

FINANCING GOVERNMENT LOANS.

The first offering of our Government's bonds to provide it with funds for the prosecution of the war, produced \$3,035,000,000 of subscriptions from over 4,000,000 subscribers, and the loan was a success beyond parallel in the history of government finance. The apparent ease with which the loan was taken and paid for must not, however, delude us into the belief that succeeding loans can be subscribed without equal or greater effort and certainly not without more thorough and extensive preparation than was possible last time.

It must be made clear to our people that loans of the magnitude now required by our Government cannot be paid for in cash, or, as we commonly express it, in "money" but they must be subscribed by transfers of bank credit to the Government in exchange for its bonds, which credit the Government must at once disburse, in order to avoid disordered money markets. Cash, which we commonly call "money" must not be confused with credit, which is also too often confused in casual conversation with "money." Cash is what we carry in our pockets in order to make hand to hand payments and is what banks carry in their vaults as reserve in order that their depositors who require cash for making payroll and other cash payments may be able to get it when needed. Bank credit on the other hand is what is owing by banks of deposit to their depositors, and is not necessarily created by depositing cash in banks, but is, in fact, principally created by loans which banks make to their customers, and which are entered on the books

of the bank as a deposit credit, owing to the borrowers, or to those to whom the borrowers have transferred the credit by drawing checks in their favor.

If subscribers for Government bonds paid for them in "cash", all of the cash held by the banks as reserves, would be transferred to the Government's vaults, when payment was made, the banks would be denuded of reserves and would be obliged to liquidate their loans, or they would be unable to meet the demands of their depositors for cash.

The payment to the Government therefore of such a vast sum as \$2,000,000,000 must be made by transfers of bank balances to the Government's credit so that the Government in turn may check on these bank balances and pay the bills which it incurs for the support of a great army and navy.

But we must not overlook the fact that bank credit consists as a rule of two kinds of credit; one being the liquid or working capital employed by business men and corporations for business purposes, which they cannot spare without impairment of the efficiency of their businesses, and the other consists of idle capital and of the savings of people and corporations who receive salaries or earn profits, which they do not need to spend and some part of which they can spare and turn over to the Government in exchange for the Government's bonds. This process of transfer of credit to the Government cannot very well exceed in amount the total of idle capital and savings which is not required for business purposes, unless, of course, the effective conduct

of the business of the country is to become impaired by too great a reduction of the working capital now employed in business affairs.

Without enlarging upon the imperative necessity for economy and the creation of savings in the form of bank balances, which may be transferred to the Government's use, it is well to see just what changes take place in banking affairs, when these loans are paid for, and this may be illustrated by a brief description of the English system, which has proved such a striking success during all of the three years of the war.

Practically all of the banks of England "clear" their checks (that is settle the differences between those which are presented for payment and those that they hold for collection) through the London Clearing House, which has only sixteen members, outside of the Bank of England. The membership consists of the principal great London joint stock banks, which have many branches throughout the Kingdom. They all carry reserve accounts with the Bank of England, and what they receive or pay as a result of each day's "clearings" is simply settled by a credit or debit in their accounts with the Bank. When a large payment is made to the British Government by subscribers to its loans, these subscribers draw checks on their banks and pay them in to the Bank of England. The payment of these checks by the sixteen clearing banks transfers to the Government an immense credit on the books of the Bank of England from the reserve balances carried with it by these sixteen banks. If one hundred million sterling is paid, it sim-

ply means that one hundred million sterling which had formerly stood on the books of the Bank of England to the credit of the joint stock banks was transferred when these checks were paid to the credit of the British Government on the books of the Bank of England. This transfer may at times so considerably impair the reserve balances of the sixteen banks with the Bank of England, that they find it necessary to discount bills with the bank in order to restore their reserve balances. At once that this great credit is transferred to the British Government, the Government draws checks to pay its debts, bills for supplies, maturing obligations and various items, the checks being payable to hundreds and thousands of people and institutions, who are creditors of the Government. These checks are at once deposited by those to whom they are payable with their banks, largely of course with the sixteen clearing banks, which in turn re-deposit them with the Bank of England, thereby restoring their reserve balances, or giving them sufficient balances to enable them to pay off their discounts.

It will be seen that the British Government has taken 100,000,000 pounds of bank credit which was originally owned by the subscribers to its bonds. This has been used in payment of Government bills and those to whom the bills are paid immediately deposit the checks and so return the credit to the banks from which the credit was originally drawn; the net result of the operation is to leave the cash reserves of the banks substantially unchanged, although the government has borrowed 100,000,000 pounds and paid 100,000,000 pounds to its creditors. One may ask why this does not create some inflation, or require some liquidation, or at any rate

affect some considerable change in the banking position? Why do not deposits suddenly shrink or suddenly expand, or why do not the banks lose cash? The answer is that those who subscribed for the bonds in the first instance have been saving "money," that is saving bank credit out of their earnings, for the purpose of subscribing; they have not been wasting the money in extravagant living or by buying new houses or automobiles or luxuries.

It is to some such thoroughly scientific basis that our banking system must now be developed and it is only when people of all classes are willing to economize, accumulate their savings in banks and then transfer them to the Government in exchange for government bonds, that we can enable our government to meet the huge financial obligations imposed upon it by its participation in the war.

There is a vast difference between what is possible in England and what is possible in this country in handling banking transactions of such volume as those involved in war finance. In England there are less than three hundred commercial banks; practically all of them carry accounts with the sixteen clearing banks in London and these sixteen banks clear practically all bank checks and bills through the London Clearing House, so that the balances resulting from these clearings are settled at once place, namely on the books of the Bank of England. In this country we have nearly thirty thousand banks, over two hundred and fifty Clearing Houses scattered throughout the country and the twelve Federal Reserve Banks are only able at the present stage of their development to clear a moderate

proportion of the checks drawn on the banks of the United States. Our country is of such vast extent, our banks are so numerous and we have so many reserve centers, that the actual settlement, that is the bookkeeping required in connection with these credit transfers, must be planned and conducted with the greatest possible skill in order to avoid disturbance of money rates and disorganization of business in various sections of the country, every time a Government loan is paid for. That it can be done was demonstrated by the success with which the transfers involved in the last loan were conducted.

To illustrate the difference between the operation of the fairly simple English machine above described and the more complicated working of our system, an account of the transfers resulting from the loan of last June is necessary:-

Prior to the offering being made it was known that banking institutions throughout the country carried balances with New York banks amounting to about \$1,000,000,000 and in addition had some hundreds of millions loaned on the New York Stock Exchange. It was fully expected that in anticipation of making payment for the Liberty Loan, these interior banks would draw a large part of their balances from New York, and transfer them to their respective Reserve Banks in their own districts, so as to have funds available at home with which to pay for the bonds subscribed by their customers. This movement of bank credit from New York to the interior had to be provided for. At the same time, inasmuch as the greater part of the payments made by our government and by its allies to whom loans were being made, were to be disbursed in

New York, interior sections of the country had reason to expect that large transfers of bank credit would be made from the interior to New York after the loan was paid for. In order to meet these movements of credit various expedients were employed and some were arranged which it never became necessary to employ. The preliminary withdrawals from New York commenced about June 1st and exceeded \$500,000,000. They were met principally by the Reserve Bank discounting bills and making loans freely for its members, its loan and bill accounts increasing in the first twenty-eight days of June from \$ _____ minimum to \$ _____ maximum. At the same time the British Government, which had considerable payments to make in this country, shipped \$ _____ of gold from Canada to New York, all of which was purchased by the Federal Reserve Bank of New York, which correspondingly increased the reserve money in New York City and made it so much easier for the New York banks to meet the withdrawal of balances made by their interior correspondents. It was also arranged with the Treasury Department to make certain transfers of Government deposits to New York, thereby somewhat offsetting the movement to the interior. The fourth expedient, a very effective one, it never became necessary to employ. Each of the Reserve Banks, well in advance of the commencement of this movement, completed all the details of an arrangement by which any one of the Reserve Banks might settle debit balances owing to any of the others, if found necessary, by transferring loans and discounted bills instead of gold (that is its reserves) and under a simple plan by which these bills and loans need not even be shipped to the bank which pur-

chased them, but could be held in trust by an officer of the borrowing bank who had already been appointed agent of the lending bank for that purpose.

The arrangements just described facilitated the movement of credit from New York to the interior without disturbance in the money market, but the return of this credit to those parts of the country from which Liberty Loan payments have been transferred to New York is a gradual process, depending upon many factors, and brought about largely by the country's commerce and trade. The funds subscribed for the purchase of Liberty bonds on the Pacific slope will ultimately be largely expended there by the Government in the construction of ships, the purchase of cattle, grain and food stuff, canned produce and the other products of that section. On the Eastern slope of the Rockies the production of oil, sugar, grains, cattle and of the mines will likewise find their way into the hands of our Government, or of its allies, and the proceeds of subscriptions to the loan in that district will gradually return to that section of the country. In the same way, the products of the cotton and woolen mills, shoe factories, munition plants, etc., of New England, which are largely purchased by the Government, will inevitably draw back to that section the funds that have been temporarily transferred to the Government and disbursed principally in New York.

The twelve Reserve Banks settle balances owing between themselves once every week and for that purpose they carry in the neighborhood of \$500,000,000 of gold in Washington, the ownership of which changes from week to week, according to the amount owing by or to the respective banks. It will be seen that the machinery above described which operates by telegraph, is simply a means of overcoming the disadvantages of distances and mail time and avoiding too heavy interior shipments of cash, or reserve money. Considering the unprecedented amounts of the transfers of credit involved in these government transactions, it may be considered to be a fairly effective machine and one which can be relied upon to accomplish the objects for which it has been created.

But after all, those who buy the bonds of our Government are not so much interested in the details of this complicated accounting, which becomes necessary every time the Government places a large loan, as they are in more specific statements of the probable amounts to be borrowed and to what extent these borrowings may prove a financial burden and involve sacrifice and hardship. It is impossible for any one to state what may be the financial requirements of our Government in connection with the war. If the war continues, we must simply expect that these requirements will be beyond all precedent and likely beyond those of our allies in Europe. We must not only finance our own armies and navy, but as the tremendous natural resources of this country must produce

a part of the supplies required to sustain the armies and home people of our allies, we must prepare to make great outlays in the way of loans to those governments that find it necessary to buy supplies in this country. The problem is not so much to convert the wealth of the nation so that it may be invested in Government loans. Our wealth is largely fixed property. We must arrive at a correct understanding of what income the capital wealth of the nation produces, how much of that income is absolutely essential to the comfortable support of our people and, lastly, how much in excess of that may be saved and turned over for use by the Government; it is undoubtedly a vast sum. The capital, wealth and income of this nation exceeds that of any other nation in the world and probably that of any two nations in the world, but we are an extravagant and wasteful people. We have lived in a land of such abundant prosperity, that we have reckoned less on the cost of things than we have on the profits resulting from the application of our energies to developing our resources. The time has now come, however, when this great capital wealth of the United States will not avail us to meet our obligations incurred in the war unless we see to it that it produces the greatest possible income and that that income is not wasted.

Various estimates have been made as to the amount of loans which it would be possible to place in this country. It is stated that as England has a wealth of less than \$100,000,000,000 and can borrow \$20,000,000,000 or more, therefore this country with a national wealth of from \$175,000,000,000 to \$225,000,000,000, should have no difficulty in borrowing \$40,000,000,000. But such

statements are rash, if they fail to take into consideration the habits and purposes of the people. The French peasants aim to save from 25% to 50% of their incomes. How many of us, rich or poor, can say that we are influenced by any such purpose? In France economy is hardly less than a national institution, the tradition of saving is so deep-rooted in the minds of the people.

The Liberty Loan just placed brought forth a fine exhibition of patriotism and self-sacrifice by those who gave freely of their time and services without compensation, in order to ensure its success; but no effort, however energetically applied or intelligently directed, can be expected to enjoy continued success, unless our people spend less than they earn, and very much less than they earn, and employ the difference in the purchase of government bonds.