlin, or any other centre

which London quotes in terms of the foreign coinage, is *higher* than the short rate.

Arbitrage operations become very complex in practice. The constantly varying market rates of discount in the gold centres add to the speculative nature of dealings in long bills, while very often operators in two centres will deal in bills drawn on a third or fourth centre; a Berlin banker, for instance, may find it worth his while to draw on Amsterdam, and remit to Paris in exchange for bills on St. Petersburg bought in Paris and remitted to Berlin.

So far we have discussed those influences which affect the rate of exchange through the demand and supply of bills, but exchange rates are subject to fluctuations which arise through no variations in the number of bills offered for sale or the demand for such bills, but simply from the condition of the currency in either or both of those countries.

A depreciated currency may be due to a debased or worn coinage, or to an over issue of paper; either of these will affect the nominal rate of exchange, because the rate is quoted in terms of the currency which can be legally tendered in payment of a debt, not in terms of the full weight coin, which is probably only a legal fiction and does not circulate. We have had examples of both in the history of our own country. Previous to the silver recoinage of William III.'s reign, when silver was the standard of value in England, the worn state of the silver coins resulted in an extremely adverse rate of exchange, which disappeared directly the new coinage was issued.

As we saw in Chapter IX., the depreciation of the Bank of England notes during the restriction of cash repayments had a similar effect in turning the rate of exchange against the country, There are several existing currencies which are depreciated by an over issue of paper; Spain, Portugal, Argentina and Brazil, among others. Russia's currency was at one time depreciated 50 per cent., and the difficulty was only overcome by legalising the depreciation and changing the rating of the gold Imperial from ten roubles to fifteen roubles. In countries where a depreciated paper currency exists, gold is not found in the ordinary channels of circulation, but can only be obtained by offering a premium in paper money. This is the meaning of the Buenos Ayres quotation in the table of Exchange Rates on London given on p. 188, in which the gold premium is given at 127 per cent.; in other words, 100 gold pesos or "dollars" are equal to 227 paper pesos.

Finally, between countries which use a different metal as their standard, the rate is subject to the variations in the gold price of silver bullion. India and Japan have now adopted a gold standard, but most of the other Asiatic nations, notably China, still use silver as their standard metal, and the exchange between these countries and London depends not only upon the demand and supply of bills and telegraphic transfers, but also upon the price of silver in the London Market.

CHAPTER XXI.

THE STOCK EXCHANGE.

It is of course impossible to give a detailed account of Stock Exchange operations within the limit of a single chapter, but a short explanation of the terms in general use may be of interest to the student.

No one is allowed to do any business on the London Stock Exchange unless he be a member, or the authorised clerk of a member. The class of men called "outside brokers" either do business through a member of the "House," or else they buy and sell shares for their customers without making use of the Stock Exchange at all.

The members of the latter are divided into two classes, stock "jobbers" or "dealers" and stock "brokers," an arrangement peculiar to this country. All orders to buy or sell securities are given by the public to a stock broker, who goes to the House and makes a bargain on the required security with a jobber. The broker makes his profit by charging a commission to the general public; the jobber makes his, by quoting a double price for all securities in which he deals; the higher price is the one at which he is willing to sell, the lower that at which he will buy. If the broker wishes to deal, he, without telling the jobber whether he is a buyer or a seller, asks him

to quote a price, and, once having quoted a price, the jobber is, by the rules of the House, bound to do business at the price up to an amount which in most cases is fixed at £1,000, though, in the case of shares, usually less. Say the jobber quotes 99 to 100 as the price; the broker, if he is satisfied, mentions the amount he wishes to buy or sell, and the bargain is duly entered; but he may think the margin between the two prices is too large, in which case he will ask for a "closer" price. If the jobber consents to this he may quote 99¼ to 99¾, or perhaps 99½ to 100. The extent of the margin between the two prices quoted depends upon the volume of the transaction in the particular security. If it is one which is being constantly bought and sold, the difference will be small, as, for instance, in Consols, where the difference is rarely more than one-eighth. If, on the other hand, it is a security in which few transactions occur, and which therefore the jobber may find difficult to deliver or to sell again, the difference will be much greater, and quotations of securities such as local brewery stocks may be found at, say, 88 to 91.

The securities which are dealt in on the Stock Exchange may be divided into three main classes—stocks, shares, and bonds.

The capital of a company or the amount of a government or corporation loan is sometimes issued so as to be divisible more or less at the will of the purchaser, in which case it is called "stock." Some stock, such as that of the Consolidated Fund, can be dealt with in any sum, so long as fractions of a

penny do not occur, whilst other stocks can only be bought or sold in multiples of a pound or five pounds, and so on. English stocks are always quoted on the Stock Exchange for the £100 of stock.

In other cases the capital of a company is divided into a number of fixed and usually equal portions which cannot be divided, in which case these portions are called "shares."

A debenture bond is a promise to pay a certain sum of money with interest, usually in English companies £100 or multiples of £100, but occasionally for smaller sums. They are redeemable either at a fixed period or at a time which shall be determined by the public drawing of lots; in other cases they are irredeemable. Many debenture bonds are secured by a "floating" or specific charge over the general effects of the company, but this is not a necessary qualification of a debenture.

British Government Stock is "inscribed" or registered in the books of the Bank of England. The owner's title is evidenced by the entry in the books, and no document of title is issued, the stock receipt given at the time of purchase being of no use except as evidence. All transfers of stock have to be made by the personal attendance at the Bank of England of the proprietor or of a legally appointed "attorney." In the case, however, of most railway and other companies, a stock certificate is issued, which is *primâ facie* evidence of title and which must be produced whenever the stock is transferred to another holder. Similar certificates are issued to the proprietors of shares, and in the case of a

transfer of the share from one proprietor to another, the company require the production of a duly executed transfer deed before registering the title and issuing the new certificate.

Some American Railroad certificates have a blank form of transfer on the back, and in order to expedite their negotiability in this country it is the custom for the registered holder to sign the transfer in blank and for the certificates to be dealt in as if they were bearer securities negotiable by delivery. The registered holders are usually certain well-known firms in London who are willing to undertake the class of business, but the real owner is the possessor of the certificate. Dividends are paid to the registered holders, and are handed on to the real owner on production of the certificate, a small commission being usually charged for so doing.

A bond is usually payable to bearer, and if so, is transferable by mere delivery, with the least possible delay and formality. Most of the international securities, such as foreign government loans, are issued in the form of bearer bonds, in order to facilitate their transfer from one country to another. Attached to the bearer bond is a sheet of paper slips called "coupons," each of which entitles the holder to interest for a certain period, either three months, six months, or a year. The coupons are distinguished by numbers, corresponding to the number on the bond, as well as a number indicating the order of payment. The company, of course, has no knowledge of the ownership of the bonds, and pays the coupons to the individual presenting them. No

bonds will be dealt in on the Stock Exchange unless all the coupons are attached, and when these are exhausted and the bond is not yet due for payment, it is necessary to send the latter to the officers of the company or the agent of the government, as the case may be, in order to obtain a fresh sheet, unless there be attached to the bond a slip called a "talon," the production of which entitles the individual presenting it to a fresh supply of coupons.

The holders of debenture bonds have a priority both as regards capital and interest, not only over the shareholders, but also over the other creditors.

Very often debentures are issued in several series, first debentures, second debentures, and so on. In this case the claim of the holders of the second debentures to payment of capital and interest is postponed till the holders of the first debentures are satisfied.

Next in priority to the debenture holders as regards the payment of interest come the preference shareholders; in the case of cumulative preference shares they obtain a right to the payment of any arrears of interest which may exist before the holders of ordinary shares obtain a dividend. Lastly, behind the ordinary shareholders come the holders of deferred shares, whose claim to interest or dividend is postponed to that of all the preceding. In the case of debentures and preference shares, as well as in ordinary shares, if deferred shares have been created, the rate of interest is fixed, either absolutely or proportionately, and the deferred shareholders, or if there are none, then the ordinary shareholders,

divide the residue of the profits which have been appropriated for dividend purposes.

The holders of shares or stock are not entitled to the return of their capital except in the case of the liquidation of the company; they have only a right to the interest or dividend on a nominal amount; but debenture bonds are in nearly all cases redeemable, either at a time mentioned in the bond, or by drawings spread over a number of years. The numbers of bonds which have been drawn for payment are advertised in the leading papers, but in the case of bearer bonds the owners cannot of course be notified. If the bonds are kept with a banker, he will usually inform his customer in case one is drawn for payment, but there is no legal obligation on a banker to do this, and he is not responsible for any loss incurred by his omission to do it. In the great majority of cases, if the bond is not presented, the next coupon is returned unpaid with the answer "bond drawn," but in a few cases, notably in Russian Government bonds, the coupons are paid and the amount deducted from the total of the bond. It is therefore necessary to keep a sharp look out for Russian drawings, for the neglect to do so may entail the repayment of the whole of the principal in the form of what the holder fondly imagines to be interest.

Consols, instead of being inscribed in the books of the Bank of England, can, at the option of the proprietor, be held in a form varying very little from bonds. What are called "consol certificates to bearer," with coupons for interest attached, have

of recent years been issued, thus avoiding the formalities of transfer which, in the case of continental holders especially, was a serious bar to dealings in the stock, though the increased convenience is to some extent counterbalanced by the risk attaching to securities negotiable by delivery only, and to which the holder of the certificate has a *primâ facie* title.

"Scrip" or "scrip certificates" are provisional certificates issued by a company or other body to bridge over the interval before the definitive bond or certificate is ready. A new issue of capital or a newly-floated Government loan is usually payable in instalments spread over a period of some months, and until all these instalments are paid, full certificates will not be issued; but in order that the issue may be dealt in on the Stock Exchange, scrip is issued, usually payable to bearer and with receipt forms attached for the various instalments. When these are all paid, upon production of the scrip with the receipts duly signed, definitive certificates are issued in exchange. Bearer bonds and bearer scrip are by mercantile custom negotiable instruments, that is to say, the individual who obtains possession of them for a valid consideration and without knowledge of any defect in the transferor's title, acquires a good title, notwithstanding any defects in a previous holder's title. This is an exception to the general operation of English law. If a man purchases any article which is not a negotiable instrument and the person from whom he bought it has no title to it, as, for instance, when the article has been stolen, he is liable to the true owner for its

value, except only when the sale was in "market overt." But negotiable instruments are transferable by mere delivery, and the *bonâ fide* transferee for value gets a good title in spite of any previous theft or other bar to a good title.

We can now return and follow the operations on the Stock Exchange mentioned at the beginning of the chapter. After the broker has made his bargain with the jobber, a contract is prepared and despatched the same day to the broker's customer. This contract note states the nominal amount of stock or the number of shares bought or sold, the price to be paid, and the commission charged by the broker, varying from one-eighth per cent. upwards according to the nature of the security; it also states when the bargain has to be settled. Securities are bought and sold on the Stock Exchange either for cash or for "the account." If for cash, the bargain must be paid for and the securities delivered at once. Consols and other British Government stocks are frequently dealt in for cash, as well as bearer bonds in small amounts; but in other cases the bargain is completed on the next settling day.

Settling days for Consols are once a month, on days fixed by the Committee of the Stock Exchange; for other securities there are two settlements in the month. Besides these, "special settlements" are granted in the case of new companies or issues. All bargains in a new stock or company are made for this special settlement, which may not take place until some months after the allotment of capital; after that, bargains are settled at the usual fortnightly settlement.

The settlement occupies three days: the first, the "carrying over" day, called also "continuation" or "contango" day; the second, the "ticket" day; the third, the settling or pay day. In the case of mining shares two days are allotted for the business of carrying over.

On carrying-over day it has to be decided whether the bargain is to be completed; if this is not convenient, the settlement of the bargain is postponed till the next account by the following process: We will suppose that a broker has bought £500 Caledonian Railway Stock at 101, and when the next settling day comes his client is unwilling to pay for it, since he believes the price will shortly rise, and that he can sell and profit to the extent of the difference. The broker goes to the jobber he has bought from, or to any jobber if necessary, and sells it back at the current price at 12 o'clock on the carrying-over day, called the "making-up" price, at the same time contracting to buy it again at the same price for the next ensuing account. Say the making-up price is 99. The broker's client will pay the difference of £10 on the £500 stock at once, and the payment of the remaining £495 will be postponed till the next account. Besides this the buyer will have to pay interest for the fortnight's postponement of payment at a rate called the "contango rate." It sometimes happens that there have been a great many sales of a particular security and that it is difficult to obtain stock to deliver to the buyers. In this case very often it is the sellers who are anxious to carry over the bargains, and instead of the buyer having to pay interest for the

postponement of payment, the seller may offer to pay the buyer a premium for the privilege of carrying over. In this case the rate is called a "backwardation" or "back." It must not be imagined, however, that if a seller is unwilling to deliver that he will necessarily have to pay backwardation. Whether he is paid a contango or has to pay backwardation depends, not upon the individual bargain, but upon the general relations of demand to supply in the particular security. Briefly stated, if there is a "bull" account in the security contango rates will prevail; if a "bear" account, backwardation will be more in evidence.

These terms demand a few words of explanation.

The words in use on the Stock Exchange are strangely suggestive of a menagerie, and to tell the truth, if rumour speaks true, the House behaves at times more like a menagerie than a society of highly respectable business men. Anyhow, we hear of "bulls," "bears," "stags," "guinea pigs," "kangaroos," "wild cats," and "lame ducks," among other members of the animal kingdom. A "bull" is a man who has bought securities which he does not intend to "take up" and pay for, but hopes to sell at a higher price and profit by the difference; in short, a bull "buys for the rise."

A "bear," on the other hand, is one who has sold securities which he does not intend to deliver, but hopes to buy back at a lower price. He has "sold for the fall."

All Stock Exchange business can be divided into two main classes. There is the class of business

entered into by the investing public, who buy securities which they pay for at the next account and hold as an investment, or who will sell stock only which they possess, because they require the money for some purpose.

The other class of business is that carried on by the regular operators on the Stock Exchange who deal in stocks which they never intend taking up or delivering as the case may be, but whose object is to make a profit from the differences between the prices at which they buy and those at which they sell. These are the speculative classes, to which belong the bulls and bears. If in the course of an account, that is, between one settling day and another, bull operations have predominated in any group of securities, it is said to be a bull account, and contango rates will prevail. Similarly, if it is a bear account, there will be many brokers who have sold but are unwilling or unable to deliver, and backwardation rates will prevail.

Many of the rather sensational reports which emanate from the Stock Exchange are the direct result of bull or bear accounts, and are circulated with the object of inducing the public to buy or sell, as the case may be, in order to make the price of certain securities rise or fall.

It may be remarked that since it is considered unadvisable that bank shares should be subject to speculative influences, and in order that, owing to the heavy liabilities of the banks to the public, the shares should, as far as possible, be held by the investing classes, an Act called "Leeman's Act"

was passed in 1867, according to the terms of which all contracts for the purchase or sale of the shares of joint stock banks, must mention the registered numbers of the shares. This was intended to prevent operators selling shares which they did not possess; but the Act is often disregarded and is practically a dead letter.

Bull operations do not necessarily have the effect of sending up prices, even for a sufficient period for the operators to realise; neither do bear operations always have the reverse effect. If bulls have bought and the anticipated rise does not come, they may be compelled to sell at a loss, and this forced selling will probably send prices down rapidly. The market very often knows that there is a heavy bull or bear account in a particular security, and, anticipating a re-action, they hold off and await events before buying or selling as the case may be.

After the carrying-over day comes the "ticket-day" or "name day," which is devoted to finding out who is going ultimately to take up or deliver securities which have been dealt in during the account. It takes its name from the tickets which are passed through the Settling Department or Clearing House of the Stock Exchange. The last day is the "pay day," all differences being paid by crossed cheques on a Clearing banker.

A few words are necessary as to the quotations of prices. When a bargain is struck between a broker and a jobber, either may have the bargain "marked," in which case the price at which it was effected is posted publicly on a board. These prices are

telegraphed to the evening papers by the Exchange Telegraph Company, who are allowed to be in the House for this purpose; they are called "tape prices," the word being taken from the long strips of paper on which the reproducing machines of the Exchange Telegraph Company record their telegrams. The Stock Exchange publish a daily official list of the more important securities dealt in. The right to be quoted in this list is only granted to companies which comply with certain regulations as to the allotment and registration of capital.

The official list, which is the basis of that appearing in the morning papers, contains two principal columns, those of the "business done" and of the "closing prices."

The first consists of the prices of actual bargains which have been marked during the day, and is a better indication of the real level of prices than the second. The closing prices are often little more than nominal; it may be that no dealings have taken place in a particular security for several days, and in this case the closing price would be either that of the last bargain made, or an approximate calculation of what the price is likely to be.

It will be noticed that some prices are marked with the letters "x.d.," *i.e.*, *ex* dividend. It is a general rule on the Stock Exchange that securities are sold with the accruing or declared dividend up to the time the shares or the stock are quoted *ex div.* Most companies close their books for a short period while the dividend warrants are being prepared, and will not register a transfer. The warrants are posted

to the holder registered at the time of closing the books, but if he has in the meantime sold his shares or stock before the price is quoted *ex div.*, he must surrender the dividend to the buyer. As a rule prices are quoted *ex div.* at the beginning of the account following the declaration of the dividend, bearer securities, however, being marked x.d. on the day the dividend is payable, and the price in either case falls to the extent of the dividend just paid. The terms "*ex* interest" and "*ex* rights" have a similar application, the latter usually referring to the right to subscribe to a new issue of capital, preference in such cases being often given to the holders of the original capital, to the exclusion of the public.

CHAPTER XXII.

FINANCIAL CRISES.

The peculiar regularity with which financial crises occurred during the nineteenth century, at intervals of as near as possible ten years, has given rise to extraordinary theories to account for these so-called credit cycles, no less an authority than Professor Jevons seeking to find an explanation in the periodic recurrence of spots on the sun's surface.

Such theorists seem to wander unnecessarily far afield in their search for a cause, but, although we cannot perhaps accept such explanations, yet we cannot but be impressed by the striking regularity of the crises up to the last quarter of the century.

In 1825 there was an especially virulent panic, usually attributed to speculation in foreign mining companies, when the Bank of England was reduced to issuing forgotten £1 notes. In 1836 there was a crisis which was one of the immediate causes of the restriction of country note issues by the Act of 1844. Again in 1847, speculation in railway companies precipitated a crisis which necessitated the suspension of a part of the Act of 1844. Ten years later a totally unexpected crisis took the mercantile world by surprise, and resulted in a second suspension of the Act.

The next, and probably the worst panic, that of 1866, is usually associated with speculative company promotion following upon the passing of the Companies Acts of 1862, and was precipitated by fluctuations in the price of cotton due to the American Civil War. It was especially notable for the failure of Overend, Gurney & Co., the bill brokers, with liabilities of over ten millions, and for the third and last time the Act of 1844 had to be suspended, while such was the gravity of the situation that the Bank Rate remained for three months at 10 per cent. England's credit has seldom been so low on the continent, and notwithstanding the high rate of interest, gold was attracted very slowly.

The last of the series occurred in 1875, and is generally ascribed to the reaction following the abnormally high prices of 1872 and 1873, and to the great amount of accommodation bills in existence.

The City of Glasgow Bank failure in 1878 caused some anxiety in London, but did not produce an actual crisis, while the suspension of Baring's, in 1890, might have easily caused a panic, but for the promptitude with which the Bank of England and the leading joint stock banks joined in guaranteeing the engagements of the defaulting firm.

A study of these crises seems to convince us that in economics, no less than in the physical world, the law is true that "Every action has its reaction, equal in extent and opposite in direction." After each crisis comes almost invariably a period of stagnation. Speculation is checked, moneyed men

are afraid to venture, prices droop. This state of affairs gradually and naturally wears away. Men become more enterprising, confidence returns, speculation grows and gives way to over-speculation, and over-speculation ends suddenly in a monetary crisis, and maybe a panic.

Speaking generally, all, or almost all, monetary crises are caused by excessive speculation. John Stuart Mill has an excellent description of the steps which lead to such crises (*a*) : "There is said to be a commercial crisis when a great number of merchants and traders at once either have, or apprehend that they shall have, a difficulty in meeting their engagements. The most usual cause of this general embarrassment is the recoil of prices after they have been raised by a spirit of speculation, intense in degree, and extending to many commodities. . . . At periods of this kind a great extension of credit takes place. Not only do all whom the contagion reaches employ their credit much more freely than usual, but they really have more credit, because they seem to be making unusual gains, and because a generally reckless and adventurous spirit prevails. . . . When, after such a rise, the reaction comes and prices begin to fall, speculative purchases cease. When everybody seems to be losing, and many fail entirely, it is with difficulty that firms of known solidity can obtain even the credit to which they are accustomed, and which it is the greatest inconvenience to them to be without. . . . There is

(*a*) Political Economy, Book III., Chap. XII., s. 3.

super-added in extreme cases a panic as unreasoning as the previous over-confidence; money is borrowed for short periods at almost any rate of interest, and sales of goods for immediate payment are made at almost any sacrifice."

If we analyse the above paragraph, we find three important points to remember: First of all, there must be a speculative spirit abroad, "a generally reckless and adventurous feeling," as Mill calls it. Unless this feeling becomes general, it is almost impossible for the demand for credit to assume such proportions as to threaten the stability of the financial world. Take, for example, that form of business which is most openly speculative, that is to say, Stock Exchange operations; for the past ten years or so, long before the late war had so disastrously influenced prices, the public have been cajoled by every artifice and by the most reckless prophecies, to give their assistance in forcing up prices in one or the other of the Stock Exchange markets. But in spite of some very clever engineering, prices have gradually drooped, and the embryo "booms" have died at their birth, the chief reason being that the spirit of speculation was, for the time being, dormant.

Secondly, it will be noticed that speculation acts by means of its effect upon prices. Speculation means an increased demand, it may be for the majority of commodities, it may be for one particular commodity, but in the latter case such a rise will usually affect the prices of all commodities in that group, because what is a finished product in one trade is only raw material in another.

The third point to remember is that speculation acts upon prices by means of an increase in credit; "at periods such as these," says Mill, "a great extension of credit takes place."

If credit did not exist and everything had to be paid for in gold or silver, the limitations of speculation would be very narrow. The quantity of gold in circulation cannot be greatly increased at a moment's notice, and taking for granted that nothing occurs to diminish the supply of goods offered for sale, you cannot have a general rise in the prices of commodities, except by increasing the quantity of money in circulation, and the only way of so increasing it is by the creation of credit.

Up to a certain extent this can be safely done in a country like England. Our currency is "elastic," and there is no absolutely fixed relation between the amount of credit and the gold basis upon which it rests. But beyond certain limits there is a great danger attaching to the creation of credit, and the greater the inflation of credit, the more violent is the inevitable recoil in prices which leads up to the monetary crisis.

It must not be imagined that speculation has necessarily an evil effect upon business conditions. It is somewhat difficult to define speculation, because there is a speculative element in all modern business transactions, but the term is used here to denote particularly that class of business enterprise which is prompted by the expectation of a rise or fall in prices, and which is very often carried on with borrowed capital. Up to a certain point speculation

of this kind is productive of more good than evil, and undoubtedly helps to prevent wide fluctuations in price. If the price of any commodity falls abnormally, the speculator steps in to buy, and so raises the price. Conversely, a rise in prices tempts the speculator to sell for the fall. In all markets, whether stocks and shares or corn or cotton, the speculative operator is always at work and by his dealings hinders prices from fluctuating too far in either direction.

But speculation occasionally runs wild, and it is then that it begins to be harmful. Speculation is good, over-speculation is excessively dangerous, because the artificial raising or lowering of prices is sure to result in a recoil, resulting in a contraction of credit and widespread disaster.

America is the home of the speculator, the reason being that immense sums of money are controlled by individuals or syndicates. The artificial interference with prices in a particular market can therefore be carried to a great extent, and sustained for a long period. In England we have as yet had few instances of such concentration of capital as is characteristic of American finance, and the speculator has often to depend upon borrowed capital.

We can now estimate the position of bankers in this country in those periods of reckless speculation which have culminated in a monetary crisis. It is safe to say that bankers cannot originate speculation. Without the existence of a spirit of speculation and the anticipation of making a quick profit, there will be but a small demand for borrowed capital from

the productive and commercial classes. It is these classes who originate speculative movements. But, as we saw above, no speculation can spread very far without an extension of credit, and to a certain limited extent bankers can control the amount of credit at the disposal of the commercial classes. To a limited extent only this is true. A banker cannot know, and it is not a banker's function to inquire, the purposes for which each individual customer requires an advance, and whether his business is of a speculative character. If the banker decides that the loan is a safe one, and he can spare the money, he will usually be content with this knowledge.

But when the signs of speculation are evident to a banker, and to an experienced practical man of business it is not difficult to detect such signs, he can discourage further borrowings by raising the rate of interest, and he can prepare against possible emergencies by strengthening his own position and increasing his "liquid" assets.

When the early signs of an approaching crisis are detected, the first step should be to raise the prevailing rate of interest. This operates in two ways: (1) it attracts foreign capital and so helps to attract gold by turning the exchanges in our favour; (2) it discourages needless borrowing by the more timid class of business men.

Neither of these effects is certain. In normal times a rise in the rate of interest is certain to eventually attract gold, but in times of panic the foreigner may balance the increased risk against

the increased profit, and decide against us. In the second case, as Mill points out in the paragraph quoted above, when panic has seized the commercial classes and failures follow each other in rapid succession, no increase in rates will discourage borrowing on the part of those whose position is desperate. It becomes a matter of extreme urgency; money must be obtained whatever the cost, and if the rate were raised to 50 per cent. there would be plenty of people who would borrow to escape certain failure.

But a word of warning is necessary. A very sudden rise in the rate of interest is often the most dangerous proceeding in cases of panic, because it has the effect of aggravating the prevailing feeling of nervousness and distrust, and is regarded by the public as a sign of weakness. When a crisis is imminent, the first step on the part of those upon whom responsibility rests should be to restore confidence; once this is done, the rest is easy. If one may make use of an everyday simile, the rate of interest at the time of a monetary crisis may be likened to the brake on a bicycle which is descending a steep hill with sudden and unexpected gradients. A rash use of the brake at the worst part of the hill will probably only precipitate the calamity which it is desired to avoid. The brake must be gradually brought into play in the earlier stages of the descent, and in like manner the rate of interest should be raised before the crisis has had time to develop into a panic.

The second palliative to a crisis is the free lending of money in all quarters where lending is warranted

and the security is satisfactory. A refusal to lend might be the natural desire of banks, in order to strengthen their own position, but this restriction of credit should have preceded the time of the crisis; once the public is alarmed money must be lent in order to restore confidence. It must not be forgotten that every failure at such times is apt to bring about a series of catastrophes, because the suspension of payment by a business firm ties the hands of all of its creditors, as well as spreading alarm in other directions.

If neither of these steps results in the restoration of confidence, the last resource is the suspension of the Act of 1844. A long continued crisis must inevitably diminish the Bank Reserve, and as this Reserve gradually approaches the point of disappearance, the nervousness of the public is apt to become acute. Three times the suspension of the Act has been necessary, and every time it has had the desired effect of restoring confidence. The feeling that a further reserve of Bank notes has been created seems to bring about a revulsion of opinion and dissipate alarm.

Perhaps it is necessary to explain clearly what is meant by the "suspension of the Bank Act." A question set in a recent examination in banking came under the notice of the present writer, in which the examiner referred to the suspension of the Act as a "restriction of cash payment" by the Bank of England. Needless to say, this was quite wrong. The suspension was not a complete suspension of the Act, but only that part of Clause II.

which forbids the issue of notes beyond the amount of the securities lodged in the Issue Department, except in exchange for gold or silver. No restriction of payment in cash was sanctioned or contemplated, and all notes presented during the period of suspension would be paid in gold if desired. The letter signed by Earl Russell and Mr. Gladstone, in 1866, authorising the suspension, runs as follows: ". . . If, then, the directors of the Bank of England, proceeding upon the prudent rules of action by which their administration is usually governed, shall find that, in order to meet the wants of legitimate commerce, it be requisite to extend their discounts and advances upon approved securities, so as to require issues of notes beyond the limits fixed by law, her Majesty's Government recommend that this necessity should be met immediately upon its occurrence, and in that event they will not fail to make application to Parliament for its sanction. No such discount or advance, however, should be granted at a rate of interest less than 10 per cent. . . ." (*a*)

It will be seen from this extract that the sole reason for the suspension was to enable the Bank of England to lend freely "to meet the wants of legitimate commerce."

If we except the Baring crisis of 1890, which was not known to the public until the danger was past, and which never looked like assuming the dimensions of a panic, thanks to the way in which the danger was met, we have been free from such disturbances

(*a*) Gilbart on Banking, Vol. II., p. 352.

in London for nearly thirty years. What are the reasons for this?

It is hardly true to say that we have been free from speculation during this period. Yet what speculation has occurred has been both limited in its area and open in its character. Anything like a wide speculative movement has been hindered by the tendency to falling prices, which until the last few years has handicapped our trade.

We have had speculative movements on the Stock Exchange, as, for instance, in South African mining shares and South American securities; there has also been speculation in certain trades from time to time, but all these have been of an openly speculative nature, and the banks and more important financial houses have mostly abstained from direct participation.

A second reason for the absence of any monetary crisis during this period—a reason closely related to that just given—is, that bankers, profiting from past experience, have conducted their business on sounder lines.

A glance at some bank reports issued during the years between 1860 and 1870 will show that extravagant profits were often made, and the dividends and bonuses declared by many of the leading banks amounted to as much as 40 per cent. per annum. When we compare these with the steady and moderate dividends now earned, the conclusion is forced upon us that much of the business carried on by banks at the former period must have been of a risky nature, and that bankers did not pay sufficient heed to the dangers of extravagant lending.

Of late years bankers have kept a distinctly larger percentage of liquid assets; this has tended to reduce profits, also to ensure a better margin of safety. Not only is this so, but bankers, in spite of the greater competition which has characterised recent years, have undoubtedly in the main been more careful in the manner in which they lend money.

Perhaps a third reason may be found in the decline in the number of bills offered to bankers for discount. A good mercantile bill forms an excellent banker's security, but it has been in the past difficult to distinguish these from accommodation bills. The Select Committee of the House of Commons, appointed after the crisis of 1857, reported that the existence of a large amount of such bills was the chief cause which led up to the panic, and, although accommodation bills are not yet unknown, it is probable that their number has greatly declined.

CHAPTER XXIII.

BIBLIOGRAPHY.

This chapter does not pretend to be an exhaustive record of banking and financial authorities. It is only intended to guide the student in the selection of those works which will be useful to him, if he wishes to pursue further the topics which have been treated in the course of the preceding chapters. No doubt many other works which are well worthy of perusal will occur to the mind of the reader, but in the interests of simplicity, and to avoid overwhelming the student with too formidable a mass of literature, it has been thought advisable to omit any mention of more than one or two works which cover the same ground.

On the general subject of money there is still no text-book to supersede Jevons' Money and the Mechanism of Exchange, although written about thirty years ago. Owing to its admirable lucidity, it is specially suited to those whose knowledge of the subject is slight, but it requires supplementing as regards some of the more recent monetary developments. J. S. Nicholson's Money and Monetary Problems is another short work of similar scope, but containing a critical explanation of the later problems in monetary science. Professor

Walker's Money is a book, written from the American standpoint, which is widely read, though some of his opinions are not regarded as orthodox in many quarters.

Perhaps the most generally accepted text-book on banking is Gilbart's Principles and Practice of Banking (Michie's edition, two volumes); but, notwithstanding many admirable qualities, chief among which is the fact that the author was in the forefront among practical bankers, being for many years the general manager of the London and Westminster Bank in its earlier days, yet it must be admitted that the banking problems of to-day are very different from what they were at the time Gilbart wrote his book. Macleod's Theory and Practice of Banking is a comprehensive work, with an excellent historical account of the development of English banking and of English monetary history, but it is disfigured by a too emphatic style and an irritating insistence on certain aspects of banking and monetary problems. Hutchison's Practice of Banking (four volumes) is an exhaustive and practical work by a writer who also shows considerable knowledge of the legal side of the subject he discusses.

Perhaps the best short practical hand-book is Moxon's English Practical Banking, a succinct and clear exposition of every-day banking operations by a man with wide experience of his subject. Rae's Country Banker is also an interesting book, written in a more colloquial style, though it is perhaps somewhat diffuse for perusal by a busy man. The

Journal of the Institute of Bankers contains a mine of information upon all subjects connected with banking and money, written by the best authorities of the day, and the volume of Questions on Banking Practice contains the opinion of the Council of the Institute on almost every subject of practical interest which can arise. Two useful general works on the theory of banking, written by Americans, are Dunbar's Theory and History of Banking and W. A. Scott's Money and Banking.

Turning from these general works on banking and currency to the more specialised subjects, we are met by the difficulty of finding a single adequate account of the first of these subjects, the question of a standard of value, monometallic or bimetallic. There is an enormous mass of literature dealing with the question, but as it has so recently been, and still is, a polemical controversy, most of the literature is one-sided, and a satisfactory impartial account of the movement has yet to appear. W. A. Shaw's History of Currency is a reliable account of the developments leading up to the recent controversy, but on the subject of bimetallism itself it is perhaps better to read each side of the question and draw one's own conclusions. For this purpose Giffen's Case against Bimetallism and Macleod's Bimetallism are two of the leading expositions of the monometallic case, and Walker's International Bimetallism and the Colloquy on Currency by H. H. Gibbs (now Lord Aldenham) are two of the best accounts of the reverse side. Those, however, who wish a thorough knowledge of the subject are strongly recommended to study the Reports and

Evidence of the Royal Commission appointed to inquire into the Changes in the Relative Values of the Precious Metals, commonly called the Gold and Silver Commission, which sat in 1887—1888.

Turning to the Bank of England, both Macleod and Gilbart have detailed accounts of its development, while Palgrave's Bank Rate and the Money Market gives an excellent description of the position which the Bank of England occupies with regard to the public and the other banks, and also a comparison between the Bank and the leading European banks.

The Bank Act of 1844 is discussed by all the writers on banking theory mentioned above, while the Reports of the Select Committees on the Bank Act in 1857 and 1858 are useful reading.

On the subject of the Money Market we have, first of all, Bagehot's Lombard Street, a work which, like Jevons' Money, never seems to grow old. This should be supplemented by Clare's Money Market Primer, and also Straker's Money Market, while there is a small book, called How to read the Money Article, by C. Duguid, which will be found convenient for reference.

A clear description of the London Clearing House and its methods, and also of some of the leading provincial Houses, will be found in Howarth's Our Clearing System. Those wishing to study the Foreign Exchanges will find two works indispensable—one, Goschen's Theory of the Foreign Exchanges, which is written from the point of

view of the economist; the other, Clare's A B C of the Foreign Exchanges, written from the Market standpoint. Each is admirable in its way, and both should be read. The bulk of Clare's book is also contained in his Money Market Primer.

If a more detailed account of market operations and foreign currencies is desired, a work should be consulted such as Tate's Cambist or Deutsch's Arbitrage.

There are several works on the Stock Exchange, either of which can be consulted with advantage. Stutfield and Cautley's Rules and Usages of the Stock Exchange is well known, while Branson's Stock Exchange and its Machinery, and Duguid's Stock Exchange are two recently published books which have been well received.

As regards banking law, Grant's Law of Bankers has long been the standard work, but Paget's Law of Banking will be found most useful for banking men, to whom it appeals more strongly than Grant, which is more a book for lawyers. Sir John Paget's position as standing counsel to the Institute of Bankers enables him to appreciate better the attitude of bankers towards the law, an attitude which, it is needless to say, is quite different from that of the lawyer.

Besides these two works, Hart's Law of Banking, a recently published work, is likely to find favour, being both comprehensive and up-to-date.

The law of bills of exchange is best studied from the Act of 1882, which has been annotated by

Judge Chalmers, the draughtsman of the Act. He has also published a larger commentary on Bills of Exchange.

Those wishing further information concerning the constitution and powers of joint stock banks and other companies registered under the Companies Acts, should consult a standard work such as Rawlins and Macnaghten on Companies, or Palmer's Company Law. If a smaller work be desired, there is an excellently arranged text book on the Principles of Company Law, by A. F. Topham.

Finally, as regards commercial crises, and the relations between money, credit and prices, the student cannot do better than consult Mill's Political Economy. A full historical account of most of the crises and panics which have occurred is contained in Macleod's Theory and Practice of Banking.

TEST QUESTIONS.

The following questions are intended to assist the student in testing the extent of his knowledge of the subjects treated in the preceding chapters. They are taken, by kind permission, from papers set by the undermentioned examining bodies. The initials at the end of each question denote the source from which the question is quoted :

I.B.	=	Institute of Bankers.
I.B.S.	=	Institute of Bankers in Scotland.
I.B.I.	=	Institute of Bankers in Ireland.
L.C.C.	=	London Chamber of Commerce.

CHAPTERS I. AND II.

1. What do you understand by a measure of value ? Describe its attributes ; illustrate by considering the respective fitness of wheat, labour and gold to act as such measure. [I.B.

2. What are the grounds upon which it has been held that a rise in the value of money is an evil ? Examine them ; explaining how you would measure such a rise. [I.B.

3. On what grounds is stability in the value of money held to be desirable ? What is the precise meaning and proper test of such stability ? [I.B.

4. Distinguish clearly between Value and Price, and show that the distinction is sometimes important. Consider especially the case of gold. [I.B.S.

5. Why is it said to be " evident that, though there cannot be a general rise or fall in values, there can be a general rise or fall in prices " ? [I.B.I.

CHAPTER III.

1. Explain Gresham's Law, and give examples of its application. What are the conditions essential to its operation? [I.B.S.

2. Explain Gresham's Law about coins. Does it apply to paper money? [I.B.I.

3. Explain and illustrate Gresham's Law. State its cause and the modes of its operation. [I.B.

CHAPTER IV.

1. What is the meaning of legal tender—limited and unlimited? [I.B.

2. If a person had gold to sell, which course would you recommend, to sell it to the Bank of England or to send it to the Mint to be coined? Give your reasons. [I.B.I.

3. Distinguish between the simple, multiple, and composite legal tender systems. [L.C.C.

CHAPTER V.

1. What was the relation of gold to silver as legal tender in England from 1717 till the adoption of the gold standard in 1816? [L.C.C.

2. What were the causes that led to the adoption of the gold standard in England? [L.C.C.

3. "It is a very general belief that the limitation of the legal tender of silver to 40*s*. is the cause of our half-crowns circulating at their token value in gold."

Explain the terms *token* and *legal tender*. Do you consider this general belief well founded? [I.B.

CHAPTERS VI. AND VII.

1. Indicate briefly the advantages and disadvantages of gold as the standard of value. How would a return to bimetallism on the part of the United Kingdom be likely to affect the prices of commodities therein? [L.C.C.

2. How did the gold discoveries of 1848 to 1850 act on the standard of value in France? [L.C.C.

3. How is the value of gold determined? Mention the principal alterations in its value since 1848, with their causes. [I.B.

4. Explain the leading causes of the great fall in the gold price of silver since 1873. [I.B.S.

5. When and by what countries was the Latin Union first founded? State briefly the arguments used for and against bimetallism. [L.C.C.

6. Sketch briefly the causes that led to the demonetisation of silver by Germany in 1871, and by the United States in 1873. [L.C.C.

CHAPTERS VIII. AND IX.

1. Criticise the following:—If credit is the principal circulating medium, and so far as prices depend upon the circulating medium, it is to credit and not to gold that we must look as the immediate regulator of prices. [L.C.C.

2. What is inconvertible paper money? In what circumstances is it employed? How far does it satisfy the requirements of good money, and what are its defects? [I.B.

3. How could you (a) measure, (b) regulate, the value of an inconvertible currency? What are the objections to a currency of this kind? [I.B.

4. What is Credit? Show how an expansion of Credit may affect *General* Prices, and indicate the real *limits* to Credit inflation. [I.B.S.

5. During what years did the Bank Restriction Act of 1797 remain in force—what was its effect on the currency? [L.C.C.

CHAPTER X.

1. Briefly state and criticise the regulation of the note issue of (a) the Bank of England; (b) the English provincial banks. [L.C.C.

2. Describe the circumstances that led to the passing of the Bank Act of 1844, and state its principal objects. [I.B.

3. According to Lord Overstone, "the one simple duty which the manager of the currency has to perform is that of making the amount of paper circulation vary precisely as the amount of the circulation would have varied had it been exclusively metallic."

Examine this doctrine as applied to the cases (a) of a national, (b) of a local note issue. [I.B.

4. What was the main purpose of the Bank Act of 1844, and how far was it successful? Illustrate by reference to crises of 1847, 1857, and 1866. [I.B.I.

5. Show the importance in the Credit System of the United Kingdom of an adequate Banking Reserve in the Bank of England. [I.B.S.

CHAPTER XI.

1. Explain the principal provisions of the Bank Act, of 7 Geo. 4, c. 46 (1826). [L.C.C.

2. Does any and what liability attach to banks of issue registered as limited companies with respect to their notes? [L.C.C.

3. When and how was the Bank of England deprived of the monopoly of Joint Stock Banking in London? [L.C.C.

4. Enumerate the different classes of banks in England and Wales, stating briefly the differences in their constitution. [I.B.

5. A bank is registered under the Act of 1879 with a subscribed capital of £1,000,000, divided into shares of £40 each, on which £10 have been paid up: what is the nature of the "reserve liability" formed of the remaining £30 per share? [I.B.I.

6. There is a movement towards the absorption of the private banks in England by the larger joint-stock establishments. What is likely to be the ultimate effect of this amalgamation movement (a) as regards English banking, and (b) as regards the general public? [I.B.S.

CHAPTER XII.

1. Describe the manner of clearing country bank cheques through the London Bankers' Clearing House. [L.C.C.

2. Describe the Clearing House and its economic services. What inferences may be deduced from a study of the Clearing House accounts? [I.B.

3. Describe the country clearing and trace the course of a cheque payable in Leeds, and received by a banker in Bristol. [I.B.

CHAPTER XIII.

1. What do you consider the "liquid resources" of a bank? [I.B.

2. In the event of a run on a Bank, what resources would such a Bank fall back on first? [I.B.S.

3. State generally the sources of a banker's profits, the chief items in his expenditure, and the probable causes of his losses. [I.B.

4. Describe the different methods in which a banker employs his resources, and state roughly the average proportion of each holding that is usually maintained by the London banks. [I.B.

5. In discounting bills for a customer, what are the points to be considered? [I.B.

CHAPTER XIV.

1. State briefly the relations between a banker and his customer, and those between a banker and the public. [I.B.

2. John Jones has a banking account in his own name, and pays into his credit cheques payable to the order of Smith, Brown & Co., for whom he is agent, which he endorses *per pro.* Under what circumstances would you receive such cheques to his credit? [I.B.

3. A banker cashes two cheques upon another bank for a stranger. A week after payment it is discovered that in one case the drawer's signature is a forgery, in the other case the

payee's signature is a forgery. What is the position of the banker who cashed the two cheques? [I.B.

4. State what would be the liability on a bank if valuables deposited with it for safe custody were lost or stolen. [I.B.

5. What responsibilities does a banker assume for the custody of—

(a) Share certificates left with him in a closed box.

(b) Bonds from which he has instructions to cut off the coupons and collect them for his customer's credit.

(c) Railway shares left with instructions to sell them through a broker? [I.B.

CHAPTERS XV. AND XVI.

1. Compare the respective merits of the following forms of collateral security:

Deposit of title deeds.
Railway stock registered in the bank's name.
Securities to bearer.
Transfers in blank.
Local shares. [I.B.I.

2. What points are of primary importance when considering an application for an advance made by a limited company, and what particular form of security is in such cases desirable and available for the company? [I.B.I.

3. Share securities taken by a banker prove subsequently to be trust property; how is the banker affected? [I.B.I.

4. Give your opinion as to how far loans (a) on land and buildings, and (b) on life policies are advisable; and (c) if so under what safeguards. [I.B.S.

CHAPTER XVII.

1. Define "Bank Rate," "Market Rate," and "Deposit Rate," and show the connection between them. [L.C.C.

2. In what way does a rise in the Bank Rate affect (a) wholesale trade; (b) the Stock Exchange; (c) banking profits? [L.C.C.

3. Does the Bank of England Rate always control the money market? Give reasons for your answer. [I.B.I.

4. What is meant by "money at call," and what is the advantage it offers to the banker? [I.B.

5. Give an account of the principal periodic fluctuations or disturbances in the money market. Particularly explain the reasons of the extra drain upon the Bank Reserve in or about the month of October in each year. [I.B.

CHAPTER XVIII.

1. Explain the significance of the items "Other Deposits" and "Other Securities" in the weekly return of the Bank of England. How is the variation in the amount of "Other Securities" in the Banking Department at the turn of the year and of the half-year accounted for, and what weakness in our banking system does it reveal? [L.C.C.

2. State the functions which the Bank of England discharges to the State and to the other banks. [I.B.S.

3. Quote as nearly as possible a recent return of the Bank of England, and describe the meaning of the various items. [I.B.

CHAPTER XIX. AND XX.

1. Where and how are foreign bills for purpose of remittance bought and sold in this country? Mention two of the chief causes of fluctuation in the price of such bills. [L.C.C.

2. What are the essential conditions to ensure a movement of bullion from, say, Paris to London, or *vice versâ?* What determines the maximum variation in the rates of the Real Exchange between any two countries? [I.B.I.

3. Explain the terms "favourable" and "unfavourable" in connection with the Foreign Exchanges, and also the saying "high rates are for us, and low rates against us." [I.B.I.

4. Explain the reasons why Britain draws few Foreign Bills but accepts many. [I.B.S.

5. State, with reasons, what effect a rise in the value of money in London has upon Foreign Exchanges. [I.B.S.

6. If the Paris Exchange falls below 25·10 or rises above 25·35, how would accounts between London and Paris very probably be paid? Give reasons for your answer. [I.B.S.

CHAPTER XXI.

1. What is the difference between a Stock Jobber and a Stock Broker, and what are their respective duties? [I.B.S.

2. What are Inscribed Stocks; wherein do they, as a rule, differ from other British Stocks; and how are they transferred? [I.B.S.

3. Define the following terms, viz.: bull, bear, contango, and backwardation. Explain fully the method of "carrying over" Stock on the Stock Exchange. [I.B.S.

4. What is Settling-day on the Stock Exchange? How often does it occur, and what is its use? [I.B.S.

CHAPTER XXII.

1. Explain the nature and causes of commercial crises. [I.B.S.

2. Is an over-issue of Convertible Bank Notes possible? Consider what is meant by "over-issue." [I.B.S.

3. State the important functions which the Bank of England performs during times of financial crisis, and why it is in a position to perform such functions. [I.B.S.

4. Describe the nature of credit and its action as a convenience or a disturber of price; analyse a crisis, giving primary causes, subsidiary agents, the precipitating causes and subsequent results. Illustrate from some special case. [I.B.

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