HSP FREETEXT

The Bank of England and Years of Panic

by

Henry Warren

Extracted from the author's 'The Story of the Bank of England'

First Published in 1903

The Bank of England

and

Years of Panic

by

Warren Henry

Extracted from the author's

'The Story of the Bank of England'

First Published in 1903

Copyright © 2012 Hindsight Publications Limited
www.hsptexts.com
This copy provided free of charge

Contents

Title Page and Copyright
Publisher's Note
Chapter Synopses

Chapter 1. The Period of Monopoly, 1708 to 1826
Chapter 2. Before and After the Act of 1844
Chapter 3. Panic Years

Publisher’s Note

This extract comprises Chapters one, two, and seven from the author’s ‘The Story of the Bank of England’. The first two chapters in his history include discussion of panics and crises that occurred between 1745 and 1857. The last chapter was entitled ‘Panic Years’, and provides an overview of financial crises in the context of the development of the Bank of England till the end of the nineteenth century — or rather, the Bank’s evolution against a background of such episodic panic.

The short text compiled in this digital edition provides a simple summary of the main financial crises, the response of the Bank, and gives some indication of their broader impact, but does not delve deeply into the underlying economic factors. A more useful contemporary text to follow up with is David Morier Evan’s accounts of the Commercial Crises of 1847-8 and 1857-8. Those provide a more detailed examination of the inter-relationship of commercial crises and the cost of credit, and of changing (and sometimes dubious) business practices in the first half of the nineteenth century. Warren’s observations are still largely relevant today, and his comment below is still true in regard to metaphorical umbrellas, even if we can leave the real one at home:

> “*The financial prophets and the weather prophets are generally wrong, but though we have acquired the habit of tapping the glass each morning, a prudent man carries his umbrella all the same*.”

The actual body of text here has only been very slightly altered in respect of spellings and change of wording, and some emphasis has been added (bold type) by the editor.

J.A.B., Hindsight Publications, 2011

Chapter Synopses

The Period of Monopoly, 1708 to 1826

William Patterson - The "Darien Scheme", Panama - "New Edinburgh" colony fails - William III and cost of war with France - Merchants subscribe, founding charter 1694 - Scarcity of capital - The National Debt - 1826, Joint Stock banks emerge - Limitations of private bankers - Panic of 1825 - Spread of the joint stock banks

Before and After the Act of 1844

Fever of 1835 - Crisis in 1837 - Bank of France lend bullion in 1839 - Chief Aim of the Act - Shortcoming of the Act - Act blamed for 1847 crisis - Cycles of boom and bust - Railway Mania - Financial Amnesia - Effect of 1846 Irish Famine - Act suspended in 1847, temporarily - Merit of small cash reserve - Lessons for banks - Driving away the speculator - Growing cash reserves since 1866 - The Bank's honesty

Panic Years

Review of the early crises - South Sea Bubble - 1745 and "Bonnie Prince Charlie" - India, Uprising - "Quite an epidemic of crime" - Trade and Crisis of 1857 - Suspending the Bank Act - From America to Scotland, Bank failures and fraud - Run on Scotch Banks - 1861,US civil war - 1866, Overend Gurney fails - How the Bank of England saves itself in times of panic - Prudence and company balance sheets - Lessons learned, the system - The Credit machine and the Workshops - 1878, failure of City of Glasgow Bank - 1890, Baring Brothers exposed in Argentina - City rallies round - Bank of France to the rescue - Australian Bank difficulties, 1893 - Boer War 1899-1902

The Period of Monopoly, 1708 to 1826

William Patterson - The “Darien Scheme”, Panama - “New Edinburgh” colony fails - William III and cost of war with France - Merchants subscribe, founding charter 1694 - Scarcity of capital - The National Debt - 1826, Joint Stock banks emerge - Limitations of private bankers - Panic of 1825 - Spread of the joint stock banks

The Bank of England, which is managed by a Governor, Sub-Governor, and twenty-four Directors, was incorporated in 1694 at the suggestion of a Scotsman, William Paterson, a man of roving disposition, whose Darien expedition proved a miserable fiasco, cost Scotland some £400,000, and shattered the health of Paterson, who died in London at the beginning of 1719, if not in poverty at least stripped of nearly all his fortune.

Schemes relating to the Isthmus of Darien (or Panama), that narrow little strip of land which unites the two Americas, have proved fruitful in disaster. France’s great canal venture, we all remember, resulted in huge loss and grave scandal; and Paterson lived to bitterly regret his colonisation scheme, devoutly wishing that he had pinned his faith to his finance company, the Bank of England, for a finance company it then was in every sense of the word.

Little is known of William Paterson’s early career, the various accounts relating thereto being meagre and conflicting, his enemies describing him as a mere adventurer, and his friends declaring that he was actuated by the worthiest of motives. However, when it is remembered that his second great venture (the Darien scheme) involved thousands in ruin, it is

evident that had the man been a saint he would not have lacked detractors, and though his public utterances sound quaintly pious to the modern ear, it seems probable that he was only an enterprising merchant, whose morality was neither better nor worse than that of the times in which he lived.

The son of a Scotch farmer, Paterson left home at an early age, and, after settling for a short time in the West of England, set sail for the West Indies, returning to Europe about 1686 with the Darien scheme in his brain. Receiving but scant encouragement in England, despite the fact that his bank had been successfully floated, he concentrated his energies upon Scotland, where his scheme fired the public imagination, almost every Scotsman with a few pounds to invest eagerly taking the money to the company, convinced that Panama was the natural commercial centre of the world, and that gold would be rained therefrom upon fortunate Scotland. The whole nation went almost frantic with the fever, for Panama, with its gold mines and its world-wide trade, was going to make Scotland rich beyond the dreams of avarice. **It is estimated that nearly half the capital of the country was sunk in the Darien scheme**.

Chartered by the Scottish Parliament in 1695, three vessels sailed from Leith in July, 1698, with some twelve hundred settlers on board, Paterson and his wife among the number. All Edinburgh flocked down to Leith to wish the members God-speed, and then returned to their homes to dream of the streams of gold with which Scotland was to be flooded. In a few years everybody would be rich, and Edinburgh would be the greatest and proudest city in the world. Trade, however, was destined to flow to a city a little farther south.

The scheme proved a dismal failure. England and Holland opposed the new colony; the East India Company treated it as

a rival, and Spain was actively hostile. The climate did the rest. Before the close of 1699 “New Edinburgh” was deserted, and the colonists, decimated by want of provisions and disease, set sail for New York. To make matters worse, a second company meanwhile had sailed from Scotland, where the utmost enthusiasm still prevailed; but the new arrivals found the town deserted, and themselves at the mercy of the Spanish warships. Mad with rage at the lack of success of their national adventure, the Scotch openly accused the English Government of treachery, declaring that its conduct in withholding food supplies was as discreditable to it as was the butchery of Mac Ian and his clan at Glencoe in 1692, when neither old man nor child was spared, and fugitives were allowed to perish of hunger and exposure in the mountains.

Paterson’s faith in Panama must have been profound. His wife died in the new colony, and he himself suffered severely in health; yet, after his return towards the end of 1699, directly his health began to improve, we read of his approaching William with a fresh Darien venture. The King naturally refused to risk a second disaster, and Paterson, like all great speculators who have risked everything and lost, could not again persuade the public to share his enthusiasm, for that mysterious entity seldom trusts a man after a cloud has obscured his “star.” Once his spell of so-called good luck is broken, the public desert him in a body, when the adventurer, if he be wise, retires into obscurity with his spoil.

Paterson lived to discover that it is only a rising star, radiating success, that can obtain a sufficiently large following to finance a great scheme, and though he strove manfully to promote the new venture, his sanguine predictions were received sceptically. Nor did his subsequent schemes meet with

a better reception. But he must still have retained some influence, for, after the Act of Union in 1707, he was returned to Parliament by a Scotch burgh. His chief claim to distinction, however, undoubtedly rests upon the fact that he founded the Bank of England, of which he was appointed one of the first directors.

The Bank of England, from its inception down to the present day, has never been a Government institution. It was originally simply a company that advanced money to and transacted business for the Government, which, in return, granted it certain privileges and concessions; but the connection between the Government and the Bank was so close, and their interests so identical, that public opinion connected the one indissolubly with the other.

From this conception sprang the erroneous impression that the Bank is a Government establishment, when, in reality, it is no more so than is the **National Provincial Bank of England** or the **London and County Bank**.

In 1694, the Government of William III, which was generally in a state of monetary tightness, found that the war with France was draining its resources, and, having failed to raise sufficient funds by the imposition of taxes, it resolved, apparently as a kind of *dernier ressort* to accept Paterson's financial scheme, which had been shelved some three years earlier; and on 27th July, 1694, a charter was granted to the "Corporation of the Governor and Company of the Bank of England."

The capital of the company, £1,200,000, was subscribed by some forty London merchants, and lent to the Government. It is only reasonable to assume that the subscribers were

supporters of the Government, and that they were Whigs, whose aim, in supplying William with the sinews of war, was the crushing of James, whose pusillanimity had disgusted even his own followers at the battle of the Boyne in 1690.

Then, again, the commercial morality of the Stuarts was notoriously bad in the City. Charles I, when the City of London refused him a loan, took forcible possession of £200,000 deposited by the Goldsmiths in the Exchequer; and Charles II, in 1672, robbed them of considerably over £1,000,000. The Goldsmiths, in those days, were the private bankers with whom the London merchants left their cash, receiving an acknowledgment or receipt in return, promising payment on demand, and the Goldsmiths deposited their surplus cash in the Exchequer, just as the banks of today do with the Bank of England. Through this act of spoliation the Goldsmiths were unable to meet their liabilities, and many of them, together with their customers, were involved in common ruin in consequence. James II added to the financial sins of his house by debasing the currency: so small wonder that the merchants of London had had enough of the Stuarts, whose theory of the "Divine right" of kings did not even stop short at the pockets of their subjects — always their most vulnerable point.

The Bank of England, which to-day is quite outside party politics, was at its inception a Whig finance company, incorporated solely for the purpose of lending its capital to the Government at the rate of eight percent per annum; and out of this creation has evolved the present "Old Lady of Threadneedle Street" whose career, if chequered, has been one of unquestionable integrity.

It is difficult even in imagination to picture to oneself the England of 1694; but it is easy to understand that in those days

great storehouses of capital were non-existent — non-existent, that is to say, in the modern sense. Our huge credit institutions, which are indispensable in the twentieth century for the proper carrying on of trade, and which dive by means of branches into almost every corner of the land, thereby collecting millions of pounds of loanable capital, would have spread their tentacles in vain during the seventeenth century, when neither the money nor the facilities for its profitable employment existed in the country.

Capital was scarce — consequently the rate of interest was high — and eight percent was a rate at which even the Government could not borrow in the City in 1694, from ten to thirteen percent per annum being about the value of loanable capital, while the commission paid was oftentimes exorbitant. The Bank, which was established by the Whigs, was naturally bitterly opposed by the Tories, who saw in its success the destruction of the cause they had at heart. The capitalist class disliked it for selfish reasons; and the Goldsmiths, recognising a formidable opponent, joined issue with its enemies.

Holders of stock and everybody connected with the Bank were looked upon as enemies of the House of Stuart, which, were it restored to power, would naturally wreak its vengeance upon a company that had helped to finance William — for forgiveness is one of those abstract attributes with which only brave and wise men are blest, and James II had not given proof of possessing either courage or wisdom. Small wonder then that the City should support the Dutchman.

The National Debt, too, was founded during the reign of William, the first loan of £1,000,000 being raised in 1693, and those persons who held it were bound by the strongest of ties — commercial ties — to William. The fund-holders were Liberal;

the Bank was Liberal; and as its very life was dependent upon the existence of the Government, it seems only natural that, in the popular mind, it should have been looked upon as a Government institution, though there is but little excuse for so classing it now. The fact that so many people still share this illusion, however, clearly proves that a large proportion of the public is unacquainted with the Bank's history.

The Bank of England's charter was renewed in 1697, and again in 1708, when, in order to prevent the establishment of similar institutions, it was granted the monopoly of Joint Stock Banking in England. This it retained until 1826, when an Act was passed permitting the formation of Joint Stock Banks of Unlimited Liability beyond sixty-five miles of London, provided they had no branches in the Metropolis.

It is a long jump from 1708 to 1826, and, of course, the charter was renewed many times between the two dates, the Government generally taking advantage of each extension to force some concession from the Bank, which, as its credit and business expanded, had increased its original capital by many millions; but 1826 was the year of reform, and the intervening period possesses little interest except to the student.

Between 1826 and 1829 the Bank opened eleven provincial branches, but those which were established at Gloucester, Swansea, Exeter, and Norwich have since been closed; Joint Stock Banks were then started in the provinces, though not with very happy results, for in 1832 their reckless trading was severely stigmatised by Lord Overstone; but it was not until 1834 that the first joint stock bank, the **London and Westminster**, was started in London, a clause having been inserted in the Act when the charter of the Bank of England was renewed in 1833, to the effect that, provided a joint stock bank

did not issue notes, it was at liberty to carry on business in the City.

Both the Bank of England and the London private bankers opposed the new bank with acerbity, the former refusing to open an account for it in its books, and the latter, declining to admit it into the Clearing House. Not satisfied with this, the Bank brought an action against the **Westminster**. But it was quite natural that the newcomer should have been received in this fashion, for innovations, however necessary and useful, are seldom accepted rapturously in this country, which appears to have almost a Chinese dislike of the unusual. Besides, it is not the custom of the country, even for the sake of appearances, to receive a trade rival with open arms, and it would have been a little surprising had the Bank surrendered its monopoly of joint stock banking in England without a struggle, whilst its desire, after being stripped of some of its privileges, to annoy its despoilers, was, if not laudable, eminently human.

In 1836 the **London Joint Stock Bank** followed the example of the **Westminster**, and in 1839 the **Union Bank of London**, which has recently amalgamated with Messrs. **Smiths**, opened its doors, while such well-known banks as the **National Provincial Bank of England** and the **London and County Bank** were formed in 1833 and 1836 respectively. The trade of the country had by that time far outgrown the resources of the Bank of England, which was quite unable to minister to the increasing demands of a prosperous and progressive England; and to-day the only monopoly which the Bank enjoys is that left to it by the Act of 1844.

From William and Mary to Victoria, in whose reign the Act of 1844 — that Magna Carta of the banking community — was

introduced, covers a most interesting period in the history of the nation, whose development had been retarded by the “Divine right” of the Stuarts, which cost Charles I his head and James II his throne. The theory is much in evidence to-day, though it now takes the form of a great abstract idea, not compatible with practical politics, and which has found a resting place in the heart, rather than in the head, of the people — for the practical twentieth century has a strange trick of banishing disproved theories from the head to the heart; and perhaps it is this national trait which saves the country from violent revolutions.

It would be a mistake to assert that commerce had declined under the Stuarts. It increased rapidly in spite of them; but, after the “Glorious Revolution” the “Divine right” of kings became a mere theory in this country, and the power of the Crown was made subservient to the will of the people. In short, the rule of Parliament began. The trade of the country gradually expanded, and with it the influence of the Bank.

In order that we may thoroughly grasp the position previously occupied by the Bank of England, and the influence given to it by its connection with the Government, it will be better, before briefly discussing the Act of 1844, to revert to the days when the sway of the Bank of England was absolute.

In 1708, we know, the Bank was granted the monopoly of joint stock banking in England, and, further, it was made illegal for any private firm, whose partners were more than six in number, to conduct the business of a banker. This restriction was not removed until 1857, when the partners in a private bank might consist of ten, and it will be seen from the following facts that this limitation was harmful to the best interests of the country.

One result of this hard-and-fast enactment was the encouragement of small private banks in every county of England; but the fact that the number of their partners was limited to six effectually checked their expansion, and finally brought hundreds of them to the ground; for they could not strengthen themselves, and add to their resources, by amalgamation as is now possible.

As the population of the country increased, the position of the private bankers, as a class, became precarious, especially in rapidly growing commercial centres, because their supply of loanable capital was insufficient to meet the increasing demands of their clients. In their attempt to finance their customers they neglected to maintain adequate reserves, and consequently failures were numerous directly any very considerable demand was made upon them.

Instead of a few large and powerful banking companies, there existed numerous weak private firms, which, in many instances, had advanced out of all proportion to their total working resources, thereby sacrificing security to large profits. So long as times were good all went merrily; but, unfortunately, the great impetus given to trade by the conclusion of peace with France and the United States in 1783 did not last more than five or six years.

The year 1789 brings us to the French Revolution, and in 1793 we were at war with France again. Then came the reaction. Country bankers failed in every direction; but in 1797 Mr. Pitt came to the rescue in order to relieve the Bank of England, and the directors of the Bank were allowed to issue notes at their discretion, cash payments being suspended. Between 1792 and 1820 over one thousand private bankers put up their shutters; and during the 1825 crisis sixty-five banks

closed their doors, hundreds of their customers being ruined in consequence. The panic of 1825, which almost emptied the Bank's tills, thoroughly convinced the Government that the country had outgrown the monopoly of the Bank of England.

By limiting the partners in private banking companies to six in number, and prohibiting the establishment of joint stock banks in opposition to the Bank of England, the Government sanctioned a policy which could not but result in disaster. Like most monopolies, that of the Bank of England was framed to exclude powerful rivals, and to keep those in opposition small and weak; and the result was disaster and ruin in every direction. The greater the trade of the country, the more apparent became the evil, until even the Government was compelled to decide that the monopoly of the Bank of England must forthwith be curtailed.

Small tradesmen were quick to realise the possibilities attached to an unlimited issue of notes, and hundreds of them combined the business of banking with their retail trades, for, although the law placed every obstacle in the way of sound banking, it encouraged small men, who possessed little or no capital, to engage in a business which should be conducted with much capital and great caution. The country was flooded with the notes of these so-called bankers, who, directly their notes were presented for payment in large numbers, failed by the dozen.

A system which encouraged all that was bad, and excluded everything that was sound and secure, was naturally doomed to extinction; and small wonder that in 1826 the era of country joint stock banking began. Like most fresh ventures which cannot be guided by precedent, it began disastrously, for

the simple reason that those who were responsible for the guidance of the new companies had to learn from experience — a very bitter school. But the new banks laboured under fewer disadvantages than the old private bankers, and the Bank Act of 1844, we shall see, clearly defined their position.

We can now understand why the private banker was never a great success in this country. He was of course sacrificed to the monopoly of the Bank of England; for although six very rich capitalists could conduct a large banking business, the resources at their command would not be sufficient to enable them to extend their branches throughout the country. Consequently, before the advent of the joint stock banks we find the private banker, broadly speaking, confining his connections to a particular district or county.

It is true that he enjoyed free trade in banking down to 1844; but the regulation as to the number of partners in his business necessarily confined his offices or branches to a limited area, and effectually prevented his expansion on a large scale; so we get influential houses in the various counties, such as the **Gurneys** in Norfolk and Suffolk, the **Smiths** in Nottingham, and so on. It is noticeable, however, that both these well-known private firms, recognising the applicability of the joint stock system to the times, have surrendered their note issues, and taken a place in the modern movement, evidently foreseeing that, in order to progress, they must adopt the methods of their more successful rivals.

Undoubtedly, the country was not ripe for such a movement until the beginning of the nineteenth century; and though the number of partners in private banking firms was extended to ten in 1857, this concession by no means placed the private banker on an equal footing with the joint stock

companies, which could increase their members or partners by the issue of additional capital whenever it became apparent that their business was rapidly progressing. The private banker, had he desired to farm some dozen counties, would have been compelled to find a few large capitalists to join hands with him, whereas the joint stock banks had only to obtain hundreds of very small ones, and it is quite evident that the companies possessed infinitely the easier task. In fact, down to 1844 the monopoly of the Bank of England prevented their rapid growth. Then came the period of, so to speak, free banking; but not for the private firms.

People are constantly asking: Why did not the private bankers establish themselves firmly in the country and progress? They were first in the field, and, had they been well managed, surely they would have been as progressive as their joint stock rivals. But we know that the law never gave them the remotest chance. How could they progress on a really gigantic scale when their partners were limited to six? The law literally forced them to stand aside; and in 1826 and 1833 only the joint stock system profited by the concessions wrung from the Bank of England, because by that system alone could sufficient capital be obtained to enable a bank to farm the country from south of the Tweed to Land's End.

Of course the private banker was at liberty to adopt the joint stock system at an earlier date, but he did not at first believe in the new movement, and, consequently, clung to his own system until he was far outdistanced by his competitors, for directly the country was relieved from the incubus in the shape of the Bank of England's monopoly, and the joint stock system was given a free hand, that system, as might have been expected, instantly began to forge ahead, and in a very short

space of time the private banker, who to this day cannot admit more than ten persons into partnership, was left hopelessly behind by a system which was unfettered by legal restrictions and allowed fair play.

The Bank of England's monopoly reduced the private banker to impotency. It fostered in every county of England dangerously small firms, which disappeared in hundreds as soon as credit became bad and a state of panic caused their notes to be presented for payment in unusually large numbers, and it made really great private banking companies impossible in England; while but for the fact that public opinion wrenched this power from the hands of the directors, the Bank and its monopoly, which encouraged a dangerous form of banking, might both have been swept away in a bad financial crisis.

Fortunately, public opinion won the day; and though the private banker could not compete successfully against the joint stock system on account of the smallness of his capital compelling him to concentrate his energies in a particular district, that system, being unrestricted, soon covered the land with its branches. The private bankers were at first held in check by the Bank of England's monopoly. Now they are simply being smothered out of existence by the extension of a system of which, in a manner, though, of course, not in the modern sense, the Bank was the first exponent; for a banker, at the beginning of the nineteenth century, was largely dependent upon his note circulation for his profit, our present system of deposit banking being then in its infancy. In fact, the one evolved out of the other.

If a person held one hundred pounds in bank notes, it could not but occur to him that he was in reality lending the issuer one hundred pounds entirely free of interest; and as he

possessed sufficient confidence in the banker to lock up the notes in his cash box, it was only going one step farther to deposit his money at his bank and draw out the cash as he required it. Obviously, too, if he exchanged the notes for a deposit receipt, he would receive some interest upon his money; and as the receipt could be held equally as safely as the notes, he naturally adopted the plan that was the more profitable to himself. So, although in 1826 the joint stock banks in the country attached great importance to their circulation, their notes rather took the form of an advertising medium for attracting deposits, or, at least, became a means to that end, for the progressive banks did not hesitate to sacrifice their note issues in order that they might open branches in London.

We find, then, that the joint stock banks at first attempted to place as many of their notes as possible among the public, and that, by the process already explained, the holders of their notes gradually began to deposit with them, until, by degrees, our present system of deposit banking obtained a firm hold upon the habits of the people. As the trade of the country expanded, the cheque rapidly drove out a large proportion of the bank notes in circulation; and though the issue of notes certainly introduced deposit banking in this country, modern requirements have made cheques and bills of exchange the media for the transference of credit. Such being the case, the note issues of the larger joint stock banks became of secondary importance to them; and, rather than remain outside the Metropolis, we have seen that they sacrificed their notes to the monopoly of the Bank of England.

From 1708 to 1826 the Bank of England owed its predominant position entirely to monopoly, and enough has been written to show that its sway was not an unmixed blessing

to the country. The private banker, without a shadow of doubt, can trace his lack of progress to the restrictions placed upon his business by the Bank charter; and the joint stock companies may certainly be said to have succeeded in spite of the Bank; yet no greater compliment can be paid to any institution than to assert that it has earned the respect, if not the love, of its enemies; and such undoubtedly may be truthfully affirmed of the “Old Lady of Threadneedle Street” even when her rule was autocratic and her rivals’ dislike of her intense.

Before and After the Act of 1844

Fever of 1835 - Crisis in 1837 - Bank of France lend bullion in 1839 - Chief Aim of the Act - Shortcoming of the Act - Act blamed for 1847 crisis - Cycles of boom and bust - Railway Mania - Financial Amnesia - Effect of 1846 Irish Famine - Act suspended in 1847, temporarily - Merit of small cash reserve - Lessons for banks - Driving away the speculator - Growing cash reserves since 1866 - The Bank's honesty

We have seen that part of the Bank of England's monopoly was annulled in 1826, and that in 1833 a clause was inserted in the charter to the effect that joint stock banks of unlimited liability could open in London, provided they did not issue notes; and though the state of the law still allowed the Bank to harass and annoy the new companies, its power was thoroughly broken, and its monopoly of joint stock banking gone — fortunately for ever.

The country enjoyed a period of prosperity from 1833 to 1836, but the speculative fever soon began to develop, and by the end of 1835 it was burning fiercely, for men and women possessed an extraordinary faith in those much advertised short cuts to wealth in the early thirties. No path, if it were sufficiently short, was too precipitous. Hope was boundless, credit was unlimited, and companies in profusion were formed by the philanthropists and dreamers of those times.

Then came the crisis of 1837, when the Bank's policy rose almost to the verge of madness. Just at a critical moment, when it was imperative that no untoward incident should occur to

disturb the already depressed state of credit, the Bank of England refused, and persisted in its refusal, to discount bills bearing the endorsement of the joint stock banks.

The action of the Bank added to the confusion, and, as speculation in America had been rampant, it dealt a final blow to the houses engaged in the American trade by issuing instructions that their bills also should not be discounted. Then, as might have been expected, the fury of the storm beat against the Bank itself; and by the end of February, 1837, its bullion was reduced to £4,077,000. In 1839 another crisis occurred, and the bullion declined to £2,522,000. Upon this occasion £2,500,000 was borrowed from the Bank of France, and the discount rate of the Bank of England was gradually advanced to six percent.

These constantly recurring panics thoroughly alarmed the Government, which, having stripped the Bank of England of its monopoly of joint stock banking, now turned its attention to the currency, and by the Bank Act of 1844 secured the convertibility of the note. In fact, the chief aim of the Act was to reduce the issues of the country bankers, who, by forcing large numbers of their one pound notes into circulation and neglecting to maintain a sufficient proportion of cash in hand to meet them on presentation, helped to finance the gamble of 1824. Some of the banks paid the penalty in the year following, and disappeared from the scene.

In 1821 the Bank of England, after a period of restriction, began to pay off its notes under the value of £5, but the Government allowed the country bankers to continue issuing their small notes until the expiry of the Bank Charter in 1833. In 1826 an Act was passed prohibiting the stamping of notes

under £5, and forbidding the circulation after April, 1829, of those then current.

The Bank Act of 1844 confirmed the alterations of 1826 and 1833, and, in addition, made great alterations in connection with the currency. The Issue Department of the Bank of England was to be kept entirely distinct from the Banking Department. Notes, to the extent of £14,000,000, might be issued against the debt owing by the Government to the Bank and against other securities, but coin and bullion must be deposited in the Issue Department against every note issued in excess of that sum.

Notes issued by the Bank of England are, therefore, secured principally by specie, and by the Government debt, which amounts (1902) to £11,015,100; and as every note is a warrant entitling the holder to gold on demand, a Bank of England note is really and truly equivalent to gold. However, under certain possible, if improbable, conditions, the Bank could not fulfill its obligations or promises to pay cash on presentation, for if all its notes in circulation were presented simultaneously there would not be sufficient coin in the Issue Department to meet them; but that is a most unlikely contingency.

Further, these notes are “legal tender” in England. In other words, a debtor can compel his creditor to accept them in discharge of his debt; but nobody is obliged to give out change should the value of the notes tendered exceed the amount of the sum owing. In Scotland and Ireland Bank of England notes are “current” but not “legal” tender. Neither are they by the Bank itself, nor by any of its branches, and sovereigns, though not half-sovereigns or silver, may be demanded in exchange. All notes are convertible at the London Office of the Bank, whose

branches, however, are only responsible for those notes issued therefrom.

The Bank still retains the monopoly of issuing notes in London and at a distance not greater than sixty-five miles from the Metropolis. No new bank of issue may be formed; and as the private bankers in London had ceased circulating their notes prior to 1844, the Act practically gave the Bank the monopoly of note issue within the prescribed area. This monopoly alone is of great value; but when we remember that its notes are legal tender in England as well, it is evident that the Bank of England still enjoys a most important concession.

The private bankers of London, and the joint stock banks in London and within sixty-five miles of it, were debarred by the Act of 1844 from issuing notes. Of course the private bankers who still issued notes within the prescribed space retained their privilege, but they were no longer able to circulate as many as they could persuade the public to accept.

Bankers, both joint stock and private, who claimed the privilege of issuing notes were compelled to make a return of their issues for a period of twelve weeks to a given date, when the average amount was ascertained, and the extent of the future issue of each bank settled in accordance therewith. The issues, in other words, were fixed, and they could not exceed the sum authorised without breaking the law, and exposing themselves to a fine equivalent to the average excess during any one month. The Government, anxious to avoid a repetition of the scandals of 1825 and 1836, was evidently determined to limit the note circulations of the country banks, and there seems little doubt that, when the Act was framed, one of its aims was the slow but sure extermination of the country bank note.

Banks which intend giving up their note circulations may compound with the Bank of England, which is then allowed to increase its own issue by two-thirds of the disappearing issues. The Government, however, takes all the profit accruing from such arrangements.

The result of these regulations can be seen in the accretions made from time to time to the Bank's authorised issue of £14,000,000, which has now increased to £18,175,000. The majority of the issues of the private bankers fixed by the Act of 1844 have since lapsed; and the same may be said of the more progressive of the country joint stock banks, which, as their deposits grew, opened branches in London, thereby sacrificing their note circulations to the monopoly of the Bank of England, whose notes are fast driving those of the small country bankers out of circulation. Broadly speaking, it may be said that Bank of England notes are the only notes accepted readily by the English public; but the mere fact of their being legal tender ensures that.

Readers who are not acquainted with the history of Banking must not assume that the Act of 1844 affects either Scotland or Ireland. The note circulation of both those countries is regulated by the Act of 1845, but in neither country are the provisions identically the same as those affecting England.

Any person may demand of the Issue Department notes in exchange for gold bullion of standard fineness at the rate of £3 17*s*. 9*d.* per ounce.

The Bank Act of 1844, according to its framers, would make panics and crises evils of the past; but, as a matter of fact, it was a new broom, and its sweeping powers were greatly overestimated. Its provisions, we can see, related

entirely to currency reform; and though the country bankers could no longer borrow on their notes to an unlimited extent, it must be remembered that Sir Robert Peel's famous Act, if it fixed the maximum amount of their issues, did not take the precaution to also fix the minimum reserve of cash in hand to be held against them. Obviously, no Act could strengthen the position of the banks against panics unless it laid down the minimum or legal reserve of cash to be maintained against deposits, and we shall see that, in this respect, the Act of 1844 did not realise expectations.

Controversy raged furiously around Peel's Act, and, needless to say, it became the bone of party contention. Whenever a subject reaches that stage in this country, its merits are forced into the background. Sides are taken, critics and politicians range themselves upon either the one or the other, and the subject, consequently, speedily gets all the truth lashed out of it. The number of people who really understand the question thoroughly is infinitesimal; and they, as a rule, by a strange irony of fate, do not dabble in politics. The important subject is therefore handed over to the tender mercies of the multitude, which, quite ignorant of its underlying principles, splits itself into two hostile camps, beats out the dust with sticks, and then returns a man to Parliament to vote on this side or on that.

When in 1847, three years after the passing of the Act, another crisis occurred, public opinion attached all the blame to Peel's Act; but public opinion was wrong. Public opinion is usually based upon instinct rather than upon reason, and, consequently, carried away by a sense of indignation or wrong, it rushes madly at what it considers the cause of the mischief. In

this case its bugbear was Peel's Act. The real reason was to be found in the simple fact that neither the Bank of England nor any of the large banks held a sufficient proportion of cash in hand to meet those sudden demands for gold which may be made upon a banker at any moment, and to which his business is peculiarly exposed during periods of bad credit.

It was the old, old story, which in these days seems hardly to require an explanation. After a period of exceptional prosperity, there almost invariably follows a lean year or two, when loanable capital is cheap and the prices of commodities depressed. Then is the company promoter's opportunity, and schemes, wise and otherwise, are brought to the notice of the public. Presently there comes a gradual expansion of enterprise, and rising prices beget confidence, when a whisper goes round to the effect that good times are coming.

At first business improves slowly and surely. Then, as prices mount higher and higher, every producer increases his output, anxious to share in the general prosperity. Suddenly, just before the end, there is a boom. Prices rush madly upwards, until every prudent man sees that business has degenerated into a mere gamble, and that he must act quickly if he does not wish to be caught by the receding tide. Unless the banks are strong at that moment, disaster is inevitable; and as they had not taken the necessary precaution in 1847, the result was a crisis.

Capital was cheap during the last quarter of 1844, the Bank rate remaining stationary at two-and-a-half percent from September of that year to October, 1845. Cheap money gives the promoter his opportunity; and in 1845 the railway mania was at its zenith. England was in the hands of the surveyor, and

the "boom" began in real earnest. As usual, everybody was to become immensely rich, and, as usual, most people were again bitterly disappointed. By a strange process of reasoning, experience does not count in finance. Hope, after a very little while, drives out of the memory of human beings the nightmare of disaster; so, in an astonishingly short space of time, they are gambling again. The crisis of 1837 had lost all its significance by 1845; and then, of course, the Bank Act was to prevent commercial panics in the future!

At the end of 1846 the Bank rate was raised to four percent, and in October, 1847, it touched eight percent. The speculation in railways naturally resulted in a gamble in iron; and, after the terrible famine in Ireland of 1846, when thousands died of fever and want in their wretched hovels and even on the roadsides, the suspension of the Corn Laws led to large importations of foreign grain. A sudden fall in prices immediately followed the increased supply, and the merchants in Mark Lane began to fail. Then people looked gravely at one another, and inquired what would happen next.

Credit is the disposition of one person to trust another; therefore as business gradually expands, credit or confidence increases at precisely the same ratio; and when prices are high and profits large, the impression prevails that everybody is making money — consequently, confidence begins to drive out caution; so, towards the end of a period of prosperity the acquisitive fever burns fiercely. Everybody is in mad haste to get rich; caution is flung to the winds; and we get a *débâcle*. Then follows a time of bad credit. That is to say, immediately after the reaction, everyone is disposed to be sceptical of his neighbour's position, to wonder whether he were hit by the recent upheaval, and to be extremely cautious in granting credit

to his customers. This took place after the crisis of 1847. For a little while everybody was afraid to trust his neighbour; but by 1857 speculation was in full swing again, and the inevitable collapse followed. These periods of good and bad times, or good and bad credit, run their course with the regularity of a fever.

So it was in 1847. Directly a few failures were announced, the public became alarmed, and speculation received a check. The failures continued, and every holder of bills, anxious to have money at his credit at the banks, tried to discount them. But the banks were totally unprepared for this sudden demand, and in Liverpool and Newcastle some of them closed their doors. The London bankers refused their customers ordinary accommodation, and the Bank of England at first declined to advance against securities. Bills, consequently, could not be met at maturity, and the result was panic and a run on the banks.

The situation was saved by the suspension of the recently passed Bank Act, and on 25th October, 1847, the Government authorised the Bank of England to issue notes at its discretion, until the feeling of apprehension had subsided. The Bank thereupon advanced on bills and stock, and, although the rate of discount was eight percent, the fact that money could be obtained on good bills and first-class securities speedily allayed the panic, and by 23rd November following the Act was again in force. Further, the amount issued by the Bank beyond the limit imposed thereby did not exceed £400,000 although its reserve, by 23rd October, was reduced to £1,547,000.

Perhaps we shall now be better able to understand the Act of 1844, and to see that, though it effected a most useful reform in the currency, and prevented a host of weak country bankers

inundating the provinces with their doubtful paper, it does not contain a single clause which would either prevent or alleviate a panic. Indeed the paradox is that during a crisis relief can only be obtained by breaking the Act, and allowing the Bank of England to advance notes freely against the better-class securities. The power to issue notes was taken out of the hands of numerous weak banks, and confided to one strong one.

Perhaps, however, it would be more correct to say that the power for evil of the small country bankers was "fixed" by the Act; and, as we have seen, the Bank of England's notes are gradually driving those of the English provincial banks out of circulation. Then, again, the extinction of the country issues gave a marked impetus to our modern system of deposit banking. The cheque soon became the principal credit document in circulation, and the country joint stock banks relied absolutely for their advancement upon their ability to attract deposits to their books.

So long as the Bank of England's notes can be exchanged for gold on demand, it is impossible for them to depreciate in value, and they cannot drive more gold out of the country than is equal to the Bank's fixed or authorised maximum, because, against every note issued in excess, specie for a like amount must be deposited in the Issue Department. Certain writers urge that this limitation is an interference with the freedom of the banker; but, seeing that our modern system of banking rests upon so small a cash basis, surely it is absolutely essential that our currency at least should be above suspicion in times of falling credit. The public does not require notes then. It wants credit; and this it obtains in the books of the banks.

The currency, certainly, should be left absolutely to the laws of supply and demand; and though it is true that the Bank

of England sometimes has to protect the convertibility of its notes by raising its rate of discount, still, our present system approaches very near to perfection in so far as the exchange of the note for gold is concerned, and it certainly does not seem desirable to have the country again flooded with paper money which may, or may not, be paid on presentation.

Any person who possesses gold can have it turned into coin immediately; so, under our present system, every addition to the currency must come either direct from the mines or else be received in settlement of the balance of indebtedness owing by foreign nations to this country. We are, therefore, spared those evils which result from an over-issue of paper, and which were sometimes so greatly in evidence before the passing of the Act of 1844.

The absurdity of the attack on the Act must now be apparent, inasmuch as the only reform it could possibly effect was a currency reform, which was certainly badly needed. Viewed in that light it must surely be acknowledged that the Bank Act of 1844 is one of the soundest financial Bills that has ever become an Act of Parliament. The fact that, in spite of the great change in our banking system — which may be said to have been revolutionised since 1844 — the Act has successfully stood the test of time, is also proof positive (if proof were required) that it was framed with great skill and judgment.

Had the Act further decreed that every bank should maintain a ratio of, say, at least eighteen percent of legal tender against its public liabilities, even panics might have been avoided. At any rate, the banks would have been better prepared to meet drains upon their resources, though even then — as has been pointed out is the case with the Act itself — the law would have to be broken directly a run was made on the

banks by their customers. For all that, such a regulation would keep the banks in a fair state of preparedness during normal times, and consequently every bank in the land would be ready to face a panic.

Our system of credit is based on a small cash reserve; and it would be impossible to devise any workable scheme which would afford bankers absolute security, because it would prove too costly both to the banks themselves and to their customers, who would have to pay much higher rates in proportion as the depositors' money was secured. The most prudent banker can only insure his business up to a certain point, as, if he kept more than a certain proportion of cash in hand, he would conduct his business at a loss; so if a panic take possession of his customers and they rush for gold, he is lost if the demand should drain his reserve and encroach on his till-money. No system in the world could possibly save him then. The most our banks can do, therefore, is to be prepared to a certain extent, and, viewed in the light of past history, it is criminal of directors not to take the ordinary precautions. A clause in the Act, as already suggested, would at least ensure a fair state of preparedness in all our banking companies, and beyond that it is impossible to go.

It has been shown that the Act works most effectively in a time of panic when it is broken. It is, perhaps, interesting to recall that the Bank of Germany, in order to remedy this defect, is allowed to issue notes beyond the authorised amount at its own discretion; but the German Government, in order to check abuses, makes over-issue an unprofitable transaction for the Bank by imposing a fine of five percent on any amount issued in excess of the authorised limit. Were our own Government to adopt the same expedient, the Bank of England, during a time

of stress and excitement, could meet all demands automatically, and the Act would be almost perfect of itself. On the other hand, the Government might not like to see so much power pass into the hands of the directors of the Bank, though there can be little doubt that they would use it with the greatest moderation and to the public advantage.

The object of this chapter is to show that panics were not lessened in any degree by the Act, and perhaps it may be said that the fact has been dinned into one's ears to the verge of irritation. But an ardent reformer's feelings are strong, and it is difficult to make this subject clear to those who are not conversant with the history of Banking, and who, perhaps, are disposed to think the subject both dry and uninteresting.

The panic of 1847 was followed by another in 1857, and in 1866 the **Overend and Gurney** crisis occurred. From 1866 down to the present day, unless we include the **Baring** scare in 1890, the country has been free from these scourges, and the reason is not very far to seek.

The Act of 1844 placed the currency of the country on a sound basis, and experience, by teaching the banks caution, did the rest. The large banking companies, after the terrible panic of 1866, plainly recognised that advances must be made with great discretion, and that, if they valued their own safety, speculation must be either kept well within bounds or discouraged entirely. Merchants and traders who require capital for speculative purposes can only obtain it by making application to the banks, which, in the very great majority of instances, now refuse to make advances unless tangible securities be deposited to cover their loans.

Merchants, therefore, unless their credit be exceptionally good, or unless they possess first-rate stocks and shares, cannot speculate to the same extent as was possible forty years ago and, of course, those persons who possess marketable securities, which bring them in incomes, are the last people in the world to risk an assured position for possible great future gain. They are accustomed to the good things of this earth, and though they may earnestly desire a large accretion to their wealth, the thought that, in the event of failure, they may lose what they already possess, checks the impulse to finance a scheme, which, while holding out promises of great success, is also not without possibilities of grave disaster. As a rule, only small men will take such risks, and the banks will not finance them at any price.

By refusing to accommodate weak speculators, the banks have kept business in a healthy channel, and have largely confined speculation to those people who can afford to pay their losses — always a cautious class. The rank speculator, therefore, has been driven to outside houses, and such houses, we know, are constantly failing; but Lombard Street, having weeded this dangerous element out of its system, is now more stable.

Recognising that their system of credit is always exposed to possible disaster, and having had the fact brought forcibly home to them upon so many occasions, the banks, since 1866, have gradually accumulated larger and larger cash reserves in order to be better prepared to deal immediately and effectively with those cataclysms which from time to time are certain to assail them; and though it is an open question whether their reserves are even now sufficient, the most casual observer must acknowledge that, with a few exceptions, our banking

companies are in a better state of preparedness at the moment than perhaps during any other period of their history.

By compelling the schemers to deposit securities against their loans and advances the banks secure themselves against large bad debts; and by accumulating fair cash reserves they insure their business against suspension during panics. Having taken these precautions, it is not surprising that their path has been rendered comparatively smooth during recent years; and, further, the more prudent manner in which the business of a banker is now conducted makes the shares of the large banking companies less speculative holdings, and greatly reduces the risks of shareholders in connection with their liabilities on the uncalled portion of their shares, though that liability should by no means be forgotten or accepted in any other light than that of serious responsibility.

This brings us to another point in their history. It was not until 1858 that banks could be registered as limited liability companies, and, needless to say, no unlimited bank has been formed since that date; whilst every joint stock bank now in existence (although, in the great majority of instances, the members are liable for certain known sums on each share held by them) has limited the liability of its shareholders, those companies formed prior to 1858 having since taken the necessary steps.

Naturally, persons of wealth would not risk their fortunes by holding shares in an unlimited bank, but now that the exact liability is known the responsibility is accepted with a lighter heart, and, consequently, this class of security is considered a desirable investment by those who can afford to take a little risk in return for higher interest than that yielded by the so-called “gilt-edged” variety of securities.

The reader cannot but be struck by the gradual evolution of our banking system; and it must be evident to him that the present more secure position is the outcome of a bitter struggle with adversity. It is usual, when discussing the Bank of England's position in the money market, to degenerate into abuse, and to show that the Old Lady of Threadneedle Street has committed every conceivable folly in dealing with questions of finance. No doubt the accusations are true in the light of past experience. But they were the follies of her times, and, if we are to believe the critics, we are not greatly in advance of our own. Then is it not a little unreasonable to expect the Bank directors of 1825 to be in advance of the financial opinion then current in the City? They had the very best advice of the day at their disposal, and had the present-day critics lived in 1825 they would have urged the Bank directors to take the very course that was then adopted.

English history, at a certain period, seems an account of one long struggle between the will of the people and the power of the Crown; and Banking history, prior to 1844, reads like one long struggle between the banks and the Bank of England. But there is this distinction, to wit, the sterling honesty of the Bank. Surely, in the whole world's history there is not another such instance of unbroken faith on the part of a financial institution which has enjoyed a life of more than two hundred years. While anxious to give an accurate account of the Bank's history, and to explain all its faults and all its failings, it is impossible, the closer one examines its actions, not to be the more impressed by its honesty of purpose.

Every new movement gropes its way out of the darkness into the light. The process is, however, a slow one; and if, in the future, there are new problems to be solved, then future generations will have to learn the laws affecting them in the school of experience. Despite their increased knowledge, they will probably make the same mistakes as those recorded in these chapters, for it is astonishing, as our environment changes, how short a distance we can see in front of our noses. Banking in 1950 will in all probability be very different to banking in 1902 — especially if population increases at its present rate all the world over.

Panic Years

Review of the early crises - South Sea Bubble - 1745 and "Bonnie Prince Charlie" - India, Uprising - "Quite an epidemic of crime" - Trade and Crisis of 1857 - Suspending the Bank Act - From America to Scotland, Bank failures and fraud - Run on Scotch Banks - 1861,US civil war - 1866, Overend Gurney fails - How the Bank of England saves itself in times of panic - Prudence and company balance sheets - Lessons learned, the system - The Credit machine and the Workshops - 1878, failure of City of Glasgow Bank - 1890, Baring Brothers exposed in Argentina - City rallies round - Bank of France to the rescue - Australian Bank difficulties, 1893 - Boer War 1899-1902

When in 1667 a Dutch fleet sailed up the Medway, demolished a fort at Sheerness, and, forcing a way into Chatham Docks, burnt all the ships assembled therein, to the consternation of the inhabitants of London, there was a run upon the banks; but a Stuart regarded both events with equanimity, for "Old Rowley" had a mind above trifles of this description, possibly because he had learnt many bitter truths in a world seldom understood by Kings. Cynics are not born — they are made; and Charles II had drunk from that cup which sharpens the understanding.

France, during 1719 and 1720, was in the throes of the Mississippi scheme, which was engineered by that notorious Scotsman, John Law; and England, in 1720, witnessed the collapse of the South Sea Company, which Sir Robert Walpole, with rare insight and unerring financial instinct, had demonstrated was a mere gamble, that, at the best, could only

enjoy a temporary success, which was absolutely dependent upon a rise in the company's stock; but the Government turned a deaf ear to his warning.

Scotland, we have seen, had its Darien venture in 1699; and in 1720 all England went mad over the South Sea Company, which offered to relieve the Government of part of the National Debt, and entered into an insane competition with the Bank of England for that purpose. Then occurred some spirited bidding between the two companies for this privilege; but the directors of the Bank proved themselves the less mad, and left their rival in possession of the incubus and the road to ruin.

The result of the bidding gave the necessary stimulus to the South Sea Company's stock, and, seeing it going up, the public at once rushed in, when the stock rose faster than ever. In a very short space of time the fever for speculation infused itself into the blood of the whole nation. The pace became so furious that the more thoughtful among the gamblers began to see the end and to sell, with the result that, upon a memorable morning, everybody wanted to dispose of his stock — and then the bubble burst.

In June, 1720, the £100 stock of the South Sea Company was rushed up to £890, and a little later it touched £1,000. Then the tide turned, and, as is invariably the case, all were as anxious to sell as a few days before they had been eager to buy. Every hour intensified the panic, until at length the stock fell to £175, and the difference between the highest and lowest quotations is eloquent of the loss inflicted upon the community, for everybody who had money to invest was interested in this gigantic gamble.

Widespread misery and ruin followed. Suicide was of daily occurrence, and, after a momentary lull in the storm, popular indignation lashed itself into fury against the directors, for whom, it was openly declared, hanging was too good a fate. The Government, thoroughly alarmed, turned to the one strong man who had consistently opposed the scheme, and who, in consequence, was at that moment the most popular man in England; so Sir Robert Walpole stepped into the breach, and stemmed the tide of popular indignation and national disaster.

At first Walpole was disposed to resort to half-measures, but when it became apparent that the South Sea Company was rotten to the core and that it must go at any price, he devised a scheme by which the East India Company and the Bank of England took over £18,000,000 of South Sea stock. The Bank directors, throughout this trying period, acted with a strange lack of caution, and the situation was only saved by Walpole's better judgment.

The period was one of mad speculation, and no venture was too absurd to foist upon a public, which, until the crash came, did not display a gleam of intelligence or discernment, so blinded was it by greed. Naturally, those bankers who had advanced against South Sea stock did not escape loss, and many of the goldsmiths and private bankers were ruined by the reaction, while the Bank of England itself barely escaped. It is interesting to notice that, even in 1720, the public could only be tempted by a rising market; and it has remained true to this instinct, as, for some unaccountable reason, the "bear" is always looked upon as an undesirable kind of person.

The next disturbance of credit occurred in 1745, when the Young Pretender, "Bonnie Prince Charlie," after defeating Sir

John Cope at Prestonpans, resolved to march on London, and penetrated as far as Derby. The news of his arrival there reached London on the 4th December (Black Friday), and the City was seized with so severe a panic that business was suspended. Some of the citizens actually left the country, and even the King made preparations for flight. Everybody then wished to possess himself of gold, and a run at once began upon the Bank of England, which was taken completely by surprise, and only saved the situation by resorting to the expedient of paying its notes in sixpences — a somewhat lengthy proceeding, but one which enabled it to gain time. Nobody, however, would trust a Stuart, and the panic very quickly subsided.

Learning that the Duke of Cumberland was advancing to meet him, Charles was compelled by his followers to beat a hasty retreat towards Scotland, and by the 23rd December the Highlanders had crossed the border again. In January, 1746, they defeated General Hawley at Falkirk, but in the following April the Prince lost the battle of Culloden, which dealt the final blow to the hopes of the House of Stuart.

The panics and crises between 1745 and 1857 have been discussed in Chapters one and two of this book — principally in Chapter two.

In 1848 Lord Dalhousie carried out a policy of annexation in India in a ruthless manner, and the native princes, thirsting for revenge, insidiously propagated a rumour among the native soldiery of the East India Company to the effect that the British Government was anxious to Christianise them, knowing that the

unsophisticated Hindu preferred his sacred cow to the God of his conquerors, though he had probably little faith in either.

At any rate, the princes appealed to the patriotism of the native soldiers, who, in May, 1857, replied by refusing to accept the famous "greased" cartridges, and in a few days the insurrectionary movement was ablaze in India. The massacre at Cawnpore sent a thrill of horror and indignation through the country, and Sir Colin Campbell (afterwards Lord Clyde) was ordered post haste from England to take command of the British troops. Naturally, our trade with India was disorganised; and, speculation having exceeded all bounds in America, the grave news from that country, combined with the outbreak in India, hastened on the crisis of 1857.

Quite an epidemic of crime swept through England about the middle of the nineteenth century, and many names well known in the City were smirched, whilst even the firm of **Overend and Gurney**, whose credit was then at its zenith, were said to have compounded a felony in order to avoid a bad debt. Financial morality, which is at all times peculiar, was at this period at its lowest ebb. So small wonder that when the American banks failed by the dozen in 1857, a feeling of distrust should make itself felt in this country, which was then engaged in a fierce struggle in India.

Merchants and houses engaged in trade with India and America began to fail, and in a very little while there was a run upon some of the banks. Then followed the collapse of the **Borough Bank**, and **Dennistoun's** of Liverpool. In Scotland the **Western Bank** and the **City of Glasgow Bank** put up their shutters; and the failure in London of **Sanderson & Co.**, the well-known bill brokers, accentuated the grave condition of credit, forcibly reminded the public that the rotten state of the

American railroads had ruined thousands of speculators in this country, and generated in the public mind a feeling of positive alarm. The result was a panic, which by 12th November culminated in a crisis. The country then looked to the Government and to the Bank of England.

Both 1855 and 1856 were years of unusually high Bank rates, and during 1857 the demand for loanable capital became so pronounced that the Bank of England, in order to protect its dwindling store of bullion, had to raise its rate still further. The year opened with six percent. In July it fell to five-and-a-half percent, but by 10th October it had reached eight percent. On 5th November nine percent was recorded; and upon the 9th of the same month it was hurriedly raised to ten percent. Lombard Street had then practically arrived at the end of its available resources; and demand, of course, centred itself upon the bank which held the bankers' cash balances.

The Bank of England, as usual in those days, was quite unprepared to meet a crisis, and made application for assistance to the Government. Had help then been refused, it must inevitably have closed its doors, for the reserve in its Banking Department on 13th November, 1857, had fallen to £957,000, while it was rumoured that, at the close of a particular day, the reduction was appreciably greater. In plain English, the Bank of England was practically broken.

On 12th November the Government consented, for the second time since 1844, to the suspension of the Bank Charter Act; and when it became known that the Bank of England was in a position to increase its circulation to an unlimited extent, and to advance notes against the better-class securities, the nervous tension created by the numerous failures throughout the country instantly relaxed, and in a few days a comparative

calm followed the storm. Indeed, before the close of 1858 the Bank rate was down to two-and-a-half percent.

The suspension of the Act during a crisis creates a market for securities at the Bank of England. Furthermore, at so critical a moment the Bank is the only market in existence; consequently those securities in which it decides to deal are alone saleable, and we know that it confines its advances solely to the so-called gilt-edged securities and to good bills. Of course, if the public only thought, it would instantly perceive that the more notes the Bank issues in excess of its authorised amount the less secure is its position, because the smaller is the proportion of gold in the Issue Department to its liabilities. But the British public is led; it does not think. If it did we should speedily be in the throes of a revolution.

The public thinks the Government lends its credit to the Bank, but in reality it does nothing of the kind. It simply authorises the Bank of England to break the law, and to advance notes at its discretion. However, the credit of the Bank is so good that the public, seeing that it has the “moral” support of the Government, possesses absolute confidence in its stability; and though it trusts the Bank blindly and unreasonably, that institution has earned its gratitude upon more than one occasion, and its history, if full of mistakes, certainly entitles it to this confidence.

Mention has been made of the failure of the **Western Bank of Scotland** in 1857. This institution, besides advancing indiscreetly at home, helped to finance the gamble in American securities; consequently, when the crisis occurred in the United States, the bank found itself saddled with huge blocks of unsaleable stocks and shares. Subsequent investigation disclosed a most discreditable state of affairs.

In 1856 the **Royal British Bank**, after a short life of continual fraud, came to the ground; and in 1857 the public learned that the notorious Colonel Waugh had fled to Spain with considerable sums belonging to the **Eastern Banking Company**. A little later, when it was discovered that bank directors and auditors who, for a consideration, would attest such statements as those issued by the **Western Bank**, could be found in Scotland, the public came to the conclusion that a balance sheet is worth little more than the paper upon which it is printed; and a run at once began upon the rest of the Scotch banks, which promptly arrested the panic by guaranteeing the notes of the insolvent **Western Bank of Scotland**. The **City of Glasgow Bank**, though it closed its doors temporarily during this period of fraud and distrust, succeeded in weathering the storm, only to fail badly in 1878.

The relations between England and France were severely strained in 1859. A plot was hatched in London by an Italian secret society against the life of Napoleon III, whose publication of a denunciation of British hospitality sent a thrill of passionate resentment through this country, which replied to his threat of invasion by the inception of the volunteer movement. The call met with immediate response, for nothing kindles enthusiasm so quickly as hate, and England, for the first time in her history, created an army of citizen soldiers. At the height of the frenzy there were ominous rumours, and for a little while a state of panic prevailed; but the alarm soon subsided, and the next year a commercial treaty was enacted with France.

During 1862 loanable capital was cheap, and in July that year the Bank rate sank to two percent, whilst at no time did it

exceed three percent. With money abundant, the promoter was soon in evidence, and the speculation fever once more took possession of the public, hundreds of companies being registered under the Companies Act of 1862 within the space of a few months, until dear money began to lessen the output of limited liability concerns and the energies of that arch-enemy, the promoter. In 1861 the United States was convulsed by civil war, which caused a cessation of production there on a large scale, and produced a cotton famine in this country. Lancashire, the centre of the industry, could not obtain fresh supplies of the raw material when the ports of the Southern States were blockaded, and early in january, 1863, hundreds of thousands of operatives were out of employment. Speculation instantly received a check, and the energies of the country were concentrated upon raising huge sums for the alleviation of the distress in Lancashire — for 500,000 unemployed workers might at any moment, should their attitude become menacing, prove a danger to the State.

From 1863 to 1865 the Bank of England was undoubtedly face-to-face with a serious situation, and, for the first time in its history, its directors grasped the simple fact that only by maintaining a good reserve can the country be saved from panics and crises. The year 1863 was one of high Bank rates, and during the autumn of 1864 pressure upon the Bank's resources became so severe that a crisis was narrowly averted. Supplies of cotton from America having practically ceased, demand centred upon India, and the Bank of England, early in August, had to support a drain of silver thither to help pay for the cotton crop. On 4th August the Bank rate was raised to eight percent, and again on 8th September to nine percent, at which figure it remained until the 10th November, when it fell to

eight again. The strain upon the Bank was severe, but the crises of 1847 and 1857 had taught their lesson, and by using the "Bank rate" with effect, the directors succeeded in keeping a sufficient reserve in the Banking Department.

By about the middle of 1865 capital was cheap, but, towards the end of that year, a decided stringency manifested itself, and at the beginning of 1866 many companies which had been registered under the Act of 1862 failed. The banks, whose reserves were then much smaller than now, came in for their share of distrust, and the failure of a Liverpool firm for a large amount made the public uneasy; but when it was known on the 11th May that **Overend, Gurney & Co.** had closed their doors, the City was seized with panic, and streams of depositors rushed to Lombard Street to withdraw their money from the banks, which, in a very short time, were paying out at a rate it was impossible to maintain; and it soon became evident that unless confidence were speedily restored the banks must break.

The Bank of England had to meet large demands from the provincial banks, for distrust was general throughout the country; consequently at such a moment the country bankers required their reserves of cash in their safes, so that they could immediately meet the demands of the more nervous of their customers should necessity arise. The Bank advanced its rate to seven percent on the 3rd May; to eight percent on the 8th of the same month; and to nine percent on the 11th; and, the pressure becoming more intense, application was made to the Chancellor of the Exchequer, with the result that the Bank of England was authorised to break the Act if necessary, the Government's condition being that the rate of discount should

be ten percent while the Act was in abeyance; so, on the 12th May, the Bank rate was raised to ten percent, where it remained until the 16th August following.

By the 16th May the reserve was reduced to £731,000, but directly it became known that the Bank was in a position to advance notes against approved securities the tension relaxed, thereby proving that the public understood the cure as little as it did the disease — for it was an act of madness to make the run, and equally as stupid not to perceive that the issuing of unconvertible notes is at the best only a quack remedy. However, the remedy proved effective, and the result enables one to realise that a nation, like an individual, is the slave of habit.

The history of the firm of **Overend, Gurney & Co.** makes sorry reading. Between this old-established discount house and the Bank of England there had always existed a spirit of rivalry; and when, after the crisis of 1857, the Bank stated its intention not to again assist the bill brokers during a time of panic, and only to make advances to them at those periods when the Government takes large sums off the market, a very bitter feeling sprang up between the discount houses and the Bank.

Overends, determined to show the Bank that it was not omnipotent, allowed their account at the Bank of England to run largely into credit, and one day suddenly demanded three millions in cash. Their ruse failed. Indeed it was as stupid as the resolution which goaded them into making the effort; for, of course, were the Bank to refuse to assist the bill brokers during a panic, it would only be adding fuel to the flames and increasing its own difficulties. Small wonder then that so absurd a decree created intense irritation, for, upon examination, it is evident that the Bank of England is as dependent upon the

bankers' balances in a time of panic as are the bill brokers upon the institution which holds them. Then what folly to advertise such a decision!

Naturally, the Bank is not pleased at the thought that it must help its rivals over the stile, but the peculiarities of our banking system compel it to, whether it like the task or not. Therefore, it was an error of judgment on the part of the directors of the Bank to pose as the champions of the banking community, and to declare that the bill brokers must, in future, accumulate reserves of their own, when they knew quite well that the nature of their business utterly precluded such an attempt.

During a panic the Bank of England can only save itself by advancing freely against certain securities and good bills. The credit so created, however, swells the bankers' balances in its own books, and consequently the amount standing to the credit of the bankers increases appreciably. But, at such a moment, the bankers call in large sums from the bill brokers, and, unless the brokers can obtain advances from the Bank of England against good bills and gilt-edged securities, they will be unable to satisfy the demands of Lombard Street. By declining to advance to the bill brokers, the Bank, in reality, would be refusing credit to Lombard Street (bankers' balances); and, as the Bank itself could not live were Lombard Street to withdraw its balances at so critical a time, it follows that it must lend to the bill brokers in order to enable them to repay the bankers. It simply dare not refuse to assist them, for, if it did, the banks might decline to support the Bank which left them in the lurch just at the height of the storm. The bill brokers (the outside market) come within our present credit system, and if, when a state of panic prevails, they were left to their fate, in every

probability the system of which they form a part would collapse with them. The brokers may not be essential to the system, but it is always dangerous to "swap horses whilst crossing a stream."

In 1865 **Overend, Gurney & Co.** converted their business into a joint stock company for the same reason that some private firms adopt the procedure — because their profits were decreasing — though this was not known until after the crash of 1866. During the panic of 1857 the Bank of England made large advances to **Overends**; but when, early in May, 1866, the firm again applied to the Bank for assistance, the request was refused. It has been suggested that the Bank's decision was prompted by malevolence, but at so crucial a moment the directors of the Bank would have hesitated to make a rod for their own backs, and, had they believed in the genuineness of **Overends**' application, they would have gladly granted the accommodation in order to spare themselves the panic which they knew must follow their refusal to assist a firm with liabilities of over £19,000,000. Moreover, subsequent events confirmed the judgment of the directors of the Bank of England.

When the partners of **Overend, Gurney & Co.** discovered that their books were full of possible bad debts, they promptly converted the firm into a company, guaranteed the book debts, and appointed directors. Shortly afterwards it was noticed that the **Gurneys** were realising their property, and suspicion was at once aroused, for it was naturally assumed that they had incurred heavy losses. When, therefore, the company appealed to the Bank the next year, the directors were sceptical, for though **Overends** still retained the entire confidence of their country customers, there undoubtedly existed a feeling of

distrust in the City, and the directors of the Bank of England shared in the opinion there prevailing.

When the rash speculations of the partners were disclosed the public was loud in its abuse, and nothing short of a prosecution would satisfy it; and when, early in january, 1869, the directors of **Overends** were committed for trial on the gravest of charges, the crowd manifested its delight. But the comedy followed. The trial took place at the end of the year, by which time public opinion had completely veered round, and when it became known that the accused were acquitted, this same crowd cheered lustily. Small wonder that a Government, which must be well aware of the vagaries of crowds, should hesitate to conduct a public prosecution.

The panic of 1866, though the suspension of the Bank Act immediately brought relief, dealt a fearful blow to credit, and the country recovered from the shock with painful slowness. Foreigners, alarmed by the disorganisation of the London money market, began to withdraw their capital, and the Bank, in order to check this drain of gold outwards, was compelled to keep its discount rate at ten percent for three weary months.

By the middle of 1867 the Bank rate was at two percent; but even the company promoter had not the audacity to show himself, so depressed was the public spirit by the disasters of the previous year. The great railway companies, too, began to find themselves in financial straits, and their credit was so bad that they could only raise money on debenture stocks at high rates of interest, for the public then looked upon their ordinary shares as distinctly speculative holdings. As the railway directors neglected to borrow with the option of redemption at certain figures at a future date, it followed that, when their credit greatly improved at a later period, the companies were saddled

with a huge drain in the shape of high interest on their debenture issues, whereas, had their directors exercised ordinary prudence, they would now be paying very much less upon their prior stocks, and consequently the dividends on their ordinary shares would be proportionately greater. Evidently, then, the interests of the shareholders were sacrificed to the holders of the debenture and preferred stocks.

As the prior stocks absorb so large a share of the profits, and, moreover, as the amount so absorbed is practically always the same, whereas the revenue is variable, it follows that the distributions on the ordinary shares fluctuate considerably. This fact, of course, has not escaped speculators, who work out the ratio of ordinary share capital to total capital; and the smaller the ratio the more inconstant will be the dividends, and the greater the movement in prices. Investors know that, should the trade of the country be improving rapidly, a certain railway will earn more; and if its share capital ratio be small, then the increase in revenue will largely swell the ordinary dividends thereupon — so they speculate for a rise.

The Franco-German war, which broke out in 1870 did not at first exercise any very great effect on the English money market, for though the Bank raised its rate to six percent on the 4th August that year, it was at two and a half before the end of September. Indeed, after the panic of 1866 down to the middle of 1870, scarcely a ripple disturbed the unusual calm of the money market, but **the three crises since 1844** were largely accountable for that. They **taught both Lombard Street and the Bank of England that caution is essential to the successful working of our banking system, and that fair reserves, however great the loss of interest incurred**

thereupon, are indispensable to a banker. The result of these bitter lessons may be read in the comparatively peaceful history of English banking since 1866.

In 1870 specie payments were temporarily suspended by the Bank of France, and the European demand for the precious metals had to be met by the Bank of England. A much larger amount of foreign capital, consequently, was deposited in London, which then became the Clearing House of Europe, and the accumulation of so much foreign money unquestionably made the money market more sensitive, and increased the responsibilities of the Bank, whose store in the Issue Department was then peculiarly exposed to the danger of a drain outwards.

The Franco-German war ended disastrously for France in 1871, and the vanquished had to pay a huge indemnity to the victor. France paid considerable sums to Germany by bills on England, and although Germany employed a certain proportion of the capital so obtained in the London money market, it withdrew large sums in gold, which were required for purposes of currency reform. During the latter part of 1872 the Bank rates were decidedly high, and in November, 1873, nine percent was recorded for about two weeks, but by December it was down to four and a half again. The Bank, no doubt, had its anxious moments during this period, for the larger the drain outwards the more dependent would be the bill brokers upon it, and the directors could not refuse to increase their advances to the brokers, because, had they done so, there would have been a panic at once.

We can now see distinctly how our system works. First, we get the bill brokers or middlemen, who, from the nature of their

business, cannot afford to keep reserves, because their margin of profit is so small; and secondly there are the bankers, who keep their reserves with the Bank of England, which is thereby placed, so to speak, in the centre of the money market.

The Bank, after it was stripped of its monopoly of joint stock banking, failed for a time to understand its new environment, and it would have closed its doors three times since 1844 but for Government intervention, viz., in 1847, 1857, and 1866. However, when we remember that its directors were merchants, not trained bankers, and that the Bank had to adapt itself to entirely changed surroundings, this result is not remarkable. So little acquainted were the directors with the laws of banking that they actually believed the Act of 1844 would prove a panacea for all kinds of financial troubles; but their eyes were opened very widely indeed in 1847, and they gradually came to the common sense conclusion that "the higher the ratio of reserve in the Banking Department the smaller is the danger of disaster to the Bank and to the country."

During 1866 the Bank was fairly well prepared, and, for the first time in its history, it met a panic in a scientific or common-sense manner, and advanced without hesitation to all would-be borrowers whose securities were good. The greatest danger the Bank has to face is the suspension or stoppage of the credit machine of which it is the heart, for if the progress of that machine be arrested, then the trade of the country must also stop, and England will be bankrupt.

So long as the machine can be kept in motion a catastrophe is impossible, and experience has taught the Bank that, during a period of pronounced distrust, this can only be done by advancing liberally against certain securities, and by a

skillful use of the “Bank rate.” The whole credit machine must work smoothly, and it would be madness, at such a moment, for the Bank to attempt to leave any part of the machine (the bill brokers for instance) to its fate. This is now fully recognised, and consequently a better feeling exists between the various divisions of the money market.

The credit machine is kept in motion by the workshops; therefore, during a panic money has to be advanced to discount good trade bills in order to support the workshops, for if a rumour got about that the banks were refusing the acceptances of strong firms, the pressure to borrow would immediately increase, thereby adding a fresh danger to the situation, and causing nervous depositors to rush in a body to the banks for their money.

It follows, therefore, that in order to arrest a panic, and to prevent a dangerous run upon their resources, the banks must lend freely to strong clients. In a time of financial stress the weak go to the wall, for finance is no exception to the rule that only the strong can live when a storm bursts and causes a struggle for existence. There is no room for sentiment at such a moment. The fight is bitter and to the finish. Sentiment comes in afterwards. This state of affairs is one of the curious products of modern civilisation, and, if you want to alter it, you must first alter human nature, which changes strangely little as the centuries roll on.

At first sight these sudden advances seem highly imprudent, because the banks are parting with their resources, but unless the workshops are assisted the banks *must* break: whereas, by advancing liberally on the best securities at high rates of interest, the dangerous element is speedily weeded out, and, provided the reserves of the banks are fairly large in

proportion to their liabilities, a healthy reaction is practically certain to assert itself long before the end of their lending power is reached. The Bank, when it advances, of course creates credit in its books, and so adds to the resources of Lombard Street. The relief thus obtained is artificial, and, were it intended as a permanent cure of a disease, it must in the end only aggravate the malady. But it is temporary assistance during a trying time that the workshops require, and it is just this which our modern credit system, when skillfully administered, can give admirably. In fact it possesses the very machinery for the purpose. This sudden demand for additional credit (not specie) during a period of pronounced distrust is fortunately of short duration, and the Bank is, therefore, only called upon to make large loans for a short time, as, though the depression following a panic may prove lasting, the acute stage which the Bank has to face is soon over.

The dangers of our credit system are apparent to everybody; but when critics point to the panics which have occurred since the Act was passed, and make deductions therefrom to the effect that the Bank may find itself in a similar plight should another such whirlwind develop, they usually forget that, though the same danger exists, our banking companies are now much more prudently managed, and that the directors of the Bank of England, having the misfortunes of the past to guide them, are thoroughly acquainted with the delicacy of the machine they manage, and are, consequently, less liable to err.

We have seen that the joint stock banking movement began in 1826 under conditions which were far from favourable, and the companies, like the Bank of England itself, having to

learn their business as the movement progressed, naturally committed many blunders; but when the dangers of banking were better understood failures became much less frequent, and after 1866 they were few and far between. The credit of the joint stock banks vastly improved in consequence, and confidence in their stability soon began to take the place of distrust. But in 1878 the failure of the **City of Glasgow Bank** and of the **West of England Bank**, together with some half-dozen private bankers and banking companies, undoubtedly revived old prejudices and created a feeling of unrest among depositors and shareholders.

The **City of Glasgow Bank**, it will be remembered, was in trouble during 1857, but in 1878 both its customers and shareholders had reason to regret that it ever opened its doors again, for the gravest irregularities were disclosed when its affairs were examined, false balance sheets having been certified by auditors and directors during a period of over four years; and once again the public was startled out of its sense of security by the discovery that some bank directors and auditors were not less peccant than the majority of the human race when hazardous speculations landed them in financial difficulties.

The directors of the **City of Glasgow Bank** finding themselves out of their depth, clutched at the proverbial straw, and, like a weak individual who starts with the best of intentions, they were speedily sucked into the vortex of crime. By the Act of 1845 the directors were bound to hold gold against any excess in the amount of the bank's circulation fixed thereby, but they overcame this difficulty by the simple expedient of making false

returns to the Government. Having once crossed the line which separates the sheep from the goats the rest was easy.

With an utter disregard for the interests of the shareholders, the directors advanced huge sums to firms in which they were pecuniarily interested, and, as these firms did badly, they were compelled either to bolster them up with additional loans or to allow them to fail. They chose the latter alternative, and, as might have been expected, the bank's assets rapidly dwindled, millions of pounds in the shape of bad debts being disguised on the right hand side of the balance sheet as cash in hand, Government securities, and so on. The business of the bank soon degenerated into a mere gamble, and during the latter part of its career the institution was only kept in existence by the continuous perpetration of frauds.

Of course the longer the game (it can be dignified by no other name) continued the more desperate were the efforts it called forth, and just before the end the directors hit upon the brilliant idea of conducting a big gamble in Australia, in the vain hope that a decided success would obliterate the mistakes of the past; but about this time rumour was active, and when it was noticed that the bank's acceptances were being hawked all over the City, holders of its paper became suspicious. The bill brokers naturally do not like putting all their eggs in one basket, but endeavour to get as many good names as possible, so that, should a particular firm meet with misfortune, they may be in a position to bear the loss. When, therefore, the **City of Glasgow Bank's** paper was offered freely, they refused to place more of its bills in their cases, and, inquiries concerning the bank being made in consequence, the end soon came.

Though the revelations which followed generated a feeling of intense nervousness among bank shareholders and

depositors both in Scotland and this country, and undoubtedly caused a slight panic, the country was spared a crisis. The Scotch banks, in order to prevent the run extending to themselves, encashed the notes of the delinquent institution, and advanced liberally to those persons whose money and securities were held by the **City of Glasgow Bank**. In this manner a serious panic was averted.

The Bank of England raised its rate immediately danger was threatened, and on the 14th October, 1878, the rate touched six percent, but it fell to five percent in November, and money was exceptionally cheap during the next two years. The **West of England Bank** had also advanced its resources in a reckless manner, and it failed badly in consequence; but the Scotch scandals were not repeated, and the public gradually regained confidence in the banking companies.

When it was clearly seen after the failure of the **Glasgow Bank**, how easily a large bank, unless it be most cautiously and prudently managed, can ruin its members and customers, the public hesitated to hold shares in an unlimited banking company. For a time the prices of bank shares fell considerably, and fiction became tediously full of heroines and heroes who lost their fortunes by holding just one share in the **Glasgow Bank**. It was the “just one share” that proved so thrilling, and accentuated the sadness and the danger of possessing shares in an unlimited bank. The risks of a banking business were discussed on every side; and, after this failure, the unlimited banking companies took steps which enabled them to affix the desirable word “limited” to their registered names.

From the time of the failures of the **City of Glasgow Bank** and the **West of England Bank** until 1890, when the **Baring**

crisis suddenly opened the eyes of the public to the dangerous gamble which was taking place in South American securities, the money market enjoyed a period of comparative calm. Speculation since 1885 had increased in volume, and the prices of securities steadily rose; but early in 1890 it became apparent that continuous speculation had inflated prices and created a situation which could not last. The Bank rate during the autumn of 1889 was exceptionally high, and remained at six percent from 30th December, 1889, to 20th February, 1890, when it gradually descended, but this fall only proved the lull before the storm, which raged furiously in the November following.

England has always speculated largely in both North and South America, and the result has almost invariably been a panic. In 1890 it was the Argentine Republic which was to prove an Eldorado for the British investor, and **Baring Brothers** were so convinced that this wonderful land must prove a veritable gold mine that they practically staked the existence of their firm upon it, but Argentina sadly disappointed its backers. Having staked their all and lost, there were many who thought that **Barings** should have paid the penalty of their mistake, for Fate certainly was not so kind to some of the smaller losers in the gamble as was the Bank of England to **Baring Brothers**.

In June the **Buenos Ayres Western Railway** was unable to raise capital in this country; and when at a later date **Baring Brothers** failed to place a new Argentine loan, the worst was feared. Earlier in the year the United States had increased its circulation of silver currency, thereby creating a sudden demand for that metal and a proportionate rise in those securities upon which the interest is payable in silver. A fall soon followed; and

when it was found that the Argentine Government was in straits, Stock Exchange settlements became difficult. The banks, which had advanced huge sums to the Stock Exchange on American securities, increased their margins directly the markets looked dangerous; consequently high rates of interest, together with the rapid fall in South American securities, made “carrying over” in the House an expensive operation. Speculators became alarmed, and sold out at panic prices in order to cut their losses, and on 7th November pressure upon the Bank of England became so great that the rate was raised from five to six percent.

Lord Revelstoke, who was a partner in the firm of **Baring Brothers**, was also a director of the Bank of England, and, finding that his firm was in difficulties, he disclosed his position to the Bank directors, who, when they heard that **Barings**’ liabilities to the public amounted to over £28,000,000 felt that even the Bank of England could not afford to guarantee so large a sum; so, after much deliberation, it was decided to invite the co-operation of Lombard Street in the bolstering up of **Barings**, and, for the first time in its history, the directors of our large banking institutions met the directors of the Bank in their sacred parlour to discuss what steps should be taken in order to avoid a disturbance of credit which, should the suspension of **Barings** be announced, would probably produce a crisis even more disastrous than that caused by the **Overend and Gurney** crash in 1866.

The resources of Lombard Street combined are infinitely greater than those of the Bank, which, we have seen, largely draws its own power therefrom, and the directors of the Bank of England, in consulting with the directors of the joint stock banks, proved that they thoroughly understood the constitution

of the money market. Moreover, this new step created a precedent which bound the whole market more closely together, for each division clearly recognised how essential it is that the great machine should work smoothly. This can only be accomplished by the best of feeling existing between its constituent parts, and the wise step taken by the directors of the Bank in November, 1890, undoubtedly generated a feeling of sympathy which had formerly been noticeably absent between the various sections of the money market, and which augurs well for the harmonious working of the system in the future. Such sympathy may be the outcome of enlightened selfishness, but it is none the less valuable.

The directors of the joint stock banks, when the position of **Baring Brothers** was revealed to them, instantly recognised the danger of the position, and, as their advances to the Stock Exchange were considerable, they were naturally anxious to prevent a catastrophe which would create a panic in the House, and the end of which it was impossible to foresee. **Barings**, who are financiers in the English sense of the word, not bankers, had at the worst only been guilty of imprudent speculation, and, as all inquiries were answered in the most straightforward manner, Lombard Street was as anxious as the Old Lady herself to assist **Baring Brothers** over the stile. Undoubtedly Lombard Street would have liked to make an example of the firm that was caught short of cash, but it was afraid to leave it to its fate, because it knew that discrimination is not one of the characteristics of excited depositors, and that, were **Barings** to close their doors, the credit of Lombard Street would next be questioned.

The outcome of the meeting at the Bank was that the Bank of England agreed to make advances to **Baring Brothers** in

order to enable them to meet their liabilities as they matured, and the large banking companies, on their side, guaranteed the Bank against loss to the extent of £15,000,000.

Immense sums had been invested in South America, and when it was rumoured that the wealthy firm of **Barings** was tottering, Argentine securities were practically unsaleable on the Stock Exchange, where a state of panic prevailed. For a few days the wildest rumours were noised abroad, and the tension, just at the height of the panic, became so acute that even the Consol market was idle. The market then turned in despair to the Bank, which was compelled to borrow £3,000,000 from the Bank of France as a precautionary measure, and also to accept help from the Russian Government.

The British Government, fully alive to the gravity of the Bank's position, promised to suspend the Act in case of need; but when it became known that **Barings** were to be supported, and that the Bank of England was lending freely on approved securities at high rates of interest, confidence was restored, though a few days earlier it had looked as if a dangerous crisis were imminent. The Bank Act, however, was not suspended, but it is **difficult to say what might have happened had not the Bank of France come to the rescue, for the gold advanced by that institution at so awkward a time doubtless tended to greatly alleviate the feeling of apprehension which existed in this country, and which, at any moment, might have overcome restraint.**

The Bank rate remained at six percent until 4th December (a period of twenty-seven days), when it was reduced to five percent; for the high rates ruling in the market attracted gold to this country, and increased the reserve of the Bank of England beyond the apprehension minimum, thereby enabling that

institution to make the change in question. By the middle of the following year (1891) the Bank's rate of discount was down to two-and-a-half percent; but confidence was not restored for some considerable time; and we all remember the deadly dull years of 1894 and 1895, when it was predicted that Consols would never again fall below 100. The financial prophets and the weather prophets are generally wrong, but though we have acquired the habit of tapping the glass each morning, a prudent man carries his umbrella all the same.

The directors of the Bank of England, when they were informed of **Baring Brothers**' position, acted with great tact and ability. They did not hesitate to assist everybody who possessed good securities, and when it was found that loanable capital was obtainable, the alarming symptoms which were at first in evidence soon subsided. Whether or not the Bank were sufficiently prepared at the time is, however, a matter of opinion. The directors certainly began the year badly, for the ratio of the reserve in the Banking Department was under twenty-eight percent — a dangerously low proportion in these times, when huge sums of foreign capital may be suddenly withdrawn from the market at the least sign of discredit. Nor are high rates of discount always effective in immediately attracting gold to the Bank, as the Bank of France, should it desire to retain its bullion, can always charge a prohibitive premium on its gold. Certainly, since 1890 the Bank of England has maintained larger reserves, and the **Baring** panic unquestionably proved that such a step was necessary.

It would seem that the panic of 1890 was the result of a Stock Exchange gamble, which was only rendered possible by the large loans on securities made to members of the House by the banks. The **Baring** incident brought matters to a climax,

and Lombard Street, which was more involved in the speculation than many persons imagined, had to save both that firm and the Stock Exchange in order to avoid a crop of bad debts, which, with numerous failures, and a far greater drop in the prices of securities, would have inevitably resulted.

Mr. Lidderdale, who was Governor of the Bank during this period, acted with great energy, and after the danger was passed congratulations were showered upon him from every side. The Stock Exchange presented an address to Mr. Lidderdale, and in making the presentation its spokesman said: "If the Bank had not acted in the way it did, a great disaster would have befallen the mercantile community." Yes, and that disaster would have been largely caused by speculation on the Stock Exchange. Further, had not the directors of the Bank met this incipient panic in a scientific manner, and used their power as precedent dictated, members of the House would have failed by the dozen. **One is forced to the conclusion that Lombard Street and the Stock Exchange had a lucky escape, and that the "members of the mercantile community" were the unfortunates who, after years of toil, had to wipe out the deficit.**

Now we come to the bright side of the picture. Later on the business of **Baring Brothers** was converted into a company, and in 1895 it was definitely announced that the assets of the firm had been liquidated without any loss whatsoever to the guarantors. **Baring Brothers & Co., Limited**, now publish a strong balance sheet, which entitles the company to a place among our well-managed institutions, and **so short is the memory of the public when things financial are in question**, that the panic of 1890 is, if not quite forgotten, at least regarded as ancient history. **Indeed, the public hardly seems to realise**

that, in November, 1890, the monetary situation was so acute that a quickening of the public pulse would probably have resulted in one of the most dangerous crises the country has ever been called upon to face.

After the Baring crisis the market was unperturbed for a little while, but in 1893 many of the Australian banks found themselves in difficulties, and as the people in this country, tempted by the high rates offered at the London offices of the Australian banks, and by their agents on this side, had deposited largely with them, a very bitter feeling soon manifested itself. Australia, like South America, was to prove an Eldorado for the small investor, but the pace was forced, and the reaction came in 1893, when many of the banks suspended payment. Even now some of the Australian banks in London are not any too strong, and discrimination is certainly desirable.

On 9th October, 1899, the Boers issued their famous Ultimatum, to which they immediately received an answer that was brief and unmistakeable; but, unfortunately, the pen of the Government at first proved mightier than the sword, and by 3rd November White was shut up in Ladysmith. Then followed the failures of Methuen and Gatacre, and on 15th December General Buller was repulsed at Colenso. Thoroughly roused, the Government sent out Lord Roberts and Lord Kitchener. On the night of 6th january, 1900, the Boers made a desperate attempt to take Ladysmith, while Buller again failed to relieve the town on the 22nd, and did not enter it until after Cronje was brought to bay at Paardeberg at the end of February.

This period of disaster cast a gloom over the whole nation, which grew sullen and determined, and, when at last the tide

began to turn, the sudden lifting of the burden immediately metamorphosed a silent depressed crowd into a cheering multitude, which on Mafeking day turned London into a veritable pandemonium; but the depression caused by unpleasant surprises was intense, and, therefore, the joy at finding the incubus gone was the more irrepressible. Hence the disorderly scenes upon the day in question. A reaction after the period of suspense was inevitable, and the greater the gloom the more violent would be the excitement that followed when the first ray of sunshine pierced the mist. Yet how little was this understood at the time.

That financial barometer — the Bank rate — began to reflect the political situation early in October. Our state of unpreparedness was a by-word on the Continent, and when in September, 1899, the Boers displayed an unyielding attitude, which was at first mistaken for bravado, our overweening confidence in the British soldier blinded our eyes to the imperfections of our fighting machine. The Continent, which was better informed than the British Government, believed that the Boers were determined. On the 3rd October, when the Free State burghers occupied Van Reenen's Pass, the Bank advanced its rate to four-and-a-half percent; on the 5th October the rate was five percent, and on the 30th November six percent, where it remained until the 11th January, 1900, when five percent was recorded.

But if the Government was unprepared the Bank of England was not, and from start to finish, by a judicious use of its rate of discount, an adequate supply of bullion was maintained in the Issue Department. Long experience had taught its lesson, and our financial machine, which was in a good state of preparedness, worked without a hitch. Who can

doubt that if our fighting machine had been as ably handled, it would have done its work well from first to last?

There is also another point which is well worth attention. If our banks neglect to keep good reserves, a panic results immediately there is any unusual demand upon their resources, and the cost of a panic soon convinces their directors that it is cheaper to be always prepared. Will the expenditure of some £230,000,000 teach the Government the same simple truth? If we must have an army, it is madness not to keep it — as our banks are kept — ready. Mr. Kruger and his advisers did not consider the latent potentiality of the British fighting machine. They ascertained its state of preparedness to strike at a moment's notice, and, seeing that it was unprepared, the Boers wisely struck the first blow, hoping to drive the English into the sea before the machine could be adapted to a new environment. On the other hand, they failed to realise the resources of the Empire. Had the Boers believed that the British could land an army of even 150,000 men in South Africa, in all probability there would have been no war. The Government, which was caught unprepared, had to pour out money like water, because it had neglected to take one of the simplest business precautions — to keep the army ready.

On 31st May, 1902, peace was declared, and now the country has to face a domestic problem. In 1899 trade was good, and in 1900 the prices of commodities were at their zenith; but during 1901 a reaction set in, and at the present time trade is certainly not active. Reservists are arriving from South Africa in large numbers; and, as the labour market is already depressed, a number of them are sure to experience considerable difficulty in finding employment. War is certainly

not a business that civilises, and if a man has once tasted blood, in however just a cause, it is difficult to believe that life will seem quite so sacred to him again. Should the times become really bad, these men who have returned from the front, and who cannot again find a place in civil life, will turn instinctively to the weapons upon which they have learned to depend. Consequently, should there be a severe depression in trade, an epidemic of crime is one of those possibilities which may send a thrill of horror through the country.

Since September, 1899, the money market has certainly had to contend with great difficulties, and a system which has proved itself more than equal to the strain surely cannot be so undesirable as certain critics would have us believe. Again, the more the public understands the system, the less is the danger of panic; for it must be apparent to every man who reads this book that, if he study his own interests, he will select a strong bank, and, having taken that precaution, he will carefully refrain from rushing for his deposit during a time of stress.