GOLD DEPRECIATION AFFECTS PROSPERITY

Professor J. Pease Norton of Yale Defines Recent Money Conditions and Deprecates Presidential Campaign for Currency Issues.

The following is an article in Review of Reviews for January on "The Gold Situation and the Currency Outlook," with especial reference to congressional legislation and the danger to business from a presidential campaign on currency issues, by J. Pease Norton, assistant professor of political economy at Yale university and secretary of section 1 of the American Association for the Advancement of Science.

The financial-legal factors, disturbing business prosperity, fundamental to all the evident effects currently classed as causes, are four, namely: First, the world-wide depreciation of gold, which has and is operating to undermine the use of gold as a standard of value in various insidious ways; second, the ill-regulated practices of capitalization of corporations proceeding under a comparatively new combination of economic conditions, involving underwriting, investments of commercial and savings banks, trust companies and insurance companies; third, the inadequacy of our currency system with especial reference to the bond-secured bank note system; fourth, the rapid expansion of the banking industry under the guise of trust companies without proper legal requirements covering reserves.

Although gold is the measure of the prices of all commodities as a standard of value, prices may increase because of a cheapening of the standard relative to commodities or because of an increase in the value of commodities relative to the standard. In the one case, inventions in gold mining and new discoveries of gold would be active. In the second case, above mentioned, short crops, deficient economic progress, and great pressure of population on the means of subsistence would be the effective causes for the high prices. High prices may, then, be classed historically in two groups, (a) inflation prices due to a depreciated money, (b) famine prices due to want.

Increase World-Wide.

That high prices exist there is no question. All average price levels, whether English or American, show in eight years more than 50 per cent increase. In other words, it requires $1.50 to buy what $1 would purchase on the average eight years ago. If these are not famine prices, because during eight years the crops have been bountiful, progress extremely rapid and the standard of living throughout the world upon the increase, then the causes should be sought in the depreciation of money. If the statistics agree in showing the quantity of gold increasing, the cost of production per ton of ore diminished radically by new inventions, and the world's stock of gold showing a marked and sudden increase, little doubt remains.

The facts are plain. A golden deluge is already upon us. In the year 1700 the annual production was $7,000,000; in 1800, $12,000,000; in 1900, $262,000,000; in 1907, $425,000,000, and the rate of increase is accelerating. When we remember that the larger amount of each year's production is added to all that has been produced before, unlike all other commodities; that at the present rate of acceleration the world's stock can double in less than 12 years, and, finally, that the causes of the gold flood are not sporadic and exceptional, but entirely rational, namely, the ingenuity of chemists and metallurgists, who have succeeded in reducing the profitable working cost per ton of ore from $14 per ton to less than $2 per ton at the present time, by new inventions, this question of gold depreciation becomes easily the financial problem of the age. For the amount of cheap gold ore is unlimited in nature.

Frederick Upham Adams, in the August issue of Success, quotes John D. Rockefeller as saying: "It seems to me that one of the most startling conditions this country must face is the overproduction of gold."

The situation is not complex. Instead of a congress as in the civil war issuing millions of paper greenbacks which did not represent the amount of work which good money hitherto had cost, now a freak or combination of nature and human science is flooding the world with golden metal which does not represent the value of the gold of yesterday; as the cost of today's production largely determines the value of all the stock on hand, the sudden decrease in cost has resulted in the ordinary phenomena present in all inflation. A rapid increase of prices results. A great speculation ensues to make profit by the rise. Men borrow and pyramid their profits in the speculation in commodities, securities and land. Under this borrowing demand, interest rises until the increase in the rate tends to offset the loss in principal to the leader. For, if normal interest is 5 per cent, and prices rise on the average 5 per cent per annum, a normal interest for such inflation must be 10 per cent. Otherwise, the principal loaned will be impaired when repaid by the borrower measured in purchasing power for the lender.

Assuming that a world-wide gold depreciation is in progress, how may business men and investors take advantage of this great economic change, to the end of limiting losses in their present commitments, and, so far as possible, reaping profits by wise foresight in guarding their future financial operations?

Real Estate Investments.

The man who invests his own capital in real estate neither gains nor loses by gold depreciation. The man owning real estate heavily mortgaged at previous low rates of interest gains largely since the value of the property will advance but not the debt. The man who holds the mortgage loses what the other man gains. This inequality is adjusted by the increasing interest rates.

The common shares of corporation represent the equities and correspond largely to the case of the man who purchases land on mortgage. Common stocks will greatly appreciate in value unless special reasons intervene. Among special reasons are: First, the difficulty of raising prices of services or goods sold by the corporation, as in the street railway corporations, where the law fixes a 5-cent fare, in railways, so far as rates may not be readily raised; secondly, the difficulties of raising large amounts of new capital at high interest where extensive new construction has been or must be shortly undertaken. Otherwise, the stocks of companies, the more heavily bonded at the old rates of interest, the better, provided net earnings may readily increase and no new capital is required, and always provided the management consists of honest men, should show great profits. For the bondholder's loss becomes the stockholder's gain.

It will be unwise to buy low interest bonds unless the buyer has offerings of equal security to his present holdings on a far higher basis than at present prevails. During lulls, when general interest rates for a short time decline, biggest profits will be made in selling bonds when they rally owing to lower interest and immediately reinvesting in the stock of companies, soundly managed, having low-priced equities and heavily bonded, the bonds dating before 1901.

It will not be to the interest of salaried men to remain too long on low salaries. The more prosperous business firms will advance salaries, and by moving about, salaries may be more quickly adjusted. A great burden is placed on the poor by high prices for living. Herein lies the political uncertainties arising from social discontent. In 1892-1896 the farmers were radical because the prices for their farm products were very low on account of the appreciation in gold. Now, the farmers are prosperous on account of high prices for their products but the poor in cities paying high prices for commodities and losing employment on account of commercial depression will shortly be added to the radical element, and become the hotbeds of social discontent.

New York Bonds.

Doubtless, the sale of $40,000,000 corporate stock and bonds by the city of New York will mark no less the commencement of a new era of investment values than the necessity for early changes in the laws regulating the investments of savings banks and trust institutions. That we are on a new investment basis, a few may longer doubt. That $40,000,000 4½ per cent bonds, tax-exempt, should bring only 102 on the average, a basis yield of about 4¾ per cent adding the amount of the tax to bring this investment into comparison with securities subject to tax, say 1½ per cent, an equivalent yield of nearly 6 per cent, for New York city bonds will prove for the majority of financiers sufficient indication of the trend.

The price of the New York city bond issue represents the havoc which gold depreciation has wrought up to this date. How great is the fall in New York city bonds, few even now realize. In 1904, the New York city 3½ per cent bonds were distributed to the public as high as 104. Since then, a decline has occurred of 24 points or 25 per cent in this gilt-edged investment security. From the standpoint of the holders, the comparison is even more discouraging because the purchasing power of the dollar in the brief interval of three years has declined 10 per cent, as measured by the index number issued by Dunn last May, when presumably on account of the extraordinarily rapid advance in prices, this ancient statistical landmark was abandoned. Consequently the holder of the 3½s finds that not only has he lost 25 per cent of his capital measured in dollars, but that $80 will only purchase what $72 would three years ago. Therefore, measured in the real test of purchasing power the holder has lost 32 per cent of his capital, and received in the meantime an interest return of 3½ per cent, little more than one half the current time rates now ruling for a year. That the effect must go farther, no sane critic can doubt.

That there has been secret-selling of bonds of well-informed interests in amounts reaching great proportions is doubtless within the knowledge of a few. The difficulty in unloading bonds on account of the narrow market which many issues and specialties possess makes it difficult to show the real quotations which many issues would bring.

That a situation has developed in the finances of savings banks as well as in insurance companies requiring changes in the laws regulating the investments of savings banks, the New York city issue forcibly suggests. That the laws should restrict investments of savings banks to bonds and mortgages seemed safe to the law-makers because the thought of loss by depreciation of the standard value was lacking; moreover, the laws helped the sales of bonds by large dealers.

In New York, Massachusetts and Connecticut, the laws were made drastic enough. Savings banks were practically compelled so far as securities are concerned, to make only loans to corporations (by being forced to purchase the bonds) and restricted or rather barred from investing in the equities which represent the growth of this great country, the richest in the world. Fixed investments consist of two great classes; common stocks and bonds. In former times such securities represented capital invested, because the rate of interest in all industries was subject to comparatively small differences. In foreclosure, this value could be liquidated. On account of insufficient regulations controlling capitalization, worthless pieces of paper from the standpoint of liquidation under foreclosure inasmuch as they represent simply contingent earning power, have been sold to trust institutions for investments.

Insurance Companies.

The conditions existing in the insurance companies are familiar from the Armstrong investigations. The same problem exists in the savings banks. The temptations offered to trustees of savings banks in the way of opportunity to profit by underwriting bond issues personally, by which if the syndicate is profitable the bonds are sold by the syndicate and the profit accrues to the trustee, and if unsuccessful, the savings bank is made to purchase the share assigned to the trustee, should be rigorously dealt with. Likewise, the payment of commissions and rebates to trustees of savings banks in connection with purchases of bonds should be frowned on, as both these practices are breaches of trust.

As a result of the speculation resulting from gold depreciation and advancing prices, and the weakness in the character of certain investments of trust institutions already pointed out, the tropic conditions natural in hot-houses of inflation rapidly developed. The volume of clearings increased not only in quantity but also in value on account of higher prices. The demand for currency to transact this hot-house business became really a practical question for the bankers. Without studying the causes, congress has proceeded to remedy this real though unnatural demand for more currency. Like the man who by tugging at his boot straps to reach a higher plane, pulled so hard that he not only seriously injured his back, but tore the straps out of his boots, so the insistent demand for more currency to transact this unnatural business resulted in further inflation and increased speculation.

The increase in bond-secured notes has amounted to $400,000,000 within a few years, an inflation by fiat money on top of nature's inflation through the cheapening of gold. The Aldrich bill assisted the bankers in this inflation movement by directing the secretary to deposit all the government funds in the banks. During every fall, when on account of our inelastic currency and the genuine business expansion on account of the harvest business, this demand has been intensified.

Elastic Currency.

This legitimate demand for an elastic currency, presented at successive congresses by Charles N. Fowler, chairman of the committee on banking and currency, has been consistently shelved by congress, although the system of asset currency as used in Canada and elsewhere is in every way sound and practicable. That the currency should be elastic and vary with business demands is not only reasonable but conclusive. The short-sighted policy of congress of continuing to make the bank note circulation depend on the government debt, if continued, will produce in the end a great crisis. For in event of war, the $600,000,000 worth of 2 per cent bonds, held by the banks against the bank notes, now selling above par, would, if the government honored $2,000,000,000 or $3,000,000,000 for war purposes, greatly depreciate, since so large a sum would require at least 4 per cent interest, on which basis the 2's would not be worth over 60, jeopardizing to this extent the $600,000,000 of the present assets of the banks by at least 40 per cent.

When, then, these conditions of inflations had been carried to a pitch, and many investments believed to be good were in reality only contingent annuities without value in case of foreclosure and the inelastic currency system was laboring under a heavy discount rate, which is the safety valve of an inelastic currency, the psychological blow was struck which caused the crisis to become acute and universal, the failure of the great Knickerbocker Trust company.

All savings banks immediately retired behind the 60 days' notice clause. The national banks remained solvent by suspending. The suspension of specie payments was the result of insufficient reserves. The reserves of the national banks were insufficient simply because trust companies, state banks, private banks and insurance companies carried little, if any, reserve, redepositing in other institutions. The result is that within 15 years the average reserves against deposits for the banking industry which should include the trust companies, since trust companies are little more than banks free of reserve regulations, have been on the average cut in two. As a result a sudden run made it impossible to maintain specie payments because the reserves were entirely inadequate for the business attempted.

Trust Company's Failure.

The fright engendered by the failure of the Knickerbocker Trust company produced a psychological panic. It destroyed public confidence, because the reserves were insufficient; institutions through the country suspended specie payments. Currency sold at a premium in Wall street. The fear in the land required immediate allaying. Grasping the solution, the administration acted promptly in a way capable of accomplishing the results desired. By immediately offering bond issues of $150,000,000 all told, to be used to provide an emergency currency, a psychological impression was produced at one stroke largely restoring confidence.

As soon as it became apparent that the difficulties had been met, and the intensity of the crisis allayed, it was decided unnecessary to actually sell more than a fraction of the amount offered. Had the smaller amount been offered at the start, little would have been accomplished psychologically. The move of the administration, psychologically speaking, tended to balance in restoring public confidence, to the extent such confidence had been destroyed by the opening event, the suspension of the great Knickerbocker Trust company, the two events marking the beginning and the end of the great crisis. Great credit is due to President Roosevelt and Secretary Cortelyou in so splendidly coping with the extremely alarming situation.

Now that public confidence in a measure has been restored, and the time of normal monetary stringency is rapidly passing, two disturbing factors have for the time been tempered. The canceling of loans by banks will proceed throughout the country. The volume of trade will lessen. In a short time money will begin to accumulate in the banks, and business will pass into that state of torpor which is most discouraging to business men.

In the dismay at fortunes wrecked and profitable business swept away, the first mental reactions of men are two: Responsibility for the crisis, in order to fix the blame, and second, remedies of many kinds largely designed to affect some of the innumerable minor phases which have struck the minds of men in vivid ways.

Central Bank Situation.

Many special interests under the guise of remedies for the crisis are suggesting changes in our financial system dangerous to the interests of our people. The movement for a central bank of the United States cannot be seriously viewed when the conditions, politically and otherwise are known. The reference of such a remedy to Senator Tillman would be decisive. Leaving out of the question the many impracticable suggestions, the possible remedies, when financial, political and commercial conditions are carefully weighed are few. On the whole, it is probable that no direct legislation at all would be most advantageous for the prosperity of the country. Stripped of technicalities, the following measures, which are the substance of several bills to be introduced, would be salutary, provided a currency campaign shall not result.

(1) Require the state banks, trust companies, etc., to become national banks.

(a) By extending to the national banks complete powers possessed by trust companies and requiring adequate reserves against notes as against deposits.

(b) By taxing all institutions upon deposits by a graduated scale dependent upon the proportion of reserves, i. e., similar in a way to the 10 per cent tax on the bank notes of state banks. These two laws would if carefully worked out insure uniform administration of banking institutions and enforce adequate reserves. Trust companies and state banks would be forced to become national banks.

(2) Give to the national banks the right to issue bank notes, unsecured by government bonds against which reserves should be required, provided the bank has already outstanding say 60 per cent of the present government bond secured notes. In this way, the transition to the Canadian system of asset currency can be gradually brought about without injuring the prices of government bonds now held by the banks.

(3) Henceforth, government bonds should not be the basis for circulation to a total amount greater than the $600,000,000, now outstanding although they may be given in exchange the privilege of becoming the sole security for government deposits.

These remedies may be passed by the present congress to advantage. But, the danger to business is great, since a prolonged currency discussion in congress is apt to throw the entire question into the presidential campaign.

The remedy for the problems arising from gold depreciation, from the irregularities in regulations governing the investments of trust institutions, and, finally, the suffering caused by the financial crisis of 1907, may well be entrusted to a gold commission. Extensive testimony should be taken, and thorough investigation carried on in order to obtain the statistical data necessary for final recommendations. Moreover, this is an international question, and negotiations should be carried on with foreign countries. If the reasoning of experts that prolonged depreciation tends to upset the relations of the various classes in a society is correct, grave social conditions must shortly develop. Extensive readjustments of wages must ensue if the present cost of living does not come down. Already it costs 50 per cent more to live than 10 years ago; or it requires today a dollar and fifty cents to purchase what one dollar would buy 10 years ago. If as one expert on gold states, prices will advance in three years to 30 per cent more, this will mean that within 13 years the cost of living will have doubled. A gold commission will tend to remove these questions from politics.

From the standpoint of business, could the political and financial conditions of disturbance be removed, now that the periods of malignancy of the disturbing factors are temporarily passed, prosperity would rapidly renew its course, and a bitter commercial depression largely avoided. For in periods of gold depreciation, crises although violent are of short duration, provided political factors do not intervene. The crises of 1857 was quickly passed, but the agitation preceding the civil war immediately followed. Could all interests agree to compromise by the appointment of a gold commission with extensive powers to investigate and recommend legislation to the congress of 1909, this whole subject would be removed to the great advantage of business from the realm of politics as a disturbing cause. These questions are too perhaps safer in the hands of experts than in the throes of partisan efforts and their misuse by unprincipled political agitators. There are these two alternatives—a gold commission or a stormy campaign disturbing business. For, after all these questions must be faced and eventually solved.

NEW YORK FINANCIAL CRISIS COMES TO END

(United Press Leased Wire.)

New York, Dec. 28.—The fact that a money crisis no longer exists in New York was shown Friday when the premium on currency dropped from 1 per cent to ¼ of 1 per cent. At the same time it was announced that there had been a decided drop in cable transfers. The decline in the premium on money due to a lessened demand for it has made the importation of gold unprofitable.

MAKE COLUMBIA GIVE UP POWER

Big Things Projected on Upper River to Turn Mill and Car Wheels.

(Special Dispatch to The Journal.)

Pasco, Wash., Dec. 28.—Water power as an incident to the improvement of national waterways, with special regard to the Snake river, is the theme of lengthy resolutions drafted by a joint committee of the Franklin county chamber of commerce and the Pasco Commercial club. The resolutions indorse the bill recently introduced in congress by Congressman Jones to grant the Benton Water company the right to construct a dam on the Columbia river. They call for the support of all members of congress whose committee appointments deal with the problems which such a dam would affect, such as river improvements, irrigation and manufacturing.

Behind the resolutions is a mighty scheme to develop the country about Pasco, Kennewick and Wallula. With the recommendation of President Roosevelt in his last message regarding the improvements of our vast waterways as an inspiration, the commercial bodies of the country and town have begun a campaign to harness the rivers for water power and irrigation, as well as for navigation. According to the resolutions, Pasco, Kennewick and Wallula are to benefit by the scheme by being made manufacturing and distributing centers for this entire part of the country. Regarding this, the resolutions say:

"Some of the horsepower from such a dam would doubtless in time enable a large portion of the wheat produced in the northwest to be manufactured into flour and milling stuffs at Pasco, Kennewick, Two Rivers and Wallula, as the greater portion by far of the wheat produced in the northwest passes through these towns from the fields of production to the markets of consumption, thereby giving to those places for milling purposes a great quantity and variety of wheat to draw from."

Let Government Own Power.

The resolutions state that water power should be developed as incident to the improvement of national waterways so as to make possible the construction of electric lines as feeders for such waterways, thus securing the proper regulation of railroad rates and relieve the congestion of traffic which exists now.

The resolutions urge that the government keep control of all such water power rights granted by congress so as to secure the most beneficial use thereof and to prevent railroad companies from getting control of the water power so as to stifle the competition for which they are aimed.

Dam Across the Snake.

The committee which drafted the resolutions believes that a dam across the Snake river at Five Mile Rapids, near the confluence of the Snake and the Columbia rivers, would, in connection with locks, greatly improve that stream as a national waterway, making it navigable the entire year.

The value of such a dam for irrigation purposes is also dwelt upon in the resolutions. They argue that horsepower from the dam could be utilized in pumping water onto vast areas of arid land which could thus be made productive, increasing the agricultural wealth of the country.

Testimonials from competent and reliable navigators and engineers favoring such a dam will accompany the resolutions. Senator Ankeny and Congressman Jones will be requested to secure, if possible, the construction of such a dam.

Conspired to Kill Wife.

(United Press Leased Wire.)

Chicago, Dec. 28.—O. Rochett and his wife were arrested here today at the request of the Canadian police. It is said they are charged with having conspired to kill Rochett's first wife, who has been dead six weeks. Rochett and his present wife were married three weeks ago.

PHENOMENAL SHOTS AT COAST TARGETS

(Special Dispatch to The Journal.)

Port Townsend, Wash., Dec. 28.—Opposed by weather conditions that made the work of the gunners most difficult, full service target practice at forts of the Puget sound artillery, as concluded after two days' shooting, is pronounced the most accurate in the history of the local fortifications. Directed by Captain Buck and Lieutenant Hamilton, the firing of mortar batteries at Fort Flagler today attracted unusual attention.

With a wind tossing a target floating several thousand yards from the mortar pit, three shots fired almost simultaneously struck the bullseye. The work of the Fort Worden mortar battery gunners directed by Lieutenant C. C. Burt, district quartermaster, proved of the sensational order. A high southeast gale swept the towing course, reaching a height that it seemed unsafe to send the harbor steamer out with the targets. The feat was accomplished and the fragile canvas targets kept above water long enough to permit making a record for firing that completely satisfies the officers directing the exercises.

That results attained by the annual target shooting is proclaimed with joy by those who maintain the strength of local fortifications, is unquestionable. The test provided has demonstrated qualifications not previously deemed certain.