

MAINE STATE LEGISLATURE

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THE LEGISLATURE

OF THE

STATE OF MAINE,

DURING ITS SESSION

A. D. 1857.

PART SECOND.

AUGUSTA:
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1857.

THIRTY-SIXTH LEGISLATURE.

SENATE.]

[No. 6.]

REPORT of the Bank Commissioners on the subject of Free Banking, made to the Thirty-First Legislature, in compliance with an order passed August 28, 1849.

AUGUSTA, Jan. 16, 1852.

SIR :

We have the honor herewith to transmit to the Legislature a Report upon the subject of Free Banking, made in compliance with an order of August 28, 1849.

Very respectfully,

Your obedient servants,

JOHN HODGDON, }
MOSES SHERBURNE, } Bank
 } Commissioners.

Hon. G. P. SEWALL,

Speaker of the

House of Representatives.



STATE OF MAINE.

*To the Honorable Senate and House of Representatives in
Legislature assembled :*

The undersigned, in compliance with the provisions of an Order of the 28th of August, 1849, submitting "An act to authorize the business of Banking," to the Bank Commissioners, and directing them "carefully to examine the same and make report to the next Legislature, with such suggestions and alterations as they shall deem for the public interest," respectfully ask leave to submit the following

R E P O R T :

Much has been written within the last twenty years upon the subject of banking, in both England and the United States ; but financial essays, like homilies on ethics, have mostly fallen upon unwilling ears. While prices are advancing, and the merchant realizes liberal profits and finds no difficulty in meeting his payments, the inquiry seldom arises whether the channels of circulation are not swollen to overflowing. Bank notes discharge his liabilities as readily as gold or silver, and he is slow to believe they are not equally serviceable in carrying on the exchanges of commerce.

That the circulation of all the banks in the United States prior to the suspension of specie payments in 1837, was little short of one hundred and fifty millions,—that in 1843 it was reduced to less than sixty millions, and at the commencement of the second quarter of 1851, rose again to over one hundred and fifty millions, are historical facts not to be denied. And the wide-spread ruin and general bankruptcy following the revulsion in 1837, can be no more ignored than the years of toil and privation required to repair the ravages of that disastrous period. The rapidly increasing bank

issues, aided by the influx of gold from California, had in eight years preceding the first of June, 1851, enlarged the circulating medium of the country over one hundred and fifty millions. The inevitable consequence was, gradually to enhance the costs of production, and in many instances enable foreign goods to compete successfully with our own manufactures for the markets of the Union. Yet, instead of tracing these evils to their legitimate source—an ever fluctuating currency,—the aid of government is invoked, and air-blown bubbles are to be weighed down by duties, until foreign gold and silver kick the beam.

Paper is a currency local in its character, and generally confined to the country where it is issued. It does not flow through the great international channels of circulation, but goes on accumulating until prices have reached a point that lets in foreign merchandise, notwithstanding the duties. Raise these still higher, and you only postpone the calamities which must sooner or later fall upon the community, and with increased violence. The expansive power of a paper currency is almost illimitable, and receives a check only when its increased volume has again raised the cost of production to a level with that of other countries, added to the new protective duties. At this point a call for specie to pay balances ensues, and reduces the circulation at the very time it is most needed to supply the deficiency occasioned by the abstraction of specie, and a commercial panic is the inevitable consequence.

Every country possessing a paper currency, must experience these fluctuations; but they may be greatly alleviated by wise legislation. In Great Britain, when the bank issues reach a given point, naturally indicated by the demands of the business community, the excess must be represented by gold and silver. The banks of Maine are subject to a similar restriction, and are required to keep continually on hand in specie one-third the amount of their issues over fifty per cent. of their capital stock.

Had the power to establish banks of circulation been confined to the General Government, by requiring an ever increasing ratio of

specie as the issues expanded, the fluctuations necessarily emanating from a paper currency would have been greatly alleviated. But this authority has been retained by the States, and we shall look in vain, at least for many years, for uniformity in the banking laws of the several members of the Confederacy. All that Maine can do, is to approximate theoretic perfection, and adapt her institutions to the exigencies of the State, as modified by her business relations with the rest of the Union.

Public attention has been more frequently called to the safety of banks, their ability to redeem their bills, than the influence they exert upon the community. So long as these were paid when presented, in gold and silver, they were seldom called to answer at the bar of public opinion for other misdemeanors. It is certainly very desirable that bills should not be left worthless upon the holders, but it is no less important that the supply furnished to business men should flow in a smooth and even stream, and not come rushing and foaming to day like the mountain torrent, and to-morrow entirely disappear. With existing laws, there is little danger of losses to bill holders, and the principal question for examination is, what system will carry business men most securely and tranquilly through seasons of extreme buoyancy and depression.

The banking law which has hitherto prevailed through New England, requires a cash basis equal to the capital stock, but the proposed law substitutes evidence of indebtedness for gold and silver. States and counties must turn spendthrifts and become involved in debt before a capital can be obtained upon which to issue bills, and a system of credit is not only rendered familiar, but becomes indispensable. The much derided and somewhat obsolete idea, that "a national debt is a national blessing," is again revived. Nor is this all, the principle is indefinitely diluted and extended to counties and cities.

The example of New York is cited in favor of free banking; but her experience should deter, rather than encourage other States to abandon a safe and reliable currency, and cast themselves upon

the troubled ocean of experiment. No other State is so favorably situated for banking upon a dead capital, and with a small amount of specie as New York. Her central position gives her a vast field for circulation, and the surplus produce of the great West continually pouring through her canals and railroads to the city, absorbs as it passes from hand to hand, an amount of paper not easily computed. While her banks are thus enabled to keep up a circulation, they are plentifully supplied with specie through her commercial relations, and the myriads of passengers continually thronging her channels of communication. But with all those advantages the currency of Maine is less fluctuating in volume and more uniform in value.

The Free Banks of that State are divided into four classes. Banks secured wholly by New York State stocks, or partly by New York State stocks, and partly by United States' stocks. Banks secured by New York State stocks, and bonds and mortgages. Banks secured by New York State stocks, stocks of other States and bonds and mortgages, and banks secured by bonds and mortgages and stocks of other States. The law under which banks of the three last descriptions were organized, has been repealed, and none are permitted to go into operation with a capital less than one hundred thousand dollars. Nor is the Treasurer authorized to deliver bills, except upon deposit of New York State stocks, or stocks of the United States. City and county stocks have never been received in New York, and the stocks of other States and bonds and mortgages, after serious losses, have been rejected.

In a Bank Note Table published in 1848, the Northern Bank, Northern Exchange Bank, State Bank, Bank of Cayuga Lake, and Bank of New Rochelle, all of the first class of banks, are quoted at a discount of fifteen per cent. Of the second class, the Atlas bank of Albany, is quoted at sixty per cent. discount, and the Stock Security Bank at fifteen per cent.; and of the third class, the James Bank is put down at fifty per cent. discount. At the same period the bills of all the banks in Maine, except two, were

at par in Boston; and these two were at a discount of only five per cent., not that their standing was equivocal, but because they paid their bills only at their own counters.

Bills issued under the Free Banking Law, are liable, at every financial crisis, to deteriorate in value. Relying upon the stocks deposited with the treasurer for the redemption of their bills in an emergency, and keeping but a small amount of specie, whenever the notes discounted lie over to any considerable amount, or a panic seizes upon the public mind and occasions a rapid return of the issues, the bills cannot be redeemed, and before the slow process of converting stocks into money shall have been gone through with, a large portion of the circulation will have changed hands at a discount of from fifteen to fifty per cent. The greater liability of stock security banks to find themselves unable to pay their bills as presented, arises from the fact that they have no active capital. Two banks go into operation at the same time. One deposits a hundred thousand dollars of stocks, and receives a like amount of bills. The other, in addition to its bills, has a hundred thousand dollars of specie in its vault. They commence business at the same time—receive deposits and discount notes and drafts, representing the price of commodities sold and payable at short periods. By these operations and the aid of depositors, they are enabled to obtain a circulation of one hundred thousand dollars each. The discount line and specie of one will have reached one hundred thousand dollars, and of the other two hundred thousand. Suppose the former to have a loan of ninety thousand dollars and ten thousand in specie—the latter twenty thousand dollars in specie, and one hundred and eighty thousand dollars in bills discounted, is it not very apparent that the latter is better prepared to redeem its issues than the former. Taking forty-five days as the average length of the paper of each bank, the daily receipts of the former would be two thousand dollars, and of the latter four thousand. One could redeem half its circulation in ten days, by reducing its specie to ten thousand dollars, while the other would require twenty-five days

to take up the same proportion of its issues. With an equal circulation, the capacity of the latter is double that of the former, unless we include the stocks in the hands of the treasurer, a resort to which would always reduce the bills below par. In this view of the subject we have left deposits entirely out of the question, supposing they would be proportionate to the amount of business done by each bank, and could not materially change their relative strength.

Let us now examine the operation of these two banks upon a community, and trace the conditions of their customers through a financial cycle. Assuming forty per cent. of the capital stock as the amount of bills that may be kept in circulation under a pressure, the former, in raising the circulation from forty to one hundred thousand dollars, increases its accommodations to its customers one hundred and fifty per cent., while the latter adds to its loans less than forty per cent., being required by the laws of Maine as the circulation increases to enlarge its basis of specie. When the current turns and the circulation again goes down to forty thousand dollars, if the specie is all paid out by both banks, in one case there must be a curtailment of fifty dollars to every ninety dollars of discount—in the other, facilities to customers are reduced but forty dollars in every one hundred and eighty dollars.

These estimates are predicated upon the supposition that each bank in a time of pressure would keep up an equal circulation. But a bank doing business on a cash capital in addition to its bills, would be likely to keep up a much larger circulation than a bank whose capital was lying idle. So that in fact where the circulation of one bank was forty thousand dollars, that of the other would not be likely to exceed twenty thousand, although neither would find any difficulty when the currency was at its culminating point to raise its circulation to the highest limits permitted by law.

It sometimes happens that theories, although very plausible, will not bear reducing to practice; but the foregoing deductions force themselves irresistibly upon the mind, and are fully confirmed by past experience. The small banks of Maine, in 1835, carried

their circulation to its legal limits, although many of them had half their capital in paper discounted with the express understanding that it should be renewed as long as required. This added to the dead, and in many cases worthless paper left upon the banks by the numerous failures of 1836-7, absorbed a large portion of the capital of half the banks in the State; and their circulation in 1838-9 was a pretty correct indication of the extent to which they were crippled by the operations of 1835-6, and loaded down with accommodation paper. The ability of chartered banks to obtain a circulation and accommodate the public when all their capital is in dead paper, provided it is ultimately good, is the same as that of free banks, and the former have long since been voted a nuisance that ought to be abated.

During the year 1851, both the circulation and loan of the Maine banks increased more than six hundred thousand dollars, while with the banks of New York there was a falling off in each, of many millions. The exact amount cannot be now given, as the September return of the New York banks has not yet been published. From March to June, the date of the last exhibit made public, the curtailment was over a million and a half, and the pressure at that time was just beginning to be felt.

It is true that commercial embarrassments and financial troubles commence in cities, but Maine is as intimately connected with Boston as the interior of New York is with the city, and the country banks of that State furnish about three-fourths of its circulation. The demand for money was as great and the rate of interest as high in Boston, as in New York; but in Maine the Banks went steadily through without any perceptible change, while the country banks of New York close the year with a circulation and loan greatly diminished.

The effect of the contemplated system would be greatly to aggravate the evils inseparable from a paper currency. The young and unwary, during the expansion, would enlarge their business, extend their credit and fall into expensive habits. Money may be had for

the asking, but is so abundant no one cares to exact it, and bills at three and six months become the medium of exchange in all large transactions. In the meantime those who accumulate princely estates, through the misfortunes and indiscretions of others, impatiently await the ebb of the financial tide.

When the crisis arises, the banks which have stimulated these excesses from imperious necessity, not only refuse new facilities, but withdraw those hitherto enjoyed. The producing classes hoping the panic will soon subside, submit to ruinous exactions to sustain their credit, and capital thus robs labor of her honest earnings.

We have as yet considered only the necessary results of free bankings, but its liability to be abused should not be entirely overlooked. Brokers taking advantage of this law, deposit stocks and receive the amount in bills, without any intention of doing a regular banking business, but solely to furnish themselves with a currency to carry on their own operations, and this is usually redeemed at a discount of one per cent. An association that can raise twenty-five thousand dollars, may, when money is abundant, put half a dozen banks in operation, for the bills of one will purchase the stocks for another. Although the law prohibits associations from receiving bills on a deposit of less than fifty thousand dollars, the company may make the deposit and receive the bills through some one of their number.

The stocks proposed to be received, are those of the United States, of Maine, of Massachusetts, and of counties and cities. The stocks of the United States, of Maine and Massachusetts, are all above par, and if you pass this law, you offer a bribe to bankers and brokers, to exert their influence in favor of any project, having for its object the creation of State stocks. A measure commonly known as the canal enlargement bill, deemed a violation of the constitution, by those who believe the power of the Legislature limited and controlled by that instrument, was carried in New York last spring, by the aid of those who wished to procure stocks to bank upon. The charters of several safety fund banks were about

to expire, and to organize under the free banking law, they required New York State stocks to the amount of half their capital, but these had become scarce and might not be had. Violating the constitution and adding eleven millions to the debt of the State were trifling considerations, hardly worth taking into account. Stocks must be had, the old were scarce and at a premium, and the uncertainty of the legality of the new issues would be likely to reduce them below par.

Should we adopt this system, may not the same thing which has taken place in New York happen in Maine? Contemplated projects for spending the money of the State, are innumerable, and with this as an additional incentive, may they not, sooner or later, be carried in a mass.

It is unwise to build up by legislative enactments, a monied power whose interests might become antagonistic to those of the public. Capital is imperious and exacting, and in its conflicts with labor requires no adventitious aids. The producing classes are the pillars of the State, and it is the part of government to see that they are oppressed with no unnecessary burthens.

If this view of the subject be correct, it would seem that our present system has many advantages over the proposed one, although it less surely guaranties the ultimate redemption of the bills. Banks have sometimes bid defiance to all legal restraints, and thrown their bills upon the community with no intention of redeeming them. Directors, too, have in times past, absorbed in wild speculations the whole amount of funds under their control; and cashiers proving recreant to their trust, have squandered the entire capital of their banks. The Free Banking law places a fund beyond the reach of any officer of the bank, which must in any event pay a large per centage upon its bills. This is gaining an important point, and it is for the Legislature to determine whether it outweighs the objections to the bill.

JOHN HODGDON, } Bank
M. SHERBURNE, } Commissioners.

AUGUSTA, January 17, 1852.

STATE OF MAINE.

IN SENATE, }
February 17, 1857. }

ORDERED, That 500 copies of the Report of the Bank Commissioners made to the Legislature January 17, 1852, upon the subject of Free Banking, be printed for the use of the Legislature.

Read and passed.

JOSEPH B. HALL, *Secretary.*