

**SEPARATE RESERVE
ASSOCIATIONS PREVENTIVE OF
FINANCIAL PANICS AND
SUITABLE TO AMERICAN
CONDITIONS**

Published @ 2017 Trieste Publishing Pty Ltd

ISBN 9780649195077

Separate reserve associations preventive of financial panics and suitable to American conditions by J. Howard Cowperthwait

Except for use in any review, the reproduction or utilisation of this work in whole or in part in any form by any electronic, mechanical or other means, now known or hereafter invented, including xerography, photocopying and recording, or in any information storage or retrieval system, is forbidden without the permission of the publisher, Trieste Publishing Pty Ltd, PO Box 1576 Collingwood, Victoria 3066 Australia.

All rights reserved.

Edited by Trieste Publishing Pty Ltd.
Cover @ 2017

This book is sold subject to the condition that it shall not, by way of trade or otherwise, be lent, re-sold, hired out, or otherwise circulated without the publisher's prior consent in any form or binding or cover other than that in which it is published and without a similar condition including this condition being imposed on the subsequent purchaser.

www.triestepublishing.com

J. HOWARD COWPERTHWAIT

**SEPARATE RESERVE
ASSOCIATIONS PREVENTIVE OF
FINANCIAL PANICS AND
SUITABLE TO
AMERICAN CONDITIONS**

SEPARATE RESERVE ASSOCIATIONS

Preventive of Financial Panics
and
Suitable to American Conditions

BY
J. HOWARD COWPERTHWAIT
Author of
Money, Silver and Finance
(1892-1896)

UNIV. OF
CALIFORNIA

The Trade Supplied by
THE AMERICAN NEWS COMPANY

Price 25 Cents

HG 2481
.C7

COPYRIGHT, 1911
BY
J. HOWARD COWPERTHWAIT

TO THE
UNIVERSITY OF
CALIFORNIA

SEPARATE RESERVE ASSOCIATIONS.

No statement of the financial problem would be complete without specifications of our lack of a supply of new money and new credit in time of need, and also our lack of an open discount market for financial and commercial paper at all times. And any good plan of financial reform must give due consideration to the need for establishing an open and broad discount market as well as to the building and filling of reservoirs of new money and new credit. In England, the discount market works so well in connection with the Bank of England that the reservoir of new money has not been tapped in half a century; and, to-day, the volume of paper money in England remains as fixed by the Act of 1844, that is at less than the equivalent of \$100,000,000, excepting only such paper money as has the nature of gold certificates, the growth of British trade and industry having had to depend upon the importations of gold and upon the development of credit. And as it can not be disputed that the development of credit proceeds most generously in an open discount market where endorsed notes and accepted drafts are sold and resold over and over again, it should be worth our while to ascertain why we have no such market in this country. It may not be out of place to add that interest rates usually are lower in England than in America in spite of our superabundant issues of paper money and our almost twice as great circulation of money per capita.

TO VIEW
LIBRARY

SEPARATE RESERVE ASSOCIATIONS

There is a fundamental difference between American and foreign business customs, including English, and this difference gives a different character to the commercial paper created on the opposite sides of the Atlantic. Abroad, merchants buy goods on credit and give an acceptance on time-drafts, to cover the bill of sale or get bankers to accept for them, thus creating "prime bills" of exchange. These bills, originating in certain mercantile transactions, with two names on them, the drawer and the acceptor and sometimes getting many names, are considered suitable for the investment of any idle funds, and when approaching maturity these bills become very choice for temporary investments. The discount market is so broad that nobody in buying such bills need fear that he may not be able to sell them should he, himself, be in need of funds before the bills mature. Here, on the contrary, the general custom with exceptions in a few lines or in country districts is to buy goods for cash, less a cash discount. The buyer provides himself with the necessary funds by selling his note through a broker or by getting his own bank to discount it; the note, in either case, being more suitable for its new owner to hold until its maturity than to resell, for to attempt to resell the note is possibly to excite suspicion of its value, or, maybe, to excite distrust of the strength of the bank which tries to resell. When banks resell paper, the transactions, as a rule, are in small circles among institutions habitually working together. It will be noticed, too, that while American commercial paper is supposed to arise from the need of manufacturers and merchants to ob-

SEPARATE RESERVE ASSOCIATIONS

tain funds to pay for merchandise, yet each piece of paper has not on its face the evidence of such use of the funds. Our kind of paper, when made in Europe, is avoided by bankers because of its possible financial character, as distinct from the desirable commercial character. But however advantageous to the further development of American industry and commerce, might be the changing of the quality of our paper so as to give it a better chance to become easily salable and resalable, it must be admitted that American business methods are not at all likely to be changed and therefore that American paper will continue to be drawn somewhat as at present. The cash discount which a buyer deducts, in paying for goods, is generally twice as great as his loss of interest upon his own note, which he sells or puts through his own bank, and so the buyer will continue to pay cash. On the other hand, sellers who are in the habit of getting cash for their goods, less a cash discount, neither could nor would insist upon being given notes or acceptances instead of cash. We must therefore consider the possibility of the development of an open discount market for paper, any piece of which may or may not have arisen directly from a commercial transaction; and, certainly the prospect is not bright and may be spoiled by mistakes. Senator Aldrich proposes to confer upon national banks the right to accept time-drafts arising from commercial transactions, but as neither drafts nor notes arise in great volume **directly** from commercial transactions, it would seem to be better to say **directly or indirectly**, allowing both qualities of paper, or better still to limit the total

SEPARATE RESERVE ASSOCIATIONS

sum to be risked by any bank, in any one direction, and, say nothing about the quality of the paper to be accepted or to be endorsed. In England, there is little or no restriction upon bank action in such a matter as this, and I think that in the future we will control banks less by law and more by public opinion, exercised through clearing house associations or reserve associations. Of course, however, we are not going to lose sight of the fact that banks use the money which belongs to their depositors and, therefore, that there must be some adequate supervision.

It is not easy to over-estimate the importance of inducing the general lodgment of idle funds in commercial paper instead of in call loans. At present so much money often is put out on call that the rate of interest falls to two per cent per annum; while, at other times, there is so little money for loaning in this way that the rate may soar to one-half of one per cent. per day. Abroad, the same sort of funds is put into commercial paper to a very great extent because the paper can be resold whenever it is advisable to resell, the broad discount market thus serving the purpose of our call-loan market. The rate of interest does not change suddenly in Europe, the reason being that a slight advance operates at once as a check upon the production of commercial paper, merchants everywhere watching for changes in the bank rate and varying their own activities accordingly. Here, on the contrary, an advance in the call-money rate merely excites curiosity as to what Wall Street is doing, merchants continuing to buy goods about as usual and relying upon their banks or their

SEPARATE RESERVE ASSOCIATIONS.

note brokers to find the necessary funds. These are forthcoming until there is a very general scarcity and then comes a crash. The difference of vital importance is the foreign **gradual** hardening of money rates as compared with American **sudden** hardening of money rates.

In Europe, the open discount market and the central banking institution are in close touch at all times and neither could exist well without the other. The great market absorbs the bulk of the commercial paper and prevents an avalanche of it from reaching the central bank. The central bank standing always ready to re-discount paper or to loan money upon securities, the amount of money which it would furnish being practically unlimited, gives stability to the discount market by its assurance against any such mal-adjustment of the money-supply to the money-demand as we know under the name of "currency famine" which, of course, is a misnomer, the more suitable term being, say, currency voraciousness, since it is the appetite for currency which increases and not the quantity of currency which decreases. But although a comparison of European with American financial conditions indicates that we need a central bank as well as a discount market yet a study of American ways and American financial history shows that we can not have any such bank. American politics destroyed the first Bank of the United States in 1811, and the second in 1836. Several years ago a very important commercial body sent an investigating committee abroad and this committee reported in favor of a third experiment, the establishing of a central bank, and then the parent body adopted its committee's re-