

Panics and their Causes.

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Panics and their Causes.

Since panics are diseases of our monetary or circulatory system, to understand them we must first observe at least the general structure of the giant mechanism by which the business of the entire civilized world is carried on.

In tracing the evolution of money and that of its offspring—Credit, we must begin with the most primitive form of exchange, namely: barter. This is the exchanging of commodity for commodity, no medium of exchange being involved. While this first step upward is a great one, yet it has many disadvantages. The following are some of the most evident.

1. Every article of exchange must be given an exchange value in terms of every other commodity on the market. One hundred such articles would, under the barter system require no less than 4950 different ratios of exchange, whereas by the use of a medium of exchange the number of necessary ratios is reduced to one hundred.

2. Most articles cannot be divided without seriously impairing their value.

3. The difficulty which exists of finding a trading group or pair - The man who has the coat I wish may not want the pair of shoes I have to offer.

Men pass out of the barter period when they come to use some medium of Exchange. When they accept this or that article in exchange for their product, intending not to use it but to in turn pass it on to a third party for some desired article. This medium of exchange is called money.

This has been called one of man's greatest inventions. Some primitive forms of money are: hides, scalps, shells, glass, etc.

These were superseded by the use of the precious metals whose advantages over the more primitive forms may be briefly stated:

1. Widely distributed yet not overly abundant at any place.
2. Cost of production or extraction more or less uniform.
3. Comparatively small volume for a given value, making it more convenient to handle.

and carry.

4. Its durability.
5. It may be stamped - as inexpressible.
6. It is comparatively steady in value for reasonably short periods of time.

I though money stands high in the list of useful inventions yet its offspring credit must be given a place even higher. The word credit comes from the Latin root "credo" meaning "I believe" - hence "I have confidence". Like all words which economists have borrowed from practical life credit has many meanings.

Andersen defines it in an economic sense as the power to command wealth or service now in exchange for some assurance of a return in the future. J.S. Mill says it is the permission to use the capital of another. Ely defines it as a transfer of goods for a promised equivalent - adding by way of explanation - first, the transaction is partly present and partly future, second - the transaction involves confidence upon the part of the lender in the borrower's willingness and ability to pay. This confidence that the debtor will pay is based upon his character and

known resources or upon goods pledged by him should he fail to pay the debt.

The advantages of credit are many and important. Webster said in a speech urging the re-charter of the United States Bank in 1834 - "Credit has done more with thousand times to enrich nations than all the mines in the world." Its advantages over the precious metals as a medium of exchange are apparent. It furnishes a more perfect medium of exchange especially when the amounts involved are considerable or the parties widely separated. For instance in the numerous transactions between parties in the U.S. and England only the balances of trade need be sent across the water as cash. The English debtors ^{are} ordered by the U.S. creditors to pay their (the English debtors) debts to the English creditors and visa versa - Those who enable this to be done by acting as middle-men between the two classes on each side of the water are called bankers and brokers.

Besides doing away with the necessity of making large transfers of coin in cases where debits and credits may be balanced.

it also in the various forms of credit paper takes the place of large quantities of the precious metals, allowing them to be used for other useful purposes.

Another advantage is that it brings together capital without business qualifications and talent without capital.

Those who have idle capital may transfer it to one who will use it to the advantage not only of himself and the lender, but of Society as well. Many are the young men who have started with nothing but borrowed talent together with good business qualifications and have become capitalists in turn themselves.

Credit enables such works as railroads to be built long before they could otherwise have been completed. It also enables nations to carry on wars and bring them to a close.

It gathers up (through the medium of the savings bank) small sums that would otherwise have remained in the "old stockings" and turns them into the channels of trade - benefiting both the owner and society.

Many more advantages of credit might be mentioned but enough have been given to show

its value to mankind.

The principle end of the credit system is that it makes the world subject to panics. How it does this will now be considered.

The credit system ranks with the alphabet in the list of man's important inventions. The business of the world to day could not be carried on without it. From 90 to 95% of the world's business is today carried on by means of credit.

In structure the credit system may be likened to an inverted pyramid. its supports being a very narrow foundation of coin and that most unreliable "something" called public confidence. Each of these supports are necessary to the existence of the credit system. Without confidence the structure could not rise one inch above the foundation of coin. While with the absence of any coin we would have nothing to start from - no foundation to build upon.

At first we have only the coin foundation. Then a layer of credit is laid upon it - its sides overlapping those of the foundation below it. This is safe, for confidence exists and

keeps it from falling.

Other layers are added each succeeding one wider than the one below it. Confidence is still good and consequently the structure strong being held securely by the "props" of public confidence. But alas how unreliable are these props!

Strong and safe in times of calm and quiet, but how ready to fall with the least breath of suspicion which may sweep over the land! In our highly organized and complex society numerous and oft times unforeseen circumstances present themselves to cause these props of public confidence to come tumbling down followed by the structure they were supposed to hold in place. These props may be considered as being joined together as by a cord so that one in falling tends to pull the others down with it. When they do fall the credit structure topples then comes to the ground with a crash hurling great business houses to destruction, ruining large fortunes and rendering penniless, the vast army of those who are styled "small depositors".

This is a panic and the loss of confidence; the prime cause. Anything which tends to cause this loss of confidence may bring on

a panic. [Let it here be noted that a "glut" in the market may be the cause of a panic but as this does not come under the head of those circumstances which cause a loss of confidence it will not be considered until later.]

Precarious speculation and overtrading are common causes. We look upon a country: every thing is prosperous: business is brisk: rail roads are running at their fullest capacity: men plunge into debt, with the hope of suddenly becoming wealthy: credit is good and the pyramid of credit grows higher and broader every day. Finally, some one loses confidence: credit is contracted: cash disappears: business houses cannot meet their obligations: one house goes down followed by many others. Thus comes the panic. This is an example of a general and wide spread cause.

The failure of a single firm may bring down with it, the hosts of other houses down with it. In 1866 the failure of Overend, Gurney & Co. rendered the entire business world over-cautious, this contracted the credit. Confidence was lost and a panic was the result.

Capital may be so locked up in

internal improvements as to be rendered almost wholly useless to society. The sinking of several hundred millions of dollars in the Nicaragua Canal is as good an example as can be given. This acts by decreasing the coin foundation upon which credit rests, thus by rendering it less stable.

A rumored war, a proposed monetary change, an epidemic, a piece of unwise legislation, may each be the agent in bringing about a panic by causing people to lose confidence in the existing condition of things and demand hard cash from the banks where they have deposits. This general run upon the banks causes their downfall.

Henry George advocates the theory that land and land speculation are one if not the cause of panics. He divides the world's industries into two great classes - the primary and the secondary. The primary industries are the extractive ones such as, farming, lumbering, mining, etc. These furnish the raw material for the secondary industries to work up into the manufactured product.

Land owners when they see brisk times, advance the price of land so that capital instead of going into the primary industries which form the basis of the industrial pyramid in the proper proportion to preserve the proper pyramidal form, is compelled to turn into the secondary industries which form the apex + upper portion of the aforesaid pyramid. The growth ceases to be symmetrical. The upper portion is bulged out till it is all out of proportion to the base. Public confidence gives way and a panic is brought about.

Some writers hold that any tariff measure radical enough to rise to the dignity of a new tariff is the cause of a panic. They point to the coincidence of panics and tariff changes in the U.S. as proof of their theory.

Year of Tariff Change	Am't. of change	Year of Panic in U.S.
1815	33% to 23% = <u>10%</u>	1819
1820	23% to 34% = <u>11%</u> (Increase)	
1830-38	45% to 14% = <u>31%</u>	1837
1854-61	24% to 14% = <u>10%</u>	1857
1868-74	47% to 27% = <u>20%</u>	1873

The %'s given are the rates upon total United States imports. The underlined figures are the amount of change at the given dates.

As before stated a panic is a disease of our monetary system and this circulatory system extends over the entire civilized world stopping for neither physical nor political boundaries. Knowing this it is not surprising when we learn that the great nations of the earth have experienced nearly contemporaneous panics.

Country	Year		of	Panic	
France	18 18	18 25	1830	1857	'89-'90
England	18 18	18 25	1830	1857	'90-'91
United States	18 18	18 26	'29-'31	1857	'90-'91

There must have been some ^{cause in} common ~~time~~ for all of these and since tariff change cannot be said to be the ~~common~~ cause which existed in common in all the countries we must not say that the coincident tariff measures were the causes of the panics named. Overtrading (next to be considered) and loss of confidence were the only causes which have been found to have existed in each of the country. We must look to these as the prime causes.

A new tariff may bring on a panic by unsettling the minds & confidence of

businessmen causing a shrinkage of credit. It may also hasten or temporarily ward off a panic which is about to come from some other cause.

From the examination of the above secondary causes no difficulty need be experienced in seeing that loss of confidence is at least our prim cause of panics.

Another theory is that bad distribution, over production and the resulting "gluts" in the markets cause panics. The perfection of labor saving machinery, division of labor, centralization of industries, all tend to turn more products into the channels of trade than can be carried off through the one outlet - sales to consumers.

The expansion of the markets cannot keep pace with the expansion of the production industries. The channels of trade become blocked, much as do streams in a log "jam" when too many logs are floated down their channels.

Dealers cannot sell their goods. Mills are forced to shut down. Credit vanishes. Business houses are unable to meet their

obligations and as a consequence their goods are sold under the sheriff's hammer at greatly reduced rates.

These bankrupt sales form a sort of by-way through which the "jam" or "glut" of goods may be removed. One reason for the "glut" is the bad distribution which exists. The rich who can buy will not and the poor cannot by reason of their poverty. When the goods are sold so much cheaper than before it increases the number of effective demanders first by making it possible for some who were too poor to buy before to do so now, second many who before would not buy now purchase large amounts of goods for speculation.

In this way the market is relieved of the accumulated excess of goods. The channels of trade are cleared and products enabled, once more, to flow through them freely.

As soon as this state of affairs is brought about than the same conditions act as before to cause another panic.

We experienced no less than five such panics between the years 1825 and '77 and several since then have probably been caused in the same way.