Our National Bankig System

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The bank act was a compilation of the best results of a series of legislative experiments carried on by the States for three-quarters of a century.

It is necessary, therefore, to study carefully the practical workings of the different State systems and of the early national banking systems.

Such a study will properly form a prelude to a more thorough examination of the present national banking system.

No monetary history is more instructive than ours. We have tried every variety of paper money at different times.

To our colonial ancestors a bank meant a “bunch of paper money.”

The issue of paper money is not con-
sidered by economists to be a legitimate function of banking; but we find that the issue of paper money by banks was early considered to be the most important function. Starting, therefore, with the erroneous theory that something could be created out of nothing, the practice of issuing inconvertible paper money continued without cessation for more than eighty years and culminated in the era of continental currency which went down in such frightful ruin in 1788.

The Constitution took away from the States the power of issuing bills of credit and the opportunity for restoring the public credit was not to be thrown away. It was fortunate for the country that Alexander Hamilton was at the head
of the Treasury Department at that time. He was the exponent of the principle of a strong centralized government. Public credit and union at the time were inseparably bound together. Congress called upon Hamilton to prepare a financial policy for the new government. As a part of his financial policy he proposed the establishment of a national bank to aid the Treasury in the collection and disbursement of the revenue, and in funding the public debt. There were then only three state banks in existence in the country.

The principal argument against a national bank was its unconstitutionality. The opposite party claimed that Congress having the undoubted
power to pass laws necessary for the
collection of revenue and taxes might
constitutionally create a bank for
that purpose.

Hamilton's plan was adopted and
the First Bank of the United States was
chartered for 20 years. At the time
there was no national money except
a few copper cent pieces.

The capital stock of the bank was
limited to 25,000 shares of $100 dollars
each payable one-fourth in gold
and silver and three-fourths in
public securities bearing six and one-
per cent interest. Five thousand shares
were held by the government. The
money was popular and as bills
were issued, many tin dollars.
The opposition to the bank continues
Throughout the period of its existence, and before the expiration of its charter in 1811, eighty-eight state banks had been organized and were able to prevent a renewal of its charter.

Mr. Gallatin, then at the head of the Treasury, favored a renewal of the charter because (1) there was no other institution that afforded such facility of transmission of the public money; (2) the superior capital of the institution afforded security against loss and greater resources for loans; (3) the government could not control the state banks and it was not therefore desirable to be dependent upon them. Opposition was grounded on the fact that foreigners held a greater part of its stock and that the bank was
unconstitutional. It was, however, be said in favor of the bank that it had afforded a circulating medium acceptable alike in all parts of the country. There was no doubt that there was an excessive amount of bills in circulation, but the transfer of the issuing power to the state banks would only increase the amount already in circulation to enormous proportions. The First United States Bank had checked the state banks in their disposition to overissue by restraining their issues and holding them to a proper specific reserve.

The failure of the national bank to secure new charters was a signal for the rapid increase in the number of state banks. They were started
on the principle of limited liability and were known as the "wild cat" banks. Sudden contractions and expansions in the volume of paper money were inherent in the system. The ratio of paper money to its specie reserve was always a very high ratio and sometimes there was no specie reserve at all. During financial pressure or when commodity demand for gold, with the small amount of reserve on hand redemption was impossible. Very few banks were an exception to this rule during panics. The instability of such a system precipitated recklessness in business and frequent bankruptcies. The tendency has been to encourage speculation and extend credit in
times of quiet, but when the press
ure came, promises were not fulfilled
coins were kept out of common use
and the bills of one locality were
not current in another.

In the issue of paper money so fla
grantly abused there was a repetition
of the colonial experiments.

The depreciation of bank paper at
the close of the war of 1812 reached
20 to 25 per cent and the suspension
of the banks followed the capture of
Washington by the British.

The New England banks alone main
tained specie payments by the aid of
the Suffolk Banking system of mass
achusetts—extended throughout
New England. In this system a certain
sum was required to be kept in the
support, bank, or some other central bank, for the redemption of circulating notes. This was the distinguishing feature of the New England paper money and the stability of the system was shown by the ease with which the disasters of all crises were averted.

The Treasury department was involved in the common disaster following the war, because of the refusal of the state banks to give accommodations.

The treasury note system was resorted to as an expedient and it proved as powerless to avert disaster as when it was resorted to during the civil war, before the establishment of the present national banking system.

Again, to bring order out of chaos the people demanded a national bank.
The Second Bank of the United States was chartered in 1816 and went into operation in 1817, but too late to prevent the crash that followed. Specie payments were resumed but the state banks began to fail in 1818, and in 1819 this was another general suspension lasting for two years.

The capital of the new bank was fixed at $35,000,000 in 7,000 shares of 100 dollars each. The government subscribed 7,000 shares, the balance being subscribed by individuals. Shares were payable one-fourth in coin and three-fourths in the funded debt of the United States, notes could not be issued under five dollars.

The state banks had been creating money by suspensions and the specie...
The decline of the United States Bank for exist-
ence in the face of such difficulties
was a hard one, but it finally tri-
umphed and ten years of nearly un-
broken prosperity followed.
The bank itself was far from perfect
and many bad mistakes were made,
generally because of mismanagement.
Chief among the defects of the system
was the issue of branch drafts. These
were drawn on the parent bank by the
cashiers of the branch banks in denom-
inations of five, ten, and twenty dollars.
By the issue of these drafts the branch
banks became indebted to the par-
ent bank and the issues were then
by still further stimulated.
There were other defects of minor
importance but all of these could
have been remedied by the proper legislation. The defects were not due to any faults inherent in the system.

The bank question soon became a party issue and in 1830, six years before the expiration of the charter, the great "bank war" was waged between the friends and the enemies of the bank, resulting in the veto by President Jackson of the bill to re-charter.

The Second Bank of the United States had become a political machine, and no doubt deserved to perish; nevertheless, less it had rendered important services to the country, and the government lost not a dollar by either of these institutions, but received from the bank of 1791 and met profit.
of 1,135,152 dollars and from the
bank of 1817, a real profit of 6,093,167
dollars.
The government deposits had been
withdrawn from the bank of the United
States in 1833 and placed in several
state banks possessing a specie value
of one third of their circulation.
The state banks once more assumed
control of the currency and specie at
on a suspensory scale followed, result-
ing in the memorable crisis of 1837.
The government lost two millions of
its deposits and in 1840 Congress
passed an act establishing a cus-
tom house for the deposit of its public
funds.
So involved in embarrasments were
the financial operations of the period,
just gone over that it is almost impossible to ascertain anything in regard to banking capital, circulation, deposits, and specie reserves. The officers of some banking institutions were almost entirely ignorant in regard to the business they were conducting. To relieve the distress and restore the convertibility of bank notes, laws were passed in some states which had a salutary effect upon these institutions. Among the improvements in the state banks especially the new York system are worthy of careful consideration. The present national banking system is founded upon the principles of the Free Banking System of New York. An Act was passed in 1829 establishing...
lishing the Safety Fund System. A common fund was created by contribution, annually, of one-half per cent of the capital of each bank until 3 per cent of such capital was paid in. This fund was made applicable to the payment of the circulation and other indebtedness of any individual bank contributing, which should become insolvent. It was further improved in 1842 when the safety fund was made applicable only to the payment of circulating notes.

In 1838 the Free Banking System of New York was established and provided that the circulating notes be secured by United States or State bonds deposited at some agency of the banks. Although not perfect
The system served to check the issues of notes that had been
practiced by the other banks.

Aside from systems of this kind
founded in some of the States, the
state bank system was a necessity of
mankind. They were not founded
on real capital, but on the notes of the
shareholders, who in turn borrowed
the notes of the banks. They kept no
adequate reserves of coin and the
notes issued in one State were not
receivable in the other States.

Every device was practiced to pre-
vent themselves from redeeming for
redemption. The States supervised
no control over them by a proper
supervision of officers. When the
Civil war broke out the reserves wil
in a state of suspension, but even under these trying circumstances they were constantly increasing their issues. By an act passed March 3, 1865, a tax of 10 per cent was imposed on the issues of the State banks, which put an end to the issue of paper money by the States through banking corporations. The privilege of issuing bills of credit has ever since been withheld from the States and a sound circulating medium has been secured.

The costly experience of three quarters of a century suggests a sound and future financial policy which our statesmen and financiers were not slow in adopting.

Secretary Chase in his report of Decem-
In 1861, recommended the gradual is
issue of national bank notes on the same
basis as the New York system, but his
suggestions were not acted upon by Con-
gress at that session.
In the meantime the issue of legal
bonds notes had been so great as to
result in the suspension of specific pay-
ments. The limit had been reached,
and when this expedient had been
found to be futile, the Act of 1863
authorizing the establishment of a na-
tional bank was passed. The bill
was thoroughly revised, discussed, and
repassed June 3, 1864.
The effect upon the public credit was
speedily apparent. Bonds advanced
from 93 to par in currency and its
serious difficulty was found during,
the remainder of the year in providing for the enormous expenditures of the government.

The act of 1864 was thoroughly guarded by wholesome laws at all its points of danger indicated by previous experience. Some of these laws may first be considered before proceeding to a discussion of the merits and the future of the national banking system.

The act authorized the establishment of a national bank bureau of the Treasury and the Comptroller of the Currency was made the chief officer. Notes were made receivable by the government in payment of taxes and duties except imports, of debts except interest on the public debt and money employed in the redemption
of national bank notes.

Many abuses had occurred under the old banking system from lack of capital, and it was provided by the act that the capital of every national banking association should be fully paid in. Money cannot be loaned on real estate or on the security of the shares and of their own circulating assets or legal revenue notes and accommodations loans cannot be made to an amount exceeding one half of the capital. Thus it will be seen that more holds and deposits are alike protected.

To avoid the frequency of mismanagement examinations are periodically made to see that the necessary securities are on hand. The old system lacked a system of inspection by officials...
of the government.

The rate of interest charged by the banks is restricted to the rate of the state in which they are located.

Reports showing the condition of any bank may be called for at any time and covering any past time, and must be returned not less than five times each year. This publicity is an effective safeguard. No effective safeguard is possible against mismanagement.

This exemption is taxed one per cent annually and a tax of one-half of one per cent is put upon average deposits and capital not invested in United States bonds.

The law requires that each association shall, before the declaration of any
Dividends, carrying to its surplus fund one-tenth of its semi-annual net profit until the same shall amount to 20 per cent of its capital stock. Capital cannot be withdrawn either in the form of dividends or otherwise and losses and bad debts must be debited from net profits.

The estimated loss to the people from the destruction of crops and from failure to present for redemption is about one per cent which is a gain to the government and loss to the banks as is erroneously supposed, because the law provides that the banks shall deposit collateral with the Treasurer for the redemption of such notes.

The period of each note is allowed to continue in twenty years from
case of organization. Each bank is
governed by a board of five directors
who must own at least ten shares each
of stock unencumbered by debt. Three-
quarters of these directors must be resi-
dents of the state in which the bank is
established. Any violation of law with
their knowledge makes them liable to
stockholders for losses.

Fifty thousand dollars is the maxi-
mum of bonds required and if the
bonds depreciate an additional deposit
must be made to increase the notes perfe-
tly secure.

Banks with a capital of 50 to 500 dollars
and dollars receive 70 per cent of bonds
in metals; those with a capital of 500
dollars and as one million 80 per cent;
those with a capital of 1,000,000
15 per cent, and those with a capital of 3 millions and over 60 per cent.

Thus it will be seen that the comparatively small capitalists in large cities have an advantage over the wealthy capitalist, and the currency current at the same time concentrate in financial centres.

Prior to 1871 the aggregate state and national taxes levied upon banks amounted to 1½ per cent. Since that time it has been 3½ per cent. The banks have therefore borne their share of the public burden.

The crisis of 1873 is the only crisis in our history that has not brought on a bank panic and this was due to the instability of the national banking system. National banks
nearly have been paid dollar for dol-
lar and the average annual loss to creditors has been very much less
than in the case of other banks.
This has been possible because of
the perfect laws by which national
banks are governed.
Speculation is not countenanced and
legitimate business interests are pro-
etected. The few failures that have
occurred were occasional either by
criminal mismanagement on the
part of the officers or by neglect or
violation of the law on the part of the
directors. The dangers from these
cases are, as we have seen, reduced
to a minimum by the frequent, sys-
tematic inspection by public officials
of the affairs of the banks.
There are many reasons, overlooked by those who are unable to propose a better system, why the national banking system is deserving of great credit. The government lays the credit on its credit, as a temporary expedient for the exigencies of a great crisis, and, when it was no longer of assistance, the national banking system came, in the dark hour of need, to avert impending disaster. How well it has succeeded, has been abundantly shown by its history.

Had it not been for this system, the state banks would have continued, and their issue side by side with the government legal tenders would have made the financial situation simply appalling.
In return for the privileges conferred upon them by the government, national banks have rendered incalculable service. When the country was vacillating between a sound currency and government greenbacks, in the midst of the controversy, the national banks began and accomplished the resumption of specie payments at a great expense to themselves.

The interest on the public debt has been greatly reduced by the funding operations of national banks. The enormous saving to the government in the collection and disbursement of the revenue is due to the valuable assistance rendered by national banks. All this saving is enjoyed by the government and yet we hear not of the profits of national banks.
The services rendered by national banks to the public are of equal importance. To all classes they are of equal benefit. We have found by experience that the national bank currency possesses uniformity and is a safeguard against depreciation. What greater service could be conferred upon the capitalist than to secure him in the possession of his property and upon the laboring man than to protect him against the injury of a false standard of value. And yet the opponents
of the system inexcusable against it as a
reckless and grinding monopoly, and
inciting agencies to overthrow it are
not able to offer a better system.

To the commercial community the
system has rendered a service that can
not be overestimated. In reducing
the exchange and discount rates it
has effected a saving to that class ag-
gregating millions of dollars annually.
It is not necessary to multiply statis-
tics to prove that the old state system
had a directly opposite tendency.

The commercial banking system has
been objected to as a monopoly.
This is for prove the facts.
The right to organize a banking asso-
ciation is just as free as the right to
form a manufacturing or other in-

The bonds are always in the market and anyone with capital can purchase them and organize a national bank. Therefore the objections made to the early national banks which retiring even-compulsories do not apply to the present system.

Just as seen objection, again, that the right to determine the volume of the currency ought not to be surrendered to private associations. But since the volume of currency depends upon the demands of the business communities, who have a better right to determine the volume of our business currency.

It is significant fact that those who were once most strongly opposed to the system at its beginning have become its best friends and supporters.
We do not claim that the system is perfect but experience will continue to suggest as it has in the past, improvements in its details. Yet in the fundamental features it has already received the high commendation of acknowledged authorities in monetary science in this country. We may at some time devise a better system; but the present system is the best yet devised by the ingenuity of man.

In considering the future of the system it must not be forgotten that the present circulation rests largely upon bonds which will cease to exist when the national debt has been paid.

It is a saying that goes without ques-
tion that a national debt is not a blessing and the sooner it is paid off the better for the country and its burdens. This being the case the friends of the national banking system naturally feel some concern in regard to its future. If the national bank act can be still further improved, amended, and qualified, to secure not only stockholders but depositors and shareholders, any proposition looking in that direction will deserve careful consideration.

It is certain, however, that we cannot afford to go back to the old state laws; and it equally certain that the government cannot properly undertake to furnish a credit currency. Many suggestions and plans
have been offered in regard to perfecting the system. Some of these it would not be possible to adopt, while others would no doubt be practicable.

When bond security has entirely disappeared no other bond security is obtainable. Good State bonds cannot be secured in sufficient amounts to serve as security. Other bonds are not desirable as security for contracts, because they do not possess sufficient stability.

It is a sound principle that working is justifiable which results in more taxation than is needed to carry on the government. For this reason also the national debt cannot be continued according to sound principles of finance.
Bonds, therefore, are out of the question.

It has been proposed that a guaranty be made by all the banks for each other's notes, together with a change in the law that would give to note holders the first on the assets of a failed bank. But this guaranty could not be obtained, as the strong banks in large cities do not care about issuing circulating notes. An inducement for these banks it has been suggested that the fund from tax upon circulation be made a security for notes. This fund would have to be invested in something, and as it would not be policy to lock it up in gold coin it has been suggested that the fund be deposited in redemption banks at central points—
to be drawn upon only in case of
failures. The scheme is feasible because
the government does not need to lend
upon circulation. On the other hand
it may be said that it is not just
to require good banks to put up a fund
for poor banks. Other plans of a sim-
ilar nature have been proposed.

It is very difficult to arrive at a
plan for the regulation of the circu-
lation of national banks, but even
if the circulation does come to an
end it would be highly desirable to
continue the system in its functions
of deposit and discount, as the sys-
tem of inspection by public officers
is daily growing better.

In the consideration of this question
we must not overlook the fact that-
the national administration of laws pertaining to banks is better than State administration as we have found by costly experience.

Again it has been said, and with good reason, that the end of the circulation of national banks means the return to either the state bank system or the government paper money.

We have found out the results of national bank notes even either the state bank or the government paper money, and, if the issue is to be made between either of these and the national bank notes, the latter in some form are to be preferred.

If the old traditional habits in regard to paper money shall have as firm hold upon the people that it will
it is impossible to abandon paper money altogether and to resort entirely to honest gold and silver, as its only currency, there is but one course left — to adopt as a permanent system the national banking system which has been tried by the series of war and by the crisis of 1873 and which has been found to be better planned for service than any mechanical scheme of credit heretofore tested in this country.

N.C. Knisely.