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Published @ 2017 Trieste Publishing Pty Ltd

ISBN 9780649192786

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Edited by Trieste Publishing Pty Ltd.
Cover @ 2017

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Trieste

PUBLICATIONS OF
THE AMERICAN ACADEMY OF POLITICAL AND SOCIAL SCIENCE.
No. 225.

Issued Fortnightly. May 17, 1898.

Proposed Reforms of the Monetary System.

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A PAPER SUBMITTED TO THE
AMERICAN ACADEMY OF POLITICAL AND SOCIAL SCIENCE

PHILADELPHIA:
AMERICAN ACADEMY OF POLITICAL AND SOCIAL SCIENCE

ENGLAND: P. S. King & Son, 12 and 14 King St., Westminster, London, S. W.
FRANCE: L. Larose, rue Soufflot 22, Paris.
GERMANY: Mayer & Müller, 2 Prinz Louis Ferdinandstrasse, Berlin, N. W.
ITALY: Direzione del Giornale degli Economisti, Rome, via Monte Savello, Palazzo Orsini.
SPAIN: E. Capdeville, 9 Plaza de Santa Aña, Madrid.

Price, 25 cents. *Annual Subscription, $6.00.*

PROPOSED REFORMS OF THE MONETARY SYSTEM.

The most obvious defects of the present monetary system of the United States are its rigidity, the large proportion of credit-money, and the isolation of the ultimate redemption agency, the National Treasury, from the loan market. Other defects, such as variety in the form and legal tender quality of government obligations, are not grave; they do not menace public credit or the standard of value. Fortunately, the grave defects mentioned are so closely related that if any one is corrected, the other two must cease to cause much annoyance. If the system is made elastic, some of the causes leading to the exportation of gold and to embarrassing demands upon the treasury will cease to exist; or if the volume of credit-money is reduced, gold will be more abundant and will be more easily obtained when wanted for export; or if the business of issue and redemption can be deputed to a governmental bank similar to the Bank of England or the Bank of France, sufficient control of the loan market can be obtained to check movements of gold due to temporary irregularities of the money supply. A plan for the improvement of the monetary system must be appraised by its promise to yield one or more of these desirable results. The purpose of this paper is a critical examination of two plans recently laid before Congress and known respectively as the Gage plan and the Monetary Commission plan.

The Monetary Commission is an unofficial body of twelve men appointed as the result of a national convention of bankers and business men at Indianapolis in January, 1897. The members of this commission are men of experience and ability. They devoted several months to the study of the financial question and to the sifting of "plans" and suggestions submitted for their consideration. They finally agreed upon a plan, and published it with a "preliminary report," in January, 1898. A bill embodying the provisions of this plan has been introduced in the House of Representatives.

The commission pointed out nine defects in the system, which may be briefly stated as follows: (1) The vast amount of government credit currency. (2) The continuance in circulation of government demand obligations. (3) The lack of provision for increasing the volume of the currency with the growth of the country. (4) The inelasticity of the system. (5) The imperfect distribution of loanable capital. (6) The confused functions of the treasury. (7) The diversity in the forms of government credit-money. (8) The circulation of silver dollars of a nominal value greater than their bullion value. (9) An unscientific bank currency. The third defect noted by the commission is, if I understand it aright, the expression of a very mischievous fallacy. It is stated as follows:

"The failure to provide the means for a gradual and sufficient increase of the volume of the currency to meet the needs of an increasing population and an enlarging commerce."

That statement assumes that the money supply in a system based on the free coinage of a metal is not always self-regulating and sufficient, a fallacy which encouraged many votes for the Bland-Allison Act in 1878, and for the Sherman Act in 1890. It implies that we must make some special effort to prevent a scarcity of money as the country grows. One might suppose on the first reading that reference is here made to the inelasticity of the present system, to its incapacity to adapt itself to temporary fluctuations in the demand for money; but as that fault is clearly described in the commission's fourth "defect," the inference is unavoidable that the commission believes the future needs of the country must be satisfied with paper or credit-money rather than with gold. The correctness of the inference is confirmed by the details of the commission's plan, for under its operation any increase in the currency needs of the country would be met by an increase of credit-money. Yet, that the framers of the plan do not foresee or desire such a result is evident from the statement of their first "defect:"

"The vast amount of government credit currency without a certain and adequate provision for its redemption, and the consequent dimi nution of public confidence in the gold standard."

PLAN OF THE MONETARY COMMISSION.

The plan of the Monetary Commission proposes to create a separate division of the treasury for the issue and redemption of government credit-money, all kinds of which, except silver certificates, are to be redeemed in gold; to retire gradually all government notes within the next ten years; to protect the gold reserve by giving the Secretary of the Treasury authority to borrow in three different ways; and to establish a bank circulation unsecured by bonds, but protected by the joint liability of the issuing banks. The following is a more detailed summary:

1. ISSUE AND REDEMPTION.—To create a separate division of the Treasury, in which shall be deposited funds held against outstanding gold, silver and currency certificates, silver bullion behind the Treasury notes, and the guaranty and redemption funds of national banks; also gold equal to 25 per cent of all government notes and 5 per cent of all silver dollars (a total of about $136,000,000). Redeem in gold all forms of government credit-money, including silver dollars, but not silver certificates, which shall be redeemed in silver dollars. Silver certificates shall be in denominations under $10; all government and bank notes $10 and above. Gold and currency certificates not to be reissued.

2. GOVERNMENT NOTES.—They shall be paid out only in exchange for gold coin and currency certificates; except that the secretary, at his discretion, may use them for the purchase of United States bonds. Government notes shall be canceled as follows: $50,000,000 at once, then for five years dollar for dollar, as bank notes increase; after five years one-fifth each year, all being canceled after ten years.

3. GOLD RESERVE.—It must be kept large enough to maintain confidence. The secretary may replenish it from surplus revenues or by sale of silver bullion at his discretion, or by borrowing in one of three

ways: (1) by sale of 3 per cent twenty-year gold bonds payable after one year; (2) by sale of 3 per cent gold certificates of indebtedness payable in one to five years; (3) by borrowing at not over 3 per cent in sums not less than $50, through sub-treasuries and post-offices, keeping record of loan on books and not issuing either bonds or certificates.

4. BANKING.—Issue of bank notes to be limited to capital. Lowest denomination $10. Repressive tax of 2 per cent per annum on notes in excess of 60 per cent of capital and under 80 per cent; and of 6 per cent on notes in excess of 80 per cent of capital. The notes to be legal tender to national banks and to the government, duties on imports excepted.

(*a*) *Security*.—(1) Deposit of United States bonds equal in value to 25 per cent of capital, their value being fixed by secretary on 3 per cent basis. After five years this bond deposit shall be reduced one-fifth annually, ceasing after ten years. (2) A common guaranty fund in gold coin equal to 5 per cent of circulation; in case of its impairment all banks to be liable to assessment. (3) Notes to be first lien on assets of issuing bank. (4) Personal liability of stockholders to extent of stock.

(*b*) *Redemption*.—Each bank must maintain in the Treasury a redemption fund in gold coin equal to 5 per cent of its circulation. The present system of redemption by the government to be continued, sub-treasuries becoming redemption agencies.

(*c*) *Retirement of Notes*.—Proportionately to its payments of lawful money to the Treasury a bank's circulation to be treated as "reduced," and its liability to the guaranty fund correspondingly diminished.

(*d*) *Reserve*.—The present reserve requirements against deposits to be continued, but a bank shall not count its deposits in the redemption or guaranty funds as part of its reserve, nor its own notes as part of its cash assets. One-fourth of a bank's reserve must be "coin" held in its own vaults. No reserve required against circulation.

(*e*) *Miscellaneous*.—(1) Banks of $25,000 capital permitted in places of 4000 population or less. (2) Branch banks should be authorized. (3) A tax of one-eighth of 1 per cent per annum on capital, surplus and undivided profits to cover expenses of the Treasury. (4) Existing banks must reorganize within one year.

It is the evident purpose of this plan to provide an elastic bank currency, to reduce the amount of government demand obligations, and to relieve the strain upon the National Treasury. If it were adopted, would it really result in an improvement of the monetary system? After a careful and candid consideration of all the measures involved I am compelled to conclude that it would not. The proposed banking system is the vital feature of the plan; upon its successful operation the success of the whole depends. In its general character the banking plan is an application of the "Banking Principle," yet it is not a fair illustration of that principle; several important provisions are entirely new and have not the sanction of experience, while others have in the past been proved unsound. As a result of the defects of the proposed banking system it is most probable that the plan would not lessen the proportion of credit-money in existence, nor yield an elastic currency, nor lighten the burden of the United States Treasury. It is to be feared, indeed, that the plan, instead of removing present evils, would aggravate them and also add to their number. It would tend to diminish rather than to broaden the gold base of the monetary system; it would alienate from the national bank system some of the best banks in the country; it would supply inducements for contraction at times when there is greatest need of expansion; it would leave a door wide open for fraudulent practice. Unfortunately, the objectionable features of the plan cannot be removed simply by modifications; most of them are vital, and the plan must stand or fall with them. I will discuss the defects of the plan categorically.

First. *The plan would not lessen the proportion of credit-money in the currency*. It would merely substitute bank notes for government notes. At the present time the credit-money in use in the United States, including national bank notes, amounts to about $1,100,000,000. It is estimated that there is also in use about $700,000,000 in gold. The experience of this and other nations warrants the opinion that this is too large a proportion of credit-money. Our gold constitutes only about 35 per cent of the total money supply, whereas in England it is 72 per cent, in France 62 per cent, and in Germany 70 per cent. Even Russia, which has only just