

# WALTER BAGEHOT

LOMBARD STREET: A  
DESCRIPTION OF THE  
MONEY MARKET

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of the Money Market**

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Lombard Street: A Description of the Money Market:*

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# Walter Bagehot Lombard Street: A Description of the Money Market

## CHAPTER I

Introductory.

I venture to call this Essay 'Lombard Street,' and not the 'Money Market,' or any such phrase, because I wish to deal, and to show that I mean to deal, with concrete realities. A notion prevails that the Money Market is something so impalpable that it can only be spoken of in very abstract words, and that therefore books on it must always be exceedingly difficult. But I maintain that the Money Market is as concrete and real as anything else; that it can be described in as plain words; that it is the writer's fault if what he says is not clear. In one respect, however, I admit that I am about to take perhaps an unfair advantage. Half, and more than half, of the supposed 'difficulty' of the Money Market has arisen out of the controversies as to 'Peel's Act,' and the abstract discussions on the theory on which that act is based, or supposed to be based. But in the ensuing pages I mean to speak

as little as I can of the Act of 1844; and when I do speak of it, I shall deal nearly exclusively with its experienced effects, and scarcely at all, if at all, with its refined basis.

For this I have several reasons,—one, that if you say anything about the Act of 1844, it is little matter what else you say, for few will attend to it. Most critics will seize on the passage as to the Act, either to attack it or defend it, as if it were the main point. There has been so much fierce controversy as to this Act of Parliament—and there is still so much animosity—that a single sentence respecting it is far more interesting to very many than a whole book on any other part of the subject. Two hosts of eager disputants on this subject ask of every new writer the one question—Are you with us or against us? and they care for little else. Of course if the Act of 1844 really were, as is commonly thought, the *primum mobile* of the English Money Market, the source of all good according to some, and the source of all harm according to others, the extreme irritation excited by an opinion on it would be no reason for not giving a free opinion. A writer on any subject must not neglect its cardinal fact, for fear that others may abuse him. But, in my judgment, the Act of 1844 is only a subordinate matter in the Money Market; what has to be said on it has been said at disproportionate length; the phenomena connected with it have been magnified into greater relative importance than they at all deserve. We must never forget that a quarter of a century has passed since 1844, a period singularly remarkable for its material progress, and

almost marvellous in its banking development. Even, therefore, if the facts so much referred to in 1844 had the importance then ascribed to them, and I believe that in some respects they were even then overstated, there would be nothing surprising in finding that in a new world new phenomena had arisen which now are larger and stronger. In my opinion this is the truth: since 1844, Lombard Street is so changed that we cannot judge of it without describing and discussing a most vigorous adult world which then was small and weak. On this account I wish to say as little as is fairly possible of the Act of 1844, and, as far as I can, to isolate and dwell exclusively on the 'Post-Peel' agencies, so that those who have had enough of that well-worn theme (and they are very many) may not be wearied, and that the new and neglected parts of the subject may be seen as they really are.

The briefest and truest way of describing Lombard Street is to say that it is by far the greatest combination of economical power and economical delicacy that the world has even seen. Of the greatness of the power there will be no doubt. Money is economical power. Everyone is aware that England is the greatest moneyed country in the world; everyone admits that it has much more immediately disposable and ready cash than any other country. But very few persons are aware how much greater the ready balance—the floating loan-fund which can be lent to anyone or for any purpose—is in England than it is anywhere else in the world. A very few figures will show how large the London loan-fund is, and how much greater it is than any other.

The known deposits—the deposits of banks which publish their accounts—are, in

London (31st December, 1872) 120,000,000 L

Paris (27th February, 1873) 13,000,000 L

New York (February, 1873) 40,000,000 L

German Empire (31st January, 1873) 8,000,000 L

And the unknown deposits—the deposits in banks which do not publish their accounts—are in London much greater than those many other of these cities. The bankers' deposits of London are many times greater than those of any other city—those of Great Britain many times greater than those of any other country.

Of course the deposits of bankers are not a strictly accurate measure of the resources of a Money Market. On the contrary, much more cash exists out of banks in France and Germany, and in all non-banking countries, than could be found in England or Scotland, where banking is developed. But that cash is not, so to speak, 'money-market money:' it is not attainable. Nothing but their immense misfortunes, nothing but a vast loan in their own securities, could have extracted the hoards of France from the custody of the French people. The offer of no other securities would have tempted them, for they had confidence in no other securities. For all other purposes the money hoarded was useless and might as well not have been hoarded. But the English money is 'borrowable' money. Our people are bolder in dealing with their money than any continental nation, and even if they were not bolder, the mere fact that their money is deposited in a bank

makes it far more obtainable. A million in the hands of a single banker is a great power; he can at once lend it where he will, and borrowers can come to him, because they know or believe that he has it. But the same sum scattered in tens and fifties through a whole nation is no power at all: no one knows where to find it or whom to ask for it. Concentration of money in banks, though not the sole cause, is the principal cause which has made the Money Market of England so exceedingly rich, so much beyond that of other countries.

The effect is seen constantly. We are asked to lend, and do lend, vast sums, which it would be impossible to obtain elsewhere. It is sometimes said that any foreign country can borrow in Lombard Street at a price: some countries can borrow much cheaper than others; but all, it is said, can have some money if they choose to pay enough for it. Perhaps this is an exaggeration; but confined, as of course it was meant to be, to civilised Governments, it is not much of an exaggeration. There are very few civilised Governments that could not borrow considerable sums of us if they choose, and most of them seem more and more likely to choose. If any nation wants even to make a railway—especially at all a poor nation—it is sure to come to this country—to the country of banks—for the money. It is true that English bankers are not themselves very great lenders to foreign states. But they are great lenders to those who lend. They advance on foreign stocks, as the phrase is, with 'a margin;' that is, they find eighty per cent of the money, and the nominal lender

finds the rest. And it is in this way that vast works are achieved with English aid which but for that aid would never have been planned.

In domestic enterprises it is the same. We have entirely lost the idea that any undertaking likely to pay, and seen to be likely, can perish for want of money; yet no idea was more familiar to our ancestors, or is more common now in most countries. A citizen of London in Queen Elizabeth's time could not have imagined our state of mind. He would have thought that it was of no use inventing railways (if he could have understood what a railway meant), for you would not have been able to collect the capital with which to make them. At this moment, in colonies and all rude countries, there is no large sum of transferable money; there is no fund from which you can borrow, and out of which you can make immense works. Taking the world as a whole—either now or in the past—it is certain that in poor states there is no spare money for new and great undertakings, and that in most rich states the money is too scattered, and clings too close to the hands of the owners, to be often obtainable in large quantities for new purposes. A place like Lombard Street, where in all but the rarest times money can be always obtained upon good security or upon decent prospects of probable gain, is a luxury which no country has ever enjoyed with even comparable equality before.

But though these occasional loans to new enterprises and foreign States are the most conspicuous instances of the power of Lombard Street, they are not by any means the most remarkable

or the most important use of that power. English trade is carried on upon borrowed capital to an extent of which few foreigners have an idea, and none of our ancestors could have conceived. In every district small traders have arisen, who 'discount their bills' largely, and with the capital so borrowed, harass and press upon, if they do not eradicate, the old capitalist. The new trader has obviously an immense advantage in the struggle of trade. If a merchant have 50,000 L. all his own, to gain 10 per cent on it he must make 5,000 L. a year, and must charge for his goods accordingly; but if another has only 10,000 L., and borrows 40,000 L. by discounts (no extreme instance in our modern trade), he has the same capital of 50,000 L. to use, and can sell much cheaper. If the rate at which he borrows be 5 per cent., he will have to pay 2,000 L. a year; and if, like the old trader, he make 5,000 L. a year, he will still, after paying his interest, obtain 3,000 L. a year, or 30 per cent, on his own 10,000 L. As most merchants are content with much less than 30 per cent, he will be able, if he wishes, to forego some of that profit, lower the price of the commodity, and drive the old-fashioned trader—the man who trades on his own capital—out of the market. In modern English business, owing to the certainty of obtaining loans on discount of bills or otherwise at a moderate rate of interest, there is a steady bounty on trading with borrowed capital, and a constant discouragement to confine yourself solely or mainly to your own capital.

This increasingly democratic structure of English commerce

is very unpopular in many quarters, and its effects are no doubt exceedingly mixed. On the one hand, it prevents the long duration of great families of merchant princes, such as those of Venice and Genoa, who inherited nice cultivation as well as great wealth, and who, to some extent, combined the tastes of an aristocracy with the insight and verve of men of business. These are pushed out, so to say, by the dirty crowd of little men. After a generation or two they retire into idle luxury. Upon their immense capital they can only obtain low profits, and these they do not think enough to compensate them for the rough companions and rude manners they must meet in business. This constant levelling of our commercial houses is, too, unfavourable to commercial morality. Great firms, with a reputation which they have received from the past, and which they wish to transmit to the future, cannot be guilty of small frauds. They live by a continuity of trade, which detected fraud would spoil. When we scrutinise the reason of the impaired reputation of English goods, we find it is the fault of new men with little money of their own, created by bank 'discounts.' These men want business at once, and they produce an inferior article to get it. They rely on cheapness, and rely successfully.

But these defects and others in the democratic structure of commerce are compensated by one great excellence. No country of great hereditary trade, no European country at least, was ever so little 'sleepy,' to use the only fit word, as England; no other was ever so prompt at once to seize new advantages. A country

dependent mainly on great 'merchant princes' will never be so prompt; their commerce perpetually slips more and more into a commerce of routine. A man of large wealth, however intelligent, always thinks, more or less 'I have a great income, and I want to keep it. If things go on as they are I shall certainly keep it; but if they change I may not keep it.' Consequently he considers every change of circumstance a 'bore,' and thinks of such changes as little as he can. But a new man, who has his way to make in the world, knows that such changes are his opportunities; he is always on the look-out for them, and always heeds them when he finds them. The rough and vulgar structure of English commerce is the secret of its life; for it contains 'the propensity to variation,' which, in the social as in the animal kingdom, is the principle of progress.

In this constant and chronic borrowing, Lombard Street is the great go-between. It is a sort of standing broker between quiet saving districts of the country and the active employing districts. Why particular trades settled in particular places it is often difficult to say; but one thing is certain, that when a trade has settled in any one spot, it is very difficult for another to oust it—impossible unless the second place possesses some very great intrinsic advantage. Commerce is curiously conservative in its homes, unless it is imperiously obliged to migrate. Partly from this cause, and partly from others, there are whole districts in England which cannot and do not employ their own money. No purely agricultural county does so. The savings of a county with

good land but no manufactures and no trade much exceed what can be safely lent in the county. These savings are first lodged in the local banks, are by them sent to London, and are deposited with London bankers, or with the bill brokers. In either case the result is the same. The money thus sent up from the accumulating districts is employed in discounting the bills of the industrial districts. Deposits are made with the bankers and bill brokers in Lombard Street by the bankers of such counties as Somersetshire and Hampshire, and those bill brokers and bankers employ them in the discount of bills from Yorkshire and Lancashire. Lombard Street is thus a perpetual agent between the two great divisions of England, between the rapidly-growing districts, where almost any amount of money can be well and easily employed, and the stationary and the declining districts, where there is more money than can be used.

This organisation is so useful because it is so easily adjusted. Political economists say that capital sets towards the most profitable trades, and that it rapidly leaves the less profitable and non-paying trades. But in ordinary countries this is a slow process, and some persons who want to have ocular demonstration of abstract truths have been inclined to doubt it because they could not see it. In England, however, the process would be visible enough if you could only see the books of the bill brokers and the bankers. Their bill cases as a rule are full of the bills drawn in the most profitable trades, and *caeteris paribus* and in comparison empty of those drawn in the less profitable.

If the iron trade ceases to be as profitable as usual, less iron is sold; the fewer the sales the fewer the bills; and in consequence the number of iron bills in Lombard street is diminished. On the other hand, if in consequence of a bad harvest the corn trade becomes on a sudden profitable, immediately 'corn bills' are created in great numbers, and if good are discounted in Lombard Street. Thus English capital runs as surely and instantly where it is most wanted, and where there is most to be made of it, as water runs to find its level.

This efficient and instantly-ready organisation gives us an enormous advantage in competition with less advanced countries—less advanced, that is, in this particular respect of credit. In a new trade English capital is instantly at the disposal of persons capable of understanding the new opportunities and of making good use of them. In countries where there is little money to lend, and where that little is lent tardily and reluctantly, enterprising traders are long kept back, because they cannot at once borrow the capital, without which skill and knowledge are useless. All sudden trades come to England, and in so doing often disappoint both rational probability and the predictions of philosophers. The Suez Canal is a curious case of this. All predicted that the canal would undo what the discovery of the passage to India round the Cape effected. Before that all Oriental trade went to ports in the South of Europe, and was thence diffused through Europe. That London and Liverpool should be centres of East Indian commerce is a geographical anomaly, which the Suez Canal, it

was said, would rectify. 'The Greeks,' said M. de Tocqueville, 'the Styrians, the Italians, the Dalmatians, and the Sicilians, are the people who will use the Canal if any use it.' But, on the contrary, the main use of the Canal has been by the English. None of the nations named by Tocqueville had the capital, or a tithe of it, ready to build the large screw steamers which alone can use the Canal profitably. Ultimately these plausible predictions may or may not be right, but as yet they have been quite wrong, not because England has rich people—there are wealthy people in all countries—but because she possesses an unequalled fund of floating money, which will help in a moment any merchant who sees a great prospect of new profit.

And not only does this unconscious 'organisation of capital,' to use a continental phrase, make the English specially quick in comparison with their neighbours on the continent at seizing on novel mercantile opportunities, but it makes them likely also to retain any trade on which they have once regularly fastened. Mr. Macculloch, following Ricardo, used to teach that all old nations had a special aptitude for trades in which much capital is required. The interest of capital having been reduced in such countries, he argued, by the necessity of continually resorting to inferior soils, they can undersell countries where profit is high in all trades needing great capital. And in this theory there is doubtless much truth, though it can only be applied in practice after a number of limitations and with a number of deductions of which the older school of political economists

did not take enough notice. But the same principle plainly and practically applies to England, in consequence of her habitual use of borrowed capital. As has been explained, a new man, with a small capital of his own and a large borrowed capital, can undersell a rich man who depends on his own capital only. The rich man wants the full rate of mercantile profit on the whole of the capital employed in his trade, but the poor man wants only the interest of money (perhaps not a third of the rate of profit) on very much of what he uses, and therefore an income will be an ample recompense to the poor man which would starve the rich man out of the trade. All the common notions about the new competition of foreign countries with England and its dangers— notions in which there is in other aspects much truth require to be reconsidered in relation to this aspect. England has a special machinery for getting into trade new men who will be content with low prices, and this machinery will probably secure her success, for no other country is soon likely to rival it effectually.

There are many other points which might be insisted on, but it would be tedious and useless to elaborate the picture. The main conclusion is very plain—that English trade is become essentially a trade on borrowed capital, and that it is only by this refinement of our banking system that we are able to do the sort of trade we do, or to get through the quantity of it.

But in exact proportion to the power of this system is its delicacy I should hardly say too much if I said its danger. Only our familiarity blinds us to the marvellous nature of the system.

There never was so much borrowed money collected in the world as is now collected in London. Of the many millions in Lombard street, infinitely the greater proportion is held by bankers or others on short notice or on demand; that is to say, the owners could ask for it all any day they please: in a panic some of them do ask for some of it. If any large fraction of that money really was demanded, our banking system and our industrial system too would be in great danger.

Some of those deposits too are of a peculiar and very distinct nature. Since the Franco-German war, we have become to a much larger extent than before the Bankers of Europe. A very large sum of foreign money is on various accounts and for various purposes held here. And in a time of panic it might be asked for. In 1866 we held only a much smaller sum of foreign money, but that smaller sum was demanded and we had to pay it at great cost and suffering, and it would be far worse if we had to pay the greater sums we now hold, without better resources than we had then.

It may be replied, that though our instant liabilities are great, our present means are large; that though we have much we may be asked to pay at any moment, we have very much always ready to pay it with. But, on the contrary, there is no country at present, and there never was any country before, in which the ratio of the cash reserve to the bank deposits was so small as it is now in England. So far from our being able to rely on the proportional magnitude of our cash in hand, the amount of that

cash is so exceedingly small that a bystander almost trembles when he compares its minuteness with the immensity of the credit which rests upon it.

Again, it may be said that we need not be alarmed at the magnitude of our credit system or at its refinement, for that we have learned by experience the way of controlling it, and always manage it with discretion. But we do not always manage it with discretion. There is the astounding instance of Overend, Gurney, and Co. to the contrary. Ten years ago that house stood next to the Bank of England in the City of London; it was better known abroad than any similar firm known, perhaps, better than any purely English firm. The partners had great estates, which had mostly been made in the business. They still derived an immense income from it. Yet in six years they lost all their own wealth, sold the business to the company, and then lost a large part of the company's capital. And these losses were made in a manner so reckless and so foolish, that one would think a child who had lent money in the City of London would have lent it better. After this example, we must not confide too surely in long-established credit, or in firmly-rooted traditions of business. We must examine the system on which these great masses of money are manipulated, and assure ourselves that it is safe and right.

But it is not easy to rouse men of business to the task. They let the tide of business float before them; they make money or strive to do so while it passes, and they are unwilling to think where it is going. Even the great collapse of Overends, though it caused a

panic, is beginning to be forgotten. Most men of business think —'Anyhow this system will probably last my time. It has gone on a long time, and is likely to go on still.' But the exact point is, that it has not gone on a long time. The collection of these immense sums in one place and in few hands is perfectly new. In 1844 the liabilities of the four great London Joint Stock Banks were 10,637,000 L.; they now are more than 60,000,000 L. The private deposits of the Bank of England then were 9,000,000 L.; they now are 8,000,000 L. There was in throughout the country but a fraction of the vast deposit business which now exists. We cannot appeal, therefore, to experience to prove the safety of our system as it now is, for the present magnitude of that system is entirely new. Obviously a system may be fit to regulate a few millions, and yet quite inadequate when it is set to cope with many millions. And thus it may be with 'Lombard Street,' so rapid has been its growth, and so unprecedented is its nature.

I am by no means an alarmist. I believe that our system, though curious and peculiar, may be worked safely; but if we wish so to work it, we must study it. We must not think we have an easy task when we have a difficult task, or that we are living in a natural state when we are really living in an artificial one. Money will not manage itself, and Lombard street has a great deal of money to manage.

# CHAPTER II

A General View of Lombard Street.

# I

The objects which you see in Lombard Street, and in that money world which is grouped about it, are the Bank of England, the Private Banks, the Joint Stock Banks, and the bill brokers. But before describing each of these separately we must look at what all have in common, and at the relation of each to the others.

The distinctive function of the banker, says Ricardo, 'begins as soon as he uses the money of others;' as long as he uses his own money he is only a capitalist. Accordingly all the banks in Lombard Street (and bill brokers are for this purpose only a kind of bankers) hold much money belonging to other people on running account and on deposit. In continental language, Lombard Street is an organization of credit, and we are to see if it is a good or bad organization in its kind, or if, as is most likely, it turns out to be mixed, what are its merits and what are its defects?

The main point on which one system of credit differs from another is 'soundness.' Credit means that a certain confidence is given, and a certain trust reposed. Is that trust justified? and is that confidence wise? These are the cardinal questions. To put it more simply—credit is a set of promises to pay; will those promises be kept? Especially in banking, where the 'liabilities,' or promises to pay, are so large, and the time at which to pay them, if exacted, is so short, an instant capacity to meet engagements is the cardinal excellence.

All which a banker wants to pay his creditors is a sufficient supply of the legal tender of the country, no matter what that legal tender may be. Different countries differ in their laws of legal tender, but for the primary purposes of banking these systems are not material. A good system of currency will benefit the country, and a bad system will hurt it. Indirectly, bankers will be benefited or injured with the country in which they live; but practically, and for the purposes of their daily life, they have no need to think, and never do think, on theories of currency. They look at the matter simply. They say 'I am under an obligation to pay such and such sums of legal currency; how much have I in my till, or have I at once under my command, of that currency?' In America, for example, it is quite enough for a banker to hold 'greenbacks,' though the value of these changes as the Government chooses to enlarge or contract the issue. But a practical New York banker has no need to think of the goodness or badness of this system at all; he need only keep enough 'greenbacks' to pay all probable demands, and then he is fairly safe from the risk of failure.

By the law of England the legal tenders are gold and silver coin (the last for small amounts only), and Bank of England notes. But the number of our attainable bank notes is not, like American 'greenbacks,' dependent on the will of the State; it is limited by the provisions of the Act of 1844. That Act separates the Bank of England into two halves. The Issue Department only issues notes, and can only issue 15,000,000 L. on Government securities; for all the rest it must have bullion deposited. Take, for example an

account, which may be considered an average specimen of those of the last few years—that for the last week of 1869:

*An account pursuant to the Act 7th and 8th Victoria, cap. 32, for the week ending on Wednesday, the 29th day of December, 1869.*

### **ISSUE DEPARTMENT.**

Notes issued 33,288,640 L | Government debt 11,015,100 L

| Other securities 3,984,900 L

| Gold coin and bullion 18,288,640 L

| Silver bullion

33,288,640 | 33,288,640 L

### **BANKING DEPARTMENT.**

Proprietors' capital 14,553,000 L | Government Securities  
13,811,953 L

Rest 3,103,301 L | Other securities 19,781,988 L

Public deposits, | Notes 10,389,690 L

including Exchequer, | Gold and silver coins 907,982 L

Savings' Banks, |

Commissioners of |

National Debt, |

and dividend |

accounts 8,585,215 L |

Other deposits 18,204,607 L |

Seven-day and other |

bills 445,490 L |

44,891,613 L| 44,891,613 L

GEO. FORBES, Chief Cashier.

Dated the 30th December, 1869.

There are here 15,000,000 L. bank notes issued on securities, and 18,288,640 L. represented by bullion. The Bank of England has no power by law to increase the currency in any other manner. It holds the stipulated amount of securities, and for all the rest it must have bullion. This is the 'cast iron' system—the 'hard and fast' line which the opponents of the Act say ruins us, and which the partizans of the Act say saves us. But I have nothing to do with its expediency here. All which is to my purpose is that our paper 'legal tender,' our bank notes, can only be obtained in this manner. If, therefore, an English banker retains a sum of Bank of England notes or coin in due proportion to his liabilities, he has a sufficient amount of the legal tender of this country, and he need not think of anything more.

But here a distinction must be made. It is to be observed that properly speaking we should not include in the 'reserve' of a bank 'legal tenders,' or cash, which the Bank keeps to transact its daily business. That is as much a part of its daily stock-in-trade as its desks or offices; or at any rate, whatever words we may choose to use, we must carefully distinguish between this cash in the till which is wanted every day, and the safety-fund, as we may call it, the special reserve held by the bank to meet extraordinary and unfrequent demands.

What then, subject to this preliminary explanation, is the

amount of legal tender held by our bankers against their liabilities? The answer is remarkable, and is the key to our whole system. It may be broadly said that no bank in London or out of it holds any considerable sum in hard cash or legal tender (above what is wanted for its daily business) except the Banking Department of the Bank of England. That department had on the 29th day of December, 1869, liabilities as follows:

Public deposits 8,585,000 L

Private deposits 18,205,000 L

Seven-day and other bills 445,000 L

—

Total 27,235,000 L

and a cash reserve of 11,297,000 L. And this is all the cash reserve, we must carefully remember, which, under the law, the Banking Department of the Bank of England—as we cumbrously call it the Bank of England for banking purposes—possesses. That department can no more multiply or manufacture bank notes than any other bank can multiply them. At that particular day the Bank of England had only 11,297,000 L. in its till against liabilities of nearly three times the amount. It had 'Consols' and other securities which it could offer for sale no doubt, and which, if sold, would augment its supply of bank notes—and the relation of such securities to real cash will be discussed presently; but of real cash, the Bank of England for this purpose—the banking bank—had then so much and no more.

And we may well think this a great deal, if we examine the

position of other banks. No other bank holds any amount of substantial importance in its own till beyond what is wanted for daily purposes. All London banks keep their principal reserve on deposit at the Banking Department of the Bank of England. This is by far the easiest and safest place for them to use. The Bank of England thus has the responsibility of taking care of it. The same reasons which make it desirable for a private person to keep a banker make it also desirable for every banker, as respects his reserve, to bank with another banker if he safely can. The custody of very large sums in solid cash entails much care, and some cost; everyone wishes to shift these upon others if he can do so without suffering. Accordingly, the other bankers of London, having perfect confidence in the Bank of England, get that bank to keep their reserve for them.

The London bill brokers do much the same. Indeed, they are only a special sort of bankers who allow daily interest on deposits, and who for most of their money give security. But we have no concern now with these differences of detail. The bill brokers lend most of their money, and deposit the remnant either with the Bank of England or some London banker. That London banker lends what he chooses of it, the rest he leaves at the Bank of England. You always come back to the Bank of England at last. But those who keep immense sums with a banker gain a convenience at the expense of a danger. They are liable to lose them if the bank fail. As all other bankers keep their banking reserve at the Bank of England, they are liable to fail if it fails.

They are dependent on the management of the Bank of England in a day of difficulty and at a crisis for the spare money they keep to meet that difficulty and crisis. And in this there is certainly considerable risk. Three times 'Peel's Act' has been suspended because the Banking Department was empty. Before the Act was broken—

In 1847, the Banking Department was reduced to L 1,994,000 1857 " " L 1,462,000 1866 " " L 3,000,000

In fact, in none of those years could the Banking Department of the Bank of England have survived if the law had not been broken. Nor must it be fancied that this danger is unreal, artificial, and created by law. There is a risk of our thinking so, because we hear that the danger can be cured by breaking an Act; but substantially the same danger existed before the Act. In 1825, when only coin was a legal tender, and when there was only one department in the Bank, the Bank had reduced its reserve to 1,027,000 L., and was within an ace of stopping payment.

But the danger to the depositing banks is not the sole or the principal consequence of this mode of keeping the London reserve. The main effect is to cause the reserve to be much smaller in proportion to the liabilities than it would otherwise be. The reserve of the London bankers being on deposit in the Bank of England, the Bank always lends a principal part of it. Suppose, a favourable supposition, that the Banking Department holds more than two-fifths of its liabilities in cash—that it lends three-fifths of its deposits and retains in reserve only two-fifths. If then

the aggregate of the bankers' deposited reserve be 5,000,000 L., 3,000,000 L. of it will be lent by the Banking Department, and 2,000,000 L. will be kept in the till. In consequence, that 2,000,000 L. is all which is really held in actual cash as against the liabilities of the depositing banks. If Lombard Street were on a sudden thrown into liquidation, and made to pay as much as it could on the spot, that 2,000,000 L. would be all which the Bank of England could pay to the depositing banks, and consequently all, besides the small cash in the till, which those banks could on a sudden pay to the persons who have deposited with them.

We see then that the banking reserve of the Bank of England—some 10,000,000 L. on an average of years now, and formerly much less—is all which is held against the liabilities of Lombard Street; and if that were all, we might well be amazed at the immense development of our credit system—in plain English, at the immense amount of our debts payable on demand, and the smallness of the sum of actual money which we keep to pay them if demanded. But there is more to come. Lombard Street is not only a place requiring to keep a reserve, it is itself a place where reserves are kept. All country bankers keep their reserve in London. They only retain in each country town the minimum of cash necessary to the transaction of the current business of that country town. Long experience has told them to a nicety how much this is, and they do not waste capital and lose profit by keeping more idle. They send the money to London, invest a part of it in securities, and keep the rest with the London bankers and

the bill brokers. The habit of Scotch and Irish bankers is much the same. All their spare money is in London, and is invested as all other London money now is; and, therefore, the reserve in the Banking Department of the Bank of England is the banking reserve not only of the Bank of England, but of all London—and not only of all London, but of all England, Ireland, and Scotland too.

Of late there has been a still further increase in our liabilities. Since the Franco-German war, we may be said to keep the European reserve also. Deposit Banking is indeed so small on the Continent, that no large reserve need be held on account of it. A reserve of the same sort which is needed in England and Scotland is not needed abroad. But all great communities have at times to pay large sums in cash, and of that cash a great store must be kept somewhere. Formerly there were two such stores in Europe, one was the Bank of France, and the other the Bank of England. But since the suspension of specie payments by the Bank of France, its use as a reservoir of specie is at an end. No one can draw a cheque on it and be sure of getting gold or silver for that cheque. Accordingly the whole liability for such international payments in cash is thrown on the Bank of England. No doubt foreigners cannot take from us our own money; they must send here 'value in some shape or other for all they take away. But they need not send 'cash;' they may send good bills and discount them in Lombard Street and take away any part of the produce, or all the produce, in bullion. It is only putting the same point in other

words to say that all exchange operations are centering more and more in London. Formerly for many purposes Paris was a European settling-house, but now it has ceased to be so. The note of the Bank of France has not indeed been depreciated enough to disorder ordinary transactions. But any depreciation, however small—even the liability to depreciation without its reality—is enough to disorder exchange transactions. They are calculated to such an extremity of fineness that the change of a decimal may be fatal, and may turn a profit into a loss. Accordingly London has become the sole great settling-house of exchange transactions in Europe, instead of being formerly one of two. And this pre-eminence London will probably maintain, for it is a natural pre-eminence. The number of mercantile bills drawn upon London incalculably surpasses those drawn on any other European city; London is the place which receives more than any other place, and pays more than any other place, and therefore it is the natural 'clearing house.' The pre-eminence of Paris partly arose from a distribution of political power, which is already disturbed; but that of London depends on the regular course of commerce, which is singularly stable and hard to change.

Now that London is the clearing-house to foreign countries, London has a new liability to foreign countries. At whatever place many people have to make payments, at that place those people must keep money. A large deposit of foreign money in London is now necessary for the business of the world. During the immense payments from France to Germany, the sum *in transitu*—the sum

in London has perhaps been unusually large. But it will ordinarily be very great. The present political circumstances no doubt will soon change. We shall soon hold in Lombard Street far less of the money of foreign governments; but we shall hold more and more of the money of private persons; for the deposit at a clearing-house necessary to settle the balance of commerce must tend to increase as that commerce itself increases.

And this foreign deposit is evidently of a delicate and peculiar nature. It depends on the good opinion of foreigners, and that opinion may diminish or may change into a bad opinion. After the panic of 1866, especially after the suspension of Peel's Act (which many foreigners confound with a suspension of cash payments), a large amount of foreign money was withdrawn from London. And we may reasonably presume that in proportion as we augment the deposits of cash by foreigners in London, we augment both the chances and the disasters of a 'run' upon England.

And if that run should happen, the bullion to meet it must be taken from the Bank. There is no other large store in the country. The great exchange dealers may have a little for their own purposes, but they have no store worth mentioning in comparison with this. If a foreign creditor is so kind as to wait his time and buy the bullion as it comes into the country, he may be paid without troubling the Bank or distressing the money market. The German Government has recently been so kind; it was in no respect afraid. But a creditor who takes fright will not wait, and if

he wants bullion in a hurry he must come to the Bank of England.

In consequence all our credit system depends on the Bank of England for its security. On the wisdom of the directors of that one Joint Stock Company, it depends whether England shall be solvent or insolvent. This may seem too strong, but it is not. All banks depend on the Bank of England, and all merchants depend on some banker. If a merchant have 10,000 L. at his bankers, and wants to pay it to some one in Germany, he will not be able to pay it unless his banker can pay him, and the banker will not be able to pay if the Bank of England should be in difficulties and cannot produce his 'reserve.'

The directors of the Bank are, therefore, in fact, if not in name, trustees for the public, to keep a banking reserve on their behalf; and it would naturally be expected either that they distinctly recognized this duty and engaged to perform it, or that their own self-interest was so strong in the matter that no engagement was needed. But so far from there being a distinct undertaking on the part of the Bank directors to perform this duty, many of them would scarcely acknowledge it, and some altogether deny it. Mr. Hankey, one of the most careful and most experienced of them, says in his book on the Bank of England, the best account of the practice and working of the Bank which anywhere exists—'I do not intend here to enter at any length on the subject of the general management of the Bank, meaning the Banking Department, as the principle upon which the business is conducted does not differ, as far as I am aware, from that of

any well-conducted bank in London.' But, as anyone can see by the published figures, the Banking Department of the Bank of England keeps as a great reserve in bank notes and coin between 30 and 50 per cent of its liabilities, and the other banks only keep in bank notes and coin the bare minimum they need to open shop with. And such a constant difference indicates, I conceive, that the two are not managed on the same principle.

The practice of the Bank has, as we all know, been much and greatly improved. They do not now manage like the other Banks in Lombard Street. They keep an altogether different kind and quantity of reserve; but though the practice is mended the theory is not. There has never been a distinct resolution passed by the Directors of the Bank of England, and communicated by them to the public, stating even in the most general manner, how much reserve they mean to keep or how much they do not mean, or by what principle in this important matter they will be guided.

The position of the Bank directors is indeed most singular. On the one side a great city opinion—a great national opinion, I may say, for the nation has learnt much from many panics—requires the directors to keep a large reserve. The newspapers, on behalf of the nation, are always warning the directors to keep it, and watching that they do keep it; but, on the other hand, another less visible but equally constant pressure pushes the directors in exactly the reverse way, and inclines them to diminish the reserve.

This is the natural desire of all directors to make a good

dividend for their shareholders. The more money lying idle the less, *caeteris paribus*, is the dividend; the less money lying idle the greater is the dividend. And at almost every meeting of the proprietors of the Bank of England, there is a conversation on this subject. Some proprietor says that he does not see why so much money is kept idle, and hints that the dividend ought to be more.

Indeed, it cannot be wondered at that the Bank proprietors do not quite like their position. Theirs is the oldest bank in the City, but their profits do not increase, while those of other banks most rapidly increase. In 1844, the dividend on the stock of the Bank of England was 7 per cent, and the price of the stock itself 212; the dividend now is 9 per cent, and the price of the stock 232. But in the same time the shares of the London and Westminster Bank, in spite of an addition of 100 per cent to the capital, have risen from 27 to 66, and the dividend from 6 per cent to 20 per cent. That the Bank proprietors should not like to see other companies getting richer than their company is only natural.

Some part of the lowness of the Bank dividend, and of the consequent small value of Bank stock, is undoubtedly caused by the magnitude of the Bank capital; but much of it is also due to the great amount of unproductive cash—of cash which yields no interest—that the Banking Department of the Bank of England keeps lying idle. If we compare the London and Westminster Bank—which is the first of the joint-stock banks in the public estimation and known to be very cautiously and

carefully managed—with the Bank of England, we shall see the difference at once. The London and Westminster has only 13 per cent of its liabilities lying idle. The Banking Department of the Bank of England has over 40 per cent. So great a difference in the management must cause, and does cause, a great difference in the profits. Inevitably the shareholders of the Bank of England will dislike this great difference; more or less, they will always urge their directors to diminish (as far as possible) the unproductive reserve, and to augment as far as possible their own dividend.

In most banks there would be a wholesome dread restraining the desire of the shareholders to reduce the reserve; they would fear to impair the credit of the bank. But fortunately or unfortunately, no one has any fear about the Bank of England. The English world at least believes that it will not, almost that it cannot, fail. Three times since 1844 the Banking Department has received assistance, and would have failed without it. In 1825, the entire concern almost suspended payment; in 1797, it actually did so. But still there is a faith in the Bank, contrary to experience, and despising evidence. No doubt in every one of these years the condition of the Bank, divided or undivided, was in a certain sense most sound; it could ultimately have paid all its creditors all it owed, and returned to its shareholders all their own capital. But ultimate payment is not what the creditors of a bank want; they want present, not postponed, payment; they want to be repaid according to agreement; the contract was that they should be paid on demand, and if they are not paid on demand they may be

ruined. And that instant payment, in the years I speak of, the Bank of England certainly could not have made. But no one in London ever dreams of questioning the credit of the Bank, and the Bank never dreams that its own credit is in danger. Somehow everybody feels the Bank is sure to come right. In 1797, when it had scarcely any money left, the Government said not only that it need not pay away what remained, but that it must not. The 'effect of letters of licence' to break Peel's Act has confirmed the popular conviction that the Government is close behind the Bank, and will help it when wanted. Neither the Bank nor the Banking Department have ever had an idea of being put 'into liquidation;' most men would think as soon of 'winding up' the English nation.

Since then the Bank of England, as a bank, is exempted from the perpetual apprehension that makes other bankers keep a large reserve the apprehension of discredit—it would seem particularly necessary that its managers should be themselves specially interested in keeping that reserve, and specially competent to keep it. But I need not say that the Bank directors have not their personal fortune at stake in the management of the Bank. They are rich City merchants, and their stake in the Bank is trifling in comparison with the rest of their wealth. If the Bank were wound up, most of them would hardly in their income feel the difference. And what is more, the Bank directors are not trained bankers; they were not bred to the trade, and do not in general give the main power of their minds to it. They are

merchants, most of whose time and most of whose real mind are occupied in making money in their own business and for themselves.

It might be expected that as this great public duty was cast upon the Banking Department of the Bank, the principal statesmen (if not Parliament itself) would have enjoined on them to perform it. But no distinct resolution of Parliament has ever enjoined it; scarcely any stray word of any influential statesman. And, on the contrary, there is a whole *catena* of authorities, beginning with Sir Robert Peel and ending with Mr. Lowe, which say that the Banking Department of the Bank of England is only a Bank like any other bank—a Company like other companies; that in this capacity it has no peculiar position, and no public duties at all. Nine-tenths of English statesmen, if they were asked as to the management of the Banking Department of the Bank of England, would reply that it was no business of theirs or of Parliament at all; that the Banking Department alone must look to it.

The result is that we have placed the exclusive custody of our entire banking reserve in the hands of a single board of directors not particularly trained for the duty—who might be called 'amateurs,' who have no particular interest above other people in keeping it undiminished—who acknowledge no obligation to keep it undiminished who have never been told by any great statesman or public authority that they are so to keep it or that they have anything to do with it who are named by and are agents

for a proprietary which would have a greater income if it was diminished, who do not fear, and who need not fear, ruin, even if it were all gone and wasted.

That such an arrangement is strange must be plain; but its strangeness can only be comprehended when we know what the custody of a national banking reserve means, and how delicate and difficult it is.

## II

Such a reserve as we have seen is kept to meet sudden and unexpected demands. If the bankers of a country are asked for much more than is commonly wanted, then this reserve must be resorted to. What then are these extra demands? and how is this extra reserve to be used? Speaking broadly, these extra demands are of two kinds—one from abroad to meet foreign payments requisite to pay large and unusual foreign debts, and the other from at home to meet sudden apprehension or panic arising in any manner, rational or irrational.

No country has ever been so exposed as England to a foreign demand on its banking reserve, not only because at present England is a large borrower from foreign nations, but also (and much more) because no nation has ever had a foreign trade of such magnitude, in such varied objects, or so ramified through the world. The ordinary foreign trade of a country requires no cash; the exports on one side balance the imports on the other. But a sudden trade of import like the import of foreign corn after a bad harvestor (what is much less common, though there are cases of it) the cessation of any great export, causes a balance to become due, which must be paid in cash.

Now, the only source from which large sums of cash can be withdrawn in countries where banking is at all developed, is a 'bank reserve.' In England especially, except a few sums of no

very considerable amount held by bullion dealers in the course of their business, there are no sums worth mentioning in cash out of the banks; an ordinary person could hardly pay a serious sum without going to some bank, even if he spent a month in trying. All persons who wish to pay a large sum in cash trench of necessity on the banking reserve. But then what is 'cash?' Within a country the action of a Government can settle the quantity, and therefore the value, of its currency; but outside its own country, no Government can do so. Bullion is the cash' of international trade; paper currencies are of no use there, and coins pass only as they contain more or less bullion.

When then the legal tender of a country is purely metallic, all that is necessary is that banks should keep a sufficient store of that 'legal tender.' But when the 'legal tender' is partly metal and partly paper, it is necessary that the paper 'legal tender'—the bank note—should be convertible into bullion. And here I should pass my limits, and enter on the theory of Peel's Act if I began to discuss the conditions of convertibility. I deal only with the primary pre-requisite of effectual foreign payments—a sufficient supply of the local legal tender; with the afterstep—the change of the local legal tender into the universally acceptable commodity cannot deal.

What I have to deal with is, for the present, ample enough. The Bank of England must keep a reserve of 'legal tender' to be used for foreign payments if itself fit, and to be used in obtaining bullion if itself unfit. And foreign payments are sometimes very

large, and often very sudden. The 'cotton drain,' as it is called—the drain to the East to pay for Indian cotton during the American Civil War took many millions from this country for a series of years. A bad harvest must take millions in a single year. In order to find such great sums, the Bank of England requires the steady use of an effectual instrument.

That instrument is the elevation of the rate of interest. If the interest of money be raised, it is proved by experience that money does come to Lombard Street, and theory shows that it ought to come. To fully explain the matter I must go deep into the theory of the exchanges, but the general notion is plain enough. Loanable capital, like every other commodity, comes where there is most to be made of it. Continental bankers and others instantly send great sums here, as soon as the rate of interest shows that it can be done profitably. While English credit is good, a rise of the value of money in Lombard Street immediately by a banking operation brings money to Lombard Street. And there is also a slower mercantile operation. The rise in the rate of discount acts immediately on the trade of this country. Prices fall here; in consequence imports are diminished, exports are increased, and, therefore, there is more likelihood of a balance in bullion coming to this country after the rise in the rate than there was before.

Whatever persons—one bank or many banks—in any country hold the banking reserve of that country, ought at the very beginning of an unfavourable foreign exchange at once to raise

the rate of interest, so as to prevent their reserve from being diminished farther, and so as to replenish it by imports of bullion.

This duty, up to about the year 1860, the Bank of England did not perform at all, as I shall show farther on. A more miserable history can hardly be found than that of the attempts of the Bank—if indeed they can be called attempts—to keep a reserve and to manage a foreign drain between the year 1819 (when cash payments were resumed by the Bank, and when our modern Money Market may be said to begin) and the year 1857. The panic of that year for the first time taught the Bank directors wisdom, and converted them to sound principles. The present policy of the Bank is an infinite improvement on the policy before 1857: the two must not be for an instant confounded; but nevertheless, as I shall hereafter show, the present policy is now still most defective, and much discussion and much effort, will be wanted before that policy becomes what it ought to be.

A domestic drain is very different. Such a drain arises from a disturbance of credit within the country, and the difficulty of dealing with it is the greater, because it is often caused, or at least often enhanced, by a foreign drain. Times without number the public have been alarmed mainly because they saw that the Banking reserve was already low, and that it was daily getting lower. The two maladies—an external drain and an internal—often attack the money market at once. What then ought to be done?

In opposition to what might be at first sight supposed, the best

way for the bank or banks who have the custody of the bank reserve to deal with a drain arising from internal discredit, is to lend freely. The first instinct of everyone is the contrary. There being a large demand on a fund which you want to preserve, the most obvious way to preserve it is to hoard it—to get in as much as you can, and to let nothing go out which you can help. But every banker knows that this is not the way to diminish discredit. This discredit means, 'an opinion that you have not got any money,' and to dissipate that opinion, you must, if possible, show that you have money: you must employ it for the public benefit in order that the public may know that you have it. The time for economy and for accumulation is before. A good banker will have accumulated in ordinary times the reserve he is to make use of in extraordinary times.

Ordinarily discredit does not at first settle on any particular bank, still less does it at first concentrate itself on the bank or banks holding the principal cash reserve. These banks are almost sure to be those in best credit, or they would not be in that position, and, having the reserve, they are likely to look stronger and seem stronger than any others. At first, incipient panic amounts to a kind of vague conversation: Is A. B. as good as he used to be? Has not C. D. lost money? and a thousand such questions. A hundred people are talked about, and a thousand think,—'Am I talked about, or am I not?' 'Is my credit as good as it used to be, or is it less?' And every day, as a panic grows, this floating suspicion becomes both more intense and more diffused;

it attacks more persons; and attacks them all more virulently than at first. All men of experience, therefore, try to strengthen themselves,' as it is called, in the early stage of a panic; they borrow money while they can; they come to their banker and offer bills for discount, which commonly they would not have offered for days or weeks to come. And if the merchant be a regular customer, a banker does not like to refuse, because if he does he will be said, or may be said, to be in want of money, and so may attract the panic to himself. Not only merchants but all persons under pecuniary liabilities—present or imminent—feel this wish to 'strengthen themselves,' and in proportion to those liabilities. Especially is this the case with what may be called the auxiliary dealers in credit. Under any system of banking there will always group themselves about the main bank or banks (in which is kept the reserve) a crowd of smaller money dealers, who watch the minutae of bills, look into special securities which busy bankers have not time for, and so gain a livelihood. As business grows, the number of such subsidiary persons augments. The various modes in which money may be lent have each their peculiarities, and persons who devote themselves to one only lend in that way more safely, and therefore more cheaply. In time of panic, these subordinate dealers in money will always come to the principal dealers. In ordinary times, the intercourse between the two is probably close enough. The little dealer is probably in the habit of pledging his 'securities' to the larger dealer at a rate less than he has himself charged, and of running into the

market to lend again. His time and brains are his principal capital, and he wants to be always using them. But in times of incipient panic, the minor money dealer always becomes alarmed. His credit is never very established or very wide; he always fears that he may be the person on whom current suspicion will fasten, and often he is so. Accordingly he asks the larger dealer for advances. A number of such persons ask all the large dealers—those who have the money—the holders of the reserve. And then the plain problem before the great dealers comes to be 'How shall we best protect ourselves? No doubt the immediate advance to these second-class dealers is annoying, but may not the refusal of it even be dangerous? A panic grows by what it feeds on; if it devours these second-class men, shall we, the first class, be safe?'

A panic, in a word, is a species of neuralgia, and according to the rules of science you must not starve it. The holders of the cash reserve must be ready not only to keep it for their own liabilities, but to advance it most freely for the liabilities of others. They must lend to merchants, to minor bankers, to 'this man and that man,' whenever the security is good. In wild periods of alarm, one failure makes many, and the best way to prevent the derivative failures is to arrest the primary failure which causes them. The way in which the panic of 1825 was stopped by advancing money has been described in so broad and graphic a way that the passage has become classical. 'We lent it,' said Mr. Harman, on behalf of the Bank of England, 'by every possible means and in modes we had never adopted before; we took

in stock on security, we purchased Exchequer bills, we made advances on Exchequer bills, we not only discounted outright, but we made advances on the deposit of bills of exchange to an immense amount, in short, by every possible means consistent with the safety of the Bank, and we were not on some occasions over-nice. Seeing the dreadful state in which the public were, we rendered every assistance in our power.' After a day or two of this treatment, the entire panic subsided, and the 'City' was quite calm.

The problem of managing a panic must not be thought of as mainly a 'banking' problem. It is primarily a mercantile one. All merchants are under liabilities; they have bills to meet soon, and they can only pay those bills by discounting bills on other merchants. In other words, all merchants are dependent on borrowing money, and large merchants are dependent on borrowing much money. At the slightest symptom of panic many merchants want to borrow more than usual; they think they will supply themselves with the means of meeting their bills while those means are still forthcoming. If the bankers gratify the merchants, they must lend largely just when they like it least; if they do not gratify them, there is a panic.

On the surface there seems a great inconsistency in all this. First, you establish in some bank or banks a certain reserve; you make of it or them a kind of ultimate treasury, where the last shilling of the country is deposited and kept. And then you go on to say that this final treasury is also to be the last lending-house;

that out of it unbounded, or at any rate immense, advances are to be made when no one else lends. This seems like saying—first, that the reserve should be kept, and then that it should not be kept. But there is no puzzle in the matter. The ultimate banking reserve of a country (by whomsoever kept) is not kept out of show, but for certain essential purposes, and one of those purposes is the meeting a demand for cash caused by an alarm within the country. It is not unreasonable that our ultimate treasure in particular cases should be lent; on the contrary, we keep that treasure for the very reason that in particular cases it should be lent.

When reduced to abstract principle, the subject comes to this. An 'alarm' is an opinion that the money of certain persons will not pay their creditors when those creditors want to be paid. If possible, that alarm is best met by enabling those persons to pay their creditors to the very moment. For this purpose only a little money is wanted. If that alarm is not so met, it aggravates into a panic, which is an opinion that most people, or very many people, will not pay their creditors; and this too can only be met by enabling all those persons to pay what they owe, which takes a great deal of money. No one has enough money, or anything like enough, but the holders of the bank reserve.

Not that the help so given by the banks holding that reserve necessarily diminishes it. Very commonly the panic extends as far, or almost as far, as the bank or banks which hold the reserve, but does not touch it or them at all. In this case it is enough if the

dominant bank or banks, so to speak, pledge their credit for those who want it. Under our present system it is often quite enough that a merchant or a banker gets the advance made to him put to his credit in the books of the Bank of England; he may never draw a cheque on it, or, if he does, that cheque may come in again to the credit of some other customer, who lets it remain on his account. An increase of loans at such times is often an increase of the liabilities of the bank, not a diminution of its reserve. Just so before 1844, an issue of notes, as in to quell a panic entirely internal did not diminish the bullion reserve. The notes went out, but they did not return. They were issued as loans to the public, but the public wanted no more; they never presented them for payment; they never asked that sovereigns should be given for them. But the acceptance of a great liability during an augmenting alarm, though not as bad as an equal advance of cash, is the thing next worst. At any moment the cash may be demanded. Supposing the panic to grow, it will be demanded, and the reserve will be lessened accordingly.

No doubt all precautions may, in the end, be unavailing. 'On extraordinary occasions,' says Ricardo, 'a general panic may seize the country, when every one becomes desirous of possessing himself of the precious metals as the most convenient mode of realising or concealing his property, against such panic banks have no security *on any system*.' The bank or banks which hold the reserve may last a little longer than the others; but if apprehension pass a certain bound, they must perish too. The

use of credit is, that it enables debtors to use a certain part of the money their creditors have lent them. If all those creditors demand all that money at once, they cannot have it, for that which their debtors have used, is for the time employed, and not to be obtained. With the advantages of credit we must take the disadvantages too; but to lessen them as much as we can, we must keep a great store of ready money always available, and advance out of it very freely in periods of panic, and in times of incipient alarm.

The management of the Money Market is the more difficult, because, as has been said, periods of internal panic and external demand for bullion commonly occur together. The foreign drain empties the Bank till, and that emptiness, and the resulting rise in the rate of discount, tend to frighten the market. The holders of the reserve have, therefore, to treat two opposite maladies at once—one requiring stringent remedies, and especially a rapid rise in the rate of interest; and the other, an alleviative treatment with large and ready loans.

Before we had much specific experience, it was not easy to prescribe for this compound disease; but now we know how to deal with it. We must look first to the foreign drain, and raise the rate of interest as high as may be necessary. Unless you can stop the foreign export, you cannot allay the domestic alarm. The Bank will get poorer and poorer, and its poverty will protract or renew the apprehension. And at the rate of interest so raised, the holders—one or more—of the final Bank reserve must lend

freely. Very large loans at very high rates are the best remedy for the worst malady of the money market when a foreign drain is added to a domestic drain. Any notion that money is not to be had, or that it may not be had at any price, only raises alarm to panic and enhances panic to madness. But though the rule is clear, the greatest delicacy, the finest and best skilled judgment, are needed to deal at once with such great and contrary evils.

And great as is the delicacy of such a problem in all countries, it is far greater in England now than it was or is elsewhere. The strain thrown by a panic on the final bank reserve is proportional to the magnitude of a country's commerce, and to the number and size of the dependent banks—banks, that is, holding no cash reserve—that are grouped around the central bank or banks. And in both respects our system causes a stupendous strain. The magnitude of our commerce, and the number and magnitude of the banks which depend on the Bank of England, are undeniable. There are very many more persons under great liabilities than there are, or ever were, anywhere else. At the commencement of every panic, all persons under such liabilities try to supply themselves with the means of meeting those liabilities while they can. This causes a great demand for new loans. And so far from being able to meet it, the bankers who do not keep an extra reserve at that time borrow largely, or do not renew large loans—very likely do both.

London bankers, other than the Bank of England, effect this in several ways. First, they have probably discounted bills to a

large amount for the bill brokers, and if these bills are paid, they decline discounting any others to replace them. The directors of the London and Westminster Bank had, in the panic of 1857, discounted millions of such bills, and they justly said that if those bills were paid they would have an amount of cash far more than sufficient for any demand. But how were those bills to be paid? Some one else must lend the money to pay them. The mercantile community could not on a sudden bear to lose so large a sum of borrowed money; they have been used to rely on it, and they could not carry on their business without it. Least of all could they bear it at the beginning of a panic, when everybody wants more money than usual. Speaking broadly, those bills can only be paid by the discount of other bills. When the bills (suppose) of a Manchester warehouseman which he gave to the manufacturer become due, he cannot, as a rule, pay for them at once in cash; he has bought on credit, and he has sold on credit. He is but a middleman. To pay his own bill to the maker of the goods, he must discount the bills he has received from the shopkeepers to whom he has sold the goods; but if there is a sudden cessation in the means of discount, he will not be able to discount them. All our mercantile community must obtain new loans to pay old debts. If some one else did not pour into the market the money which the banks like the London and Westminster Bank take out of it, the bills held by the London and Westminster Bank could not be paid.

Who then is to pour in the new money? Certainly not the bill

brokers. They have been used to re-discount with such banks as the London and Westminster millions of bills, and if they see that they are not likely to be able to re-discount those bills, they instantly protect themselves and do not discount them. Their business does not allow them to keep much cash unemployed. They give interest for all the money deposited with them—an interest often nearly approaching the interest they can charge; as they can only keep a small reserve a panic tells on them more quickly than on anyone else. They stop their discounts, or much diminish their discounts, immediately. There is no new money to be had from them, and the only place at which they can have it is the Bank of England.

There is even a simpler case: the banker who is uncertain of his credit, and wants to increase his cash, may have money on deposit at the bill brokers. If he wants to replenish his reserve, he may ask for it, suppose, just when the alarm is beginning. But if a great number of persons do this very suddenly, the bill brokers will not at once be able to pay without borrowing. They have excellent bills in their case, but these will not be due for some days; and the demand from the more or less alarmed bankers is for payment at once and to-day. Accordingly the bill broker takes refuge at the Bank of England the only place where at such a moment new money is to be had.

The case is just the same if the banker wants to sell Consols, or to call in money lent on Consols. These he reckons as part of his reserve. And in ordinary times nothing can be better. According

to the saying, you 'can sell Consols on a Sunday.' In a time of no alarm, or in any alarm affecting that particular banker only, he can rely on such reserve without misgiving. But not so in a general panic. Then, if he wants to sell 500,000 L. worth of Consols, he will not find 500,000 L. of fresh money ready to come into the market. All ordinary bankers are wanting to sell, or thinking they may have to sell. The only resource is the Bank of England. In a great panic, Consols cannot be sold unless the Bank of England will advance to the buyer, and no buyer can obtain advances on Consols at such a time unless the Bank of England will lend to him.

The case is worse if the alarm is not confined to the great towns, but is diffused through the country. As a rule, country bankers only keep so much barren cash as is necessary for their common business. All the rest they leave at the bill brokers, or at the interest-giving banks, or invest in Consols and such securities. But in a panic they come to London and want this money. And it is only from the Bank of England that they can get it, for all the rest of London want their money for themselves.

If we remember that the liabilities of Lombard Street payable on demand are far larger than those of any like market, and that the liabilities of the country are greater still, we can conceive the magnitude of the pressure on the Bank of England when both Lombard Street and the country suddenly and at once come upon it for aid. No other bank was ever exposed to a demand so formidable, for none ever before kept the banking reserve

for such a nation as the English. The mode in which the Bank of England meets this great responsibility is very curious. It unquestionably does make enormous advances in every panic

In 1847 the loans on 'private securities'  
increased from 18,963,000 L to 20,409,000 L  
1857 ditto ditto 20,404,000 L to 31,350,000 L  
1866 ditto ditto 18,507,000 L to 33,447,000 L

But, on the other hand, as we have seen, though the Bank, more or less, does its duty, it does not distinctly acknowledge that it is its duty. We are apt to be solemnly told that the Banking Department of the Bank of England is only a bank like other banks—that it has no peculiar duty in times of panic—that it then is to look to itself alone, as other banks look. And there is this excuse for the Bank. Hitherto questions of banking have been so little discussed in comparison with questions of currency, that the duty of the Bank in time of panic has been put on a wrong ground.

It is imagined that because bank notes are a legal tender, the Bank has some peculiar duty to help other people. But bank notes are only a legal tender at the Issue Department, not at the Banking Department, and the accidental combination of the two departments in the same building gives the Banking Department no aid in meeting a panic. If the Issue Department were at Somerset House, and if it issued Government notes there, the position of the Banking Department under the present law would be exactly what it is now. No doubt, formerly the

Bank of England could issue what it pleased, but that historical reminiscence makes it no stronger now that it can no longer so issue. We must deal with what is, not with what was.

And a still worse argument is also used. It is said that because the Bank of England keeps the 'State account' and is the Government banker, it is a sort of 'public institution' and ought to help everybody. But the custody of the taxes which have been collected and which wait to be expended is a duty quite apart from panics. The Government money may chance to be much or little when the panic comes. There is no relation or connection between the two. And the State, in getting the Bank to keep what money it may chance to have, or in borrowing of it what money it may chance to want, does not hire it to stop a panic or much help it if it tries.

The real reason has not been distinctly seen. As has been already said—but on account of its importance and perhaps its novelty it is worth saying again—whatever bank or banks keep the ultimate banking reserve of the country must lend that reserve most freely in time of apprehension, for that is one of the characteristic uses of the bank reserve, and the mode in which it attains one of the main ends for which it is kept. Whether rightly or wrongly, at present and in fact the Bank of England keeps our ultimate bank reserve, and therefore it must use it in this manner.

And though the Bank of England certainly do make great advances in time of panic, yet as they do not do so on any distinct principle, they naturally do it hesitatingly, reluctantly,

and with misgiving. In 1847, even in 1866—the latest panic, and the one in which on the whole the Bank acted the best—there was nevertheless an instant when it was believed the Bank would not advance on Consols, or at least hesitated to advance on them. The moment this was reported in the City and telegraphed to the country, it made the panic indefinitely worse. In fact, to make large advances in this faltering way is to incur the evil of making them without obtaining the advantage. What is wanted and what is necessary to stop a panic is to diffuse the impression, that though money may be dear, still money is to be had. If people could be really convinced that they could have money if they wait a day or two, and that utter ruin is not coming, most likely they would cease to run in such a mad way for money. Either shut the Bank at once, and say it will not lend more than it commonly lends, or lend freely, boldly, and so that the public may feel you mean to go on lending. To lend a great deal, and yet not give the public confidence that you will lend sufficiently and effectually, is the worst of all policies; but it is the policy now pursued.

In truth, the Bank do not lend from the motives which should make a bank lend. The holders of the Bank reserve ought to lend at once and most freely in an incipient panic, because they fear destruction in the panic. They ought not to do it to serve others; they ought to do it to serve themselves. They ought to know that this bold policy is the only safe one, and for that reason they ought to choose it. But the Bank directors are not afraid. Even at the last moment they say that 'whatever happens to the

community, they can preserve themselves.' Both in 1847 and 1857 (I believe also in 1866, though there is no printed evidence of it) the Bank directors contended that the Banking Department was quite safe though its reserve was nearly all gone, and that it could strengthen itself by selling securities and by refusing to discount. But this is a complete dream. The Bank of England could not sell 'securities,' for in an extreme panic there is no one else to buy securities. The Bank cannot stay still and wait till its bills are paid, and so fill its coffers, for unless it discounts equivalent bills, the bills which it has already discounted will not be paid. 'When the reserve in the ultimate bank or banks—those keeping the reserve—runs low, it cannot be augmented by the same means that other and dependent banks commonly adopt to maintain their reserve, for the dependent banks trust that at such moments the ultimate banks will be discounting more than usual and lending more than usual. But ultimate banks have no similar rear-guard to rely upon.

I shall have failed in my purpose if I have not proved that the system of entrusting all our reserve to a single board, like that of the Bank directors, is very anomalous; that it is very dangerous; that its bad consequences, though much felt, have not been fully seen; that they have been obscured by traditional arguments and hidden in the dust of ancient controversies.

But it will be said—What would be better? What other system could there be? We are so accustomed to a system of banking, dependent for its cardinal function on a single bank, that we

can hardly conceive of any other. But the natural system—that which would have sprung up if Government had let banking alone—is that of many banks of equal or not altogether unequal size. In all other trades competition brings the traders to a rough approximate equality. In cotton spinning, no single firm far and permanently outstrips the others. There is no tendency to a monarchy in the cotton world; nor, where banking has been left free, is there any tendency to a monarchy in banking either. In Manchester, in Liverpool, and all through England, we have a great number of banks, each with a business more or less good, but we have no single bank with any sort of predominance; nor is there any such bank in Scotland. In the new world of Joint Stock Banks outside the Bank of England, we see much the same phenomenon. One or more get for a time a better business than the others, but no single bank permanently obtains an unquestioned predominance. None of them gets so much before the others that the others voluntarily place their reserves in its keeping. A republic with many competitors of a size or sizes suitable to the business, is the constitution of every trade if left to itself, and of banking as much as any other. A monarchy in any trade is a sign of some anomalous advantage, and of some intervention from without.

I shall be at once asked—Do you propose a revolution? Do you propose to abandon the one-reserve system, and create anew a many-reserve system? My plain answer is that I do not propose it. I know it would be childish. Credit in business is like loyalty

in Government. You must take what you can find of it, and work with it if possible. A theorist may easily map out a scheme of Government in which Queen Victoria could be dispensed with. He may make a theory that, since we admit and we know that the House of Commons is the real sovereign, any other sovereign is superfluous; but for practical purposes, it is not even worth while to examine these arguments. Queen Victoria is loyally obeyed—without doubt, and without reasoning—by millions of human beings. If those millions began to argue, it would not be easy to persuade them to obey Queen Victoria, or anything else. Effectual arguments to convince the people who need convincing are wanting. Just so, an immense system of credit, founded on the Bank of England as its pivot and its basis, now exists. The English people, and foreigners too, trust it implicitly. Every banker knows that if he has to prove that he is worthy of credit, however good may be his arguments, in fact his credit is gone: but what we have requires no proof. The whole rests on an instinctive confidence generated by use and years. Nothing would persuade the English people to abolish the Bank of England; and if some calamity swept it away, generations must elapse before at all the same trust would be placed in any other equivalent. A many-reserve system, if some miracle should put it down in Lombard Street, would seem monstrous there. Nobody would understand it, or confide in it. Credit is a power which may grow, but cannot be constructed. Those who live under a great and firm system of credit must consider that if they break up that one they will

never see another, for it will take years upon years to make a successor to it.

On this account, I do not suggest that we should return to a natural or many-reserve system of banking. I should only incur useless ridicule if I did suggest it. Nor can I propose that we should adopt the simple and straightforward expedient by which the French have extricated themselves from the same difficulty. In France all banking rests on the Bank of France, even more than in England all rests on the Bank of England. The Bank of France keeps the final banking reserve, and it keeps the currency reserve too. But the State does not trust such a function to a board of merchants, named by shareholders. The nation itself—the Executive Government—names the governor and deputy-governor of the Bank of France. These officers have, indeed, beside them a council of 'regents,' or directors, named by the shareholders. But they need not attend to that council unless they think fit; they are appointed to watch over the national interest, and, in so doing, they may disregard the murmurs of the 'regents' if they like. And in theory, there is much to be said for this plan. The keeping the single banking reserve being a national function, it is at least plausible to argue that Government should choose the functionaries. No doubt such a political intervention is contrary to the sound economical doctrine that 'banking is a trade, and only a trade.' But Government forgot that doctrine when, by privileges and monopolies, it made a single bank predominant over all others, and established the one-reserve system. As that

system exists, a logical Frenchman consistently enough argues that the State should watch and manage it. But no such plan would answer in England. We have not been trained to care for logical sequence in our institutions, or rather we have been trained not to care for it. And the practical result for which we do care would in this case be bad. The governor of the Bank would be a high Parliamentary official, perhaps in the Cabinet, and would change as chance majorities and the strength of parties decide. A trade peculiarly requiring consistency and special attainment would be managed by a shifting and untrained ruler. In fact, the whole plan would seem to an Englishman of business palpably absurd; he would not consider it, he would not think it worth considering. That it works fairly well in France, and that there are specious arguments of theory for it, would not be sufficient to his mind.

All such changes being out of the question, I can propose only three remedies.

First. There should be a clear understanding between the Bank and the public that, since the Bank hold out ultimate banking reserve, they will recognise and act on the obligations which this implies; that they will replenish it in times of foreign demand as fully, and Lend it in times of internal panic as freely and readily, as plain principles of banking require.

This looks very different from the French plan, but it is not so different in reality. In England we can often effect, by the indirect compulsion of opinion, what other countries must effect by the direct compulsion of Government. We can do so in this case. The

Bank directors now fear public opinion exceedingly; probably no kind of persons are so sensitive to newspaper criticism. And this is very natural. Our statesmen, it is true, are much more blamed, but they have generally served a long apprenticeship to sharp criticism. If they still care for it (and some do after years of experience much more than the world thinks), they care less for it than at first, and have come to regard it as an unavoidable and incessant irritant, of which they shall never be rid. But a bank director undergoes no similar training and hardening. His functions at the Bank fill a very small part of his time; all the rest of his life (unless he be in Parliament) is spent in retired and mercantile industry. He is not subjected to keen and public criticism, and is not taught to bear it. Especially when once in his life he becomes, by rotation, governor, he is most anxious that the two years of office shall 'go off well.' He is apt to be irritated even by objections to principles on which he acts, and cannot bear with equanimity censure which is pointed and personal. At present I am not sure if this sensitiveness is beneficial. As the exact position of the Bank of England in the Money Market is indistinctly seen, there is no standard to which a Bank governor can appeal. He is always in fear that 'something may be said;' but not quite knowing on what side that 'something' may be, his fear is but an indifferent guide to him. But if the cardinal doctrine were accepted, if it were acknowledged that the Bank is charged with the custody of our sole banking reserve, and is bound to deal with it according to admitted principles, then a governor of the

Bank could look to those principles. He would know which way criticism was coming. If he was guided by the code, he would have a plain defence. And then we may be sure that old men of business would not deviate from the code. At present the Board of Directors are a sort of semi-trustees for the nation. I would have them real trustees, and with a good trust deed.

Secondly. The government of the Bank should be improved in a manner to be explained. We should diminish the 'amateur' element; we should augment the trained banking element; and we should ensure more constancy in the administration.

Thirdly. As these two suggestions are designed to make the Bank as strong as possible, we should look at the rest of our banking system, and try to reduce the demands on the Bank as much as we can. The central machinery being inevitably frail, we should carefully and as much as possible diminish the strain upon it.

But to explain these proposals, and to gain a full understanding of many arguments that have been used, we must look more in detail at the component parts of Lombard street, and at the curious set of causes which have made it assume its present singular structure.

## CHAPTER III

How Lombard Street Came to Exist, and Why It Assumed Its Present Form.

In the last century, a favourite subject of literary ingenuity was 'conjectural history,' as it was then called. Upon grounds of probability a fictitious sketch was made of the possible origin of things existing. If this kind of speculation were now applied to banking, the natural and first idea would be that large systems of deposit banking grew up in the early world, just as they grow up now in any large English colony. As soon as any such community becomes rich enough to have much money, and compact enough to be able to lodge its money in single banks, it at once begins so to do. English colonists do not like the risk of keeping their money, and they wish to make an interest on it. They carry from home the idea and the habit of banking, and they take to it as soon as they can in their new world. Conjectural history would be inclined to say that all banking began thus: but such history is rarely of any value. The basis of it is false. It assumes that what works most easily when established is that which it would be the most easy to establish, and that what seems simplest when familiar would be most easily appreciated by the mind though unfamiliar. But exactly the contrary is true. Many things which seem simple and which work well when firmly established, are very hard to establish among new people, and not very easy to

explain to them. Deposit banking is of this sort. Its essence is that a very large number of persons agree to trust a very few persons, or some one person. Banking would not be a profitable trade if bankers were not a small number, and depositors in comparison an immense number. But to get a great number of persons to do exactly the same thing is always very difficult, and nothing but a very palpable necessity will make them on a sudden begin to do it. And there is no such palpable necessity in banking. If you take a country town in France, even now, you will not find any such system of banking as ours. Cheque-books are unknown, and money kept on running account by bankers is rare. People store their money in a *caisse* at their houses. Steady savings, which are waiting for investment, and which are sure not to be soon wanted, may be lodged with bankers; but the common floating cash of the community is kept by the community themselves at home. They prefer to keep it so, and it would not answer a banker's purpose to make expensive arrangements for keeping it otherwise. If a 'branch,' such as the National Provincial Bank opens in an English country town, were opened in a corresponding French one, it would not pay its expenses. You could not get any sufficient number of Frenchmen to agree to put their money there. And so it is in all countries not of British descent, though in various degrees. Deposit banking is a very difficult thing to begin, because people do not like to let their money out of their sight, especially do not like to let it out of sight without security—still more, cannot all at once agree

on any single person to whom they are content to trust it unseen and unsecured. Hypothetical history, which explains the past by what is simplest and commonest in the present, is in banking, as in most things, quite untrue.

The real history is very different. New wants are mostly supplied by adaptation, not by creation or foundation. Something having been created to satisfy an extreme want, it is used to satisfy less pressing wants, or to supply additional conveniences. On this account, political Government—the oldest institution in the world—has been the hardest worked. At the beginning of history, we find it doing everything which society wants done, and forbidding everything which society does not wish done. In trade, at present, the first commerce in a new place is a general shop, which, beginning with articles of real necessity, comes shortly to supply the oddest accumulation of petty comforts. And the history of banking has been the same. The first banks were not founded for our system of deposit banking, or for anything like it. They were founded for much more pressing reasons, and having been founded, they, or copies from them, were applied to our modern uses.

The earliest banks of Italy, where the name began, were finance companies. The Bank of St. George, at Genoa, and other banks founded in imitation of it, were at first only companies to make loans to, and float loans for, the Governments of the cities in which they were formed. The want of money is an urgent want of Governments at most periods, and seldom more urgent than

it was in the tumultuous Italian Republics of the Middle Ages. After these banks had been long established, they began to do what we call banking business; but at first they never thought of it. The great banks of the North of Europe had their origin in a want still more curious. The notion of its being a prime business of a bank to give good coin has passed out of men's memories; but wherever it is felt, there is no want of business more keen and urgent. Adam Smith describes it so admirably that it would be stupid not to quote his words:—'The currency of a great state, such as France or England, generally consists almost entirely of its own coin. Should this currency, therefore, be at any time worn, clipt, or otherwise degraded below its standard value, the state by a reformation of its coin can effectually re-establish its currency. But the currency of a small state, such as Genoa or Hamburgh, can seldom consist altogether in its own coin, but must be made up, in a great measure, of the coins of all the neighbouring states with which its inhabitants have a continual intercourse. Such a state, therefore, by reforming its coin, will not always be able to reform its currency. If foreign bills of exchange are paid in this currency, the uncertain value of any sum, of what is in its own nature so uncertain, must render the exchange always very much against such a state, its currency being, in all foreign states, necessarily valued even below what it is worth.

'In order to remedy the inconvenience to which this disadvantageous exchange must have subjected their merchants, such small states, when they began to attend to the interest of

trade, have frequently enacted, that foreign bills of exchange of a certain value should be paid, not in common currency, but by an order upon, or by a transfer in, the books of a certain bank, established upon the credit, and under the protection of the state, this bank being always obliged to pay, in good and true money, exactly according to the standard of the state. The banks of Venice, Genoa, Amsterdam, Hamburgh and Nuremburg, seem to have been all originally established with this view, though some of them may have afterwards been made subservient to other purposes. The money of such banks, being better than the common currency of the country, necessarily bore an agio, which was greater or smaller, according as the currency was supposed to be more or less degraded below the standard of the state. The agio of the bank of Hamburgh, for example, which is said to be commonly about fourteen per cent, is the supposed difference between the good standard money of the state, and the clipt, worn, and diminished currency poured into it from all the neighbouring states.

'Before 1609 the great quantity of clipt and worn foreign coin, which the extensive trade of Amsterdam brought from all parts of Europe, reduced the value of its currency about 9 per cent below that of good money fresh from the mint. Such money no sooner appeared than it was melted down or carried away, as it always is in such circumstances. The merchants, with plenty of currency, could not always find a sufficient quantity of good money to pay their bills of exchange; and the value of those bills, in spite of

several regulations which were made to prevent it, became in a great measure uncertain.

'In order to remedy these inconveniences, a bank was established in 1609 under the guarantee of the City. This bank received both foreign coin, and the light and worn coin of the country at its real intrinsic value in the good standard money of the country, deducting only so much as was necessary for defraying the expense of coinage, and the other necessary expense of management. For the value which remained, after this small deduction was made, it gave a credit in its books. This credit was called bank money, which, as it represented money exactly according to the standard of the mint, was always of the same real value, and intrinsically worth more than current money. It was at the same time enacted, that all bills drawn upon or negotiated at Amsterdam of the value of six hundred guilders and upwards should be paid in bank money, which at once took away all uncertainty in the value of those bills. Every merchant, in consequence of this regulation, was obliged to keep an account with the bank in order to pay his foreign bills of exchange, which necessarily occasioned a certain demand for bank money.'

Again, a most important function of early banks is one which the present banks retain, though it is subsidiary to their main use; viz. the function of remitting money. A man brings money to the bank to meet a payment which he desires to make at a great distance, and the bank, having a connection with other banks, sends it where it is wanted. As soon as bills of exchange are given

upon a large scale, this remittance is a very pressing requirement. Such bills must be made payable at a place convenient to the seller of the goods in payment of which they are given, perhaps at the great town where his warehouse is. But this may be very far from the retail shop of the buyer who bought those goods to sell them again in the country. For these, and a multitude of purposes, the instant and regular remittance of money is an early necessity of growing trade; and that remittance it was a first object of early banks to accomplish.

These are all uses other than those of deposit banking which banks supplied that afterwards became in our English sense deposit banks. By supplying these uses, they gained the credit that afterwards enabled them to gain a living as deposit banks. Being trusted for one purpose, they came to be trusted for a purpose quite different, ultimately far more important, though at first less keenly pressing. But these wants only affect a few persons, and therefore bring the bank under the notice of a few only. The real introductory function which deposit banks at first perform is much more popular, and it is only when they can perform this more popular kind of business that deposit banking ever spreads quickly and extensively. This function is the supply of the paper circulation to the country, and it will be observed that I am not about to overstep my limits and discuss this as a question of currency. In what form the best paper currency can be supplied to a country is a question of economical theory with which I do not meddle here. I am only

narrating unquestionable history, not dealing with an argument where every step is disputed. And part of this certain history is that the best way to diffuse banking in a community is to allow the banker to issue bank-notes of small amount that can supersede the metal currency. This amounts to a subsidy to each banker to enable him to keep open a bank till depositors choose to come to it. The country where deposit banking is most diffused is Scotland, and there the original profits were entirely derived from the circulation. The note issue is now a most trifling part of the liabilities of the Scotch banks, but it was once their mainstay and source of profit. A curious book, lately published, has enabled us to follow the course of this in detail. The Bank of Dundee, now amalgamated with the Royal Bank of Scotland, was founded in 1763, and had become before its amalgamation, eight or nine years since, a bank of considerable deposits. But for twenty-five years from its foundation it had no deposits at all. It subsisted mostly on its note issue, and a little on its remittance business. Only in 1792, after nearly thirty years, it began to gain deposits, but from that time they augmented very rapidly. The banking history of England has been the same, though we have no country bank accounts in detail which go back so far. But probably up to 1830 in England, or thereabouts, the main profit of banks was derived from the circulation, and for many years after that the deposits were treated as very minor matters, and the whole of so-called banking discussion turned on questions of circulation. We are still living in the debris of that

controversy, for, as I have so often said, people can hardly think of the structure of Lombard Street, except with reference to the paper currency and to the Act of 1844, which regulates it now. The French are still in the same epoch of the subject. The great enquete of 1865 is almost wholly taken up with currency matters, and mere banking is treated as subordinate. And the accounts of the Bank of France show why. The last weekly statement before the German war showed that the circulation of the Bank of France was as much as 59,244,000 L., and that the private deposits were only 17,127,000 L. Now the private deposits are about the same, and the circulation is 112,000,000 L. So difficult is it in even a great country like France for the deposit system of banking to take root, and establish itself with the strength and vigour that it has in England.

The experience of Germany is the same. The accounts preceding the war in North Germany showed the circulation of the issuing banks to be 39,875,000 L., and the deposits to be 6,472,000 L. while the corresponding figures at the present moment are—circulation, 60,000,000 L. and deposits 8,000,000 L. It would be idle to multiply instances.

The reason why the use of bank paper commonly precedes the habit of making deposits in banks is very plain. It is a far easier habit to establish. In the issue of notes the banker, the person to be most benefited, can do something. He can pay away his own 'promises' in loans, in wages, or in payment of debts. But in the getting of deposits he is passive. His issues depend on himself;

his deposits on the favour of others. And to the public the change is far easier too. To collect a great mass of deposits with the same banker, a great number of persons must agree to do something. But to establish a note circulation, a large number of persons need only do nothing. They receive the banker's notes in the common course of their business, and they have only not to take those notes to the banker for payment. If the public refrain from taking trouble, a paper circulation is immediately in existence. A paper circulation is begun by the banker, and requires no effort on the part of the public; on the contrary, it needs an effort of the public to be rid of notes once issued; but deposit banking cannot be begun by the banker, and requires a spontaneous and consistent effort in the community. And therefore paper issue is the natural prelude to deposit banking.

The way in which the issue of notes by a banker prepares the way for the deposit of money with him is very plain. When a private person begins to possess a great heap of bank-notes, it will soon strike him that he is trusting the banker very much, and that in re turn he is getting nothing. He runs the risk of loss and robbery just as if he were hoarding coin. He would run no more risk by the failure of the bank if he made a deposit there, and he would be free from the risk of keeping the cash. No doubt it takes time before even this simple reasoning is understood by uneducated minds. So strong is the wish of most people to see their money that they for some time continue to hoard bank-notes: for a long period a few do so. But in the end common

sense conquers. The circulation of bank-notes decreases, and the deposit of money with the banker increases. The credit of the banker having been efficiently advertised by the note, and accepted by the public, he lives on the credit so gained years after the note issue itself has ceased to be very important to him.

The efficiency of this introduction is proportional to the diffusion of the right of note issue. A single monopolist issuer, like the Bank of France, works its way with difficulty through a country, and advertises banking very slowly. Even now the Bank of France, which, I believe, by law ought to have a branch in each Department, has only branches in sixty out of eighty-six. On the other hand, the Swiss banks, where there is always one or more to every Canton, diffuse banking rapidly. We have seen that the liabilities of the Bank of France stand thus:

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