
THE USE AND ABUSE OF CREDIT

ADDRESS

DELIVERED BY

MR. JAMES J. HILL

BEFORE THE

St. Paul Association of Credit Men at their Annual Banquet
at the St. Paul Hotel.

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The invention of money was a long step toward civilization. But the invention of credit was a greater. The part it has played in the material development of the earth and the intellectual and moral advance of its people is incalculable. Mr. Henry Dunning Macleod, than whom there is no higher authority on this subject, says: "A solid system of credit—by which I mean credits, on debts, which are punctually redeemed at maturity—is the most ingenious and powerful method ever devised by the ingenuity of man for promoting and developing national wealth." He quotes the declaration of Daniel Webster that "Credit has done more, a thousand times, to enrich nations than all the mines of the world," and adds, "But there is a reverse to the medal. If solid credit has produced all these marvelous effects, on the other hand misused credit and false theories of paper money

have produced the most terrible calamities of modern times." The world deals ever more and more largely with credit. It is the motive power of current enterprise. It is therefore clear that the field of the credit man, in the widest meaning of that term, includes almost the whole of industry; and that, according as the tool which he estimates and handles is used or abused, the public will experience prosperity or misfortune.

Credit, in itself, is as old as the first man who borrowed his neighbor's stone axe to kill food with, on the promise to return it. No other human instrument has experienced such vast transformation and development. Like all big things, its mental side is as important as its physical. The word "credit" itself is the same word as "creed," which people have chosen to express their convictions and aspirations. It represents *belief* in two things: the ability of a man to pay, and his intention to pay. Satisfy these two conditions, and credit is born. Therefore, credit is based upon the reputation of a man or a concern for business efficiency and business honesty.

The special importance to the people of the United States of a system of extensive and sound credit did not escape the attention of those who helped to shape its institutions in its formative period. Alexander Hamilton, the greatest financier known to our history, wrote this in 1795: "The United States possess an immense mass of improvable matter; the development of it, continually making, may be said to enlarge the

field of improvement as it progresses; and though the actual capacity of the country has, no doubt, considerably increased, it is probable that it does not bear at present a much greater proportion to the objects of employment than it has done at any former period. Credit, upon this hypothesis, of every kind, is nearly as necessary now as it ever was. But at least it may be affirmed with absolute certainty that, to a country so situated, credit is particularly useful and important. Credit is an *entire* thing; every part of which has the nicest sympathy with every other part. Wound one limb, and the whole tree shrinks and decays."

In proportion as the country has grown and developed, the importance of credit has increased. Only a small part of the natural resources to which Hamilton referred has been utilized. The capacities of this part for satisfying human needs are far greater than we have realized; and they can be fully developed only by abundant capital. To quote Macleod once more, "If a bank can maintain in circulation a quantity of credit in excess of the cash it holds, that is, for all practical purposes, an augmentation of the capital of the country." Money makes but a small part, credit furnishes the great volume of capital by which the industries of the whole country are conducted and must continue to develop. The governing questions that relate to credit have an intimate connection with our economic and political as well as our financial future.

Outside of small retail transactions and the settlement of balances, actual cash is little used. Instruments of credit, in the manifold forms created by business for its convenience, carry on from 95 to 98 per cent of all business transactions. The entire amount of money of all kinds in the United States last year was less than the volume of our foreign trade alone. Compare the money stock, amounting to \$3,671,000,000, with the aggregate banking resources of the country, aggregating \$25,000,000,000. When it comes to doing the world's work, cash and credit are related about as the fire shovel is to the steam shovel. Without adequate agencies for creating, maintaining and regulating credit, responsive to business needs both in its expansion and its contraction, the country would come to a full stop as surely as if it tried to draw with horses the trains now running on its steam railways.

The total estimated wealth of the United States is about \$193,000,000,000. The total bank clearings in 1912 were \$175,000,000,000. Nothing could illustrate more clearly the function and place of credit than to set these figures side by side. Instruments of credit cleared through the banks and trust companies in one year's transactions almost equal the total of property values of every kind in the United States. Thus wealth is made elastic and active, the motive power in industry, through the medium of credit. Contract or expand credit unduly or improperly, and the effects may be incomparably worse than those of the wildest experiments in currency tinkering that the world has

ever seen.

If the uses of credit, which is plowing the land, turning the wheels of the factory, running the railroads and steamships, busying the merchants, bringing up to the light the minerals and oils of the under earth, reclaiming the lands and furnishing, as capital, the tool without which labor could not produce in quantities and on terms that would support the world, are so many and so great, the possibility of its abuse is equally evident. A credit man employed by any firm knows that it can be brought to ruin in a very short time, no matter how sound it might formerly have been, by a reckless and indiscriminate extension of the credit privilege. The same is true of communities and nations. No cause has been more prolific of misfortune in the past. Nothing casts a darker shadow toward our future than the misuse of credit.

The commonest form of the abuse of credit in the past has been the issue by governments of cheap money. Possibly the world has grown too wise to fall again into the trap of this delusion. But it is doing or permitting practically the same thing in other forms. The improper expansion of credit within the last generation exceeds by far in its volume and in its evil effects all the currency inflation of the last hundred years all over the world. The excessive capitalization of trusts and of some less spectacular enterprises has much the same effect as an issue of cheap money. Stocks and bonds are put out which represent little or nothing in the shape of actual values. A concern which, fifteen

or twenty years ago, would have thought it plunging to enlarge its capital stock to half a million dollars, will incorporate today for ten millions. The purpose is to get out sheaves of securities and sell them for cash, regardless of their actual value or probable return. Once in the hands of the public, such stocks and bonds are more or less used as collateral for bank loans. To the extent to which they are so accepted they enlarge the volume of credit and of the actual circulating medium of the country. So long as we have no effective laws compelling all stocks and bonds to be paid for at their full face value either in cash, property or services at a fair valuation, so long will this evil continue.

In the year 1912 bonds, stocks and notes were issued to a total of \$2,253,587,300 by private corporations. In the last five years over \$8,600,000,000 of such paper, good, bad or indifferent, came into being. Assume that these new securities are convertible into credit by taking them to banks and trust companies for only sixty per cent on the average of their face value. This total does not include a large volume of securities issued by small local concerns. Yet it accounts for an expansion of the credit medium in only five years equal to nearly fifty per cent more than the entire amount of money in the country. If congress had authorized the issue of \$5,000,000,000 in greenbacks, there would have been a revolution. Much the same thing has happened, so far as prices and industry are concerned, by the inflation of the credit basis; yet

wiseacres are still arguing about the causes of the rise in prices and the high cost of living.

Neither do the performances of combinations, syndicates and corporations organized to sell bits of lithographed paper tell the whole story. The same effect is produced by the increase of public indebtedness everywhere. The issue of a state, city or county bond affects credit volume more powerfully and produces more directly all the effects of an increase in money volume, because it is acceptable as collateral for nearly or quite its face value in credit issues. The whole American public is wild with spending. Public economy is a lost art. A bill that carries or requires an appropriation needs little else to commend it to any legislative body. All bonds of municipalities are now refunded instead of being paid when due. The excuse for a bond issue is always that "posterity" ought to bear part of the cost of public improvements. But when we, as posterity, come along, we not only repudiate the contract, but add new burdens to the old and shove both of them on to the future, in the shape of new and refunding bond issues. It is, perhaps, the meanest form of stealing ever invented; because it adds to the criminality of breach of trust the baseness of embezzling the future resources of our own children, who, since there must come an end of borrowing some time, will have these debts to pay.

The total revenues of all the states in 1901-1902 were \$190,000,000; in 1911-1912 they were \$461,000,000. In spite of an increase of 150 per cent in ten years, the

study of every state today is to find new sources of possible revenue, not to stop leaks. Many cities cannot put up a police station or acquire a playground for their school children without issuing bonds to pay for it. What ought to be considered current running expenses are met by borrowing. Now, not only has the consequent total tax burden on the people of this country risen to about \$38.50 per capita, or nearly \$200 per annum for each family of five persons, but most of these bond issues are at once used to expand the credit total. The bonds of public corporations are considered good security, because repudiation still has an ugly name in this country, however rapidly we may be running toward it. Credit accounts of one sort or another are established against them. Just so much more is added, in the form of instruments of credit, to the actual circulating medium.

Nobody can deny the quantitative theory of currency if it is enlarged to include instruments of credit as well as cash. The measure of prices is the total of all the instruments used in exchanges divided by the total of commodities and services exchanged. Is it not idle to hunt for the cause of rising prices in an increase of gold production, which was about \$256,000,000 greater for the entire world in 1910 than it was in 1895, when the credit basis has been increased in the United States alone by twenty times as much in the last five years through the issue of corporate securities, and by much more through the increase of state, city and county indebtedness? The issue of corporate secu-

rities in the single year 1912 was one-sixth as great as the aggregate of the world's gold production from the discovery of America to 1910. Here is the same mania in another form that has ruined every country that yielded to the cheap money craze. Only it is more insidious and dangerous in that it works indirectly. The same fight so often made against currency inflation must be repeated against the inflation and depreciation of credit to which excessive expenditure and unwarranted borrowing inevitably lead.

Since the part played by credit in the conduct of affairs and the prosperity of the individual is so important, the dignity and value of the credit-man's services may not be lightly estimated. An army of such men, from the great financier to he who passes on a list of country customers for his house, are engaged in performing a delicate and weighty office in the community. They are conservators of wealth. The mercantile credit man does for merchandising the service done by bankers in passing on instruments of exchange and in dealing with merchants and other customers. He sifts and classifies business men according to their records. He helps sustain and regulate the business of the nation, and for his labors there is and can be no substitute in law or other public action. His office is essentially judicial. The business fabric rests largely on the validity of his judgments. For it is easily within the province of those, great or small, who pass upon credits, to encourage or discourage individual effort; to give direction to industry and, as

their assistance is granted or withheld, to determine in no small degree the nature and extent of business development, both local and national.

Credit must always be based on something. That something must be tangible. Now, merchandise in warehouses or stores, factory products awaiting shipment, any of the commodities universally regarded as a proper basis for credit has no advantage over the wealth created directly by tilling the soil. Farm products are always in demand and saleable. The supply of them is renewed yearly. Credit based on them is doubly justified. One of the first duties resting upon those who determine the extent and direction of credit enlargement is to look with a more interested and favoring eye upon the farmer.

Prices of farm products have fallen this year, while other prices were rising. The greatest difficulty on the farm at present is to secure enough labor to grow crops and prevent them from going to waste. Last fall wages of \$3.50 and \$4 per day were offered, without attracting enough men to handle the grain. But for the extraordinary lateness of the season, a considerable part of it would have been lost. Every year a large amount of farm products goes to waste from this cause. In the face of this condition, well known and permanent, some politicians in congress are preparing to limit still further the supply of manual labor by attaching conditions to the admission of immigrants to this country which will exclude a large part of the supply. It is difficult enough, without this, to get men for the work

that must be done. The surplus labor supply of Northern Europe is practically exhausted. There is little in Great Britain; that of the Scandinavian countries has mostly found an exit; and Germany can place her people at home or in her outside possessions. We have now to depend on Italy and Southeastern Europe for the labor we so sorely need; and these people would in large measure be excluded by the conditions sought to be enforced.

Should such a policy prevail, the workers who come to this country in diminishing numbers would go elsewhere; largely to Brazil and Argentina. The latter is a great wheat and grain raising country. She has 370,000,000 acres suited to agricultural uses, only about one-seventh of which is under cultivation. Her wheat exports are increasing rapidly, amounting in 1911 to over 84,000,000 bushels. This goes into the world's surplus and helps to lower the world's price. Force the immigrant to go there, and we still further increase the cost of wheat production here, while enlarging the production and thus increasing the competition in the world's markets of a rapidly growing rival. This is the effect of what the politicians are proposing to do, in the same breath that they pretend solicitude for the farmer's interests. We need at Washington a good deal less politics, and at least a glimmering of statesmanship.

Of course, the farmer, too, must do his share. There must be better farm practice. While grain prices are low, meat prices are high. Steers have sold

lately as high as 12 cents, and hogs as high as $8\frac{1}{2}$ cents a pound. At these prices the farmer might get a dollar a bushel for his wheat by feeding it to cattle and hogs. He must turn his attention more to the growing of coarser grains for fattening live stock, which enrich his land while putting the product of it in available form for the most profitable marketing. He must learn to accommodate himself to his market, and thus broaden and strengthen the basis for his credit. By so doing he will not only help himself, but every other business in the country; for all of them, in the end, rest on him.

The conclusion of the whole matter is that the modern industrial community, in its widest as well as its narrowest scope, rests on credit. The two questions ultimately decisive in business relations are "Is he able to pay?" and "Is he willing to pay?." Credit men all over the world are engaged in answering these questions, as constantly repeated, under as many varying conditions, as is the process of buying and selling itself. Grant credit unwisely and you open Pandora's box. Expand it too widely by admitting a fictitious base or helping reckless borrowing and spending, and you have the same rise of prices and the same progress toward inevitable collapse that wait on successive issues of irredeemable paper money. Contract it too severely or discriminate against industry, thrift and enterprise, and all industry suffers by the withdrawal of its principal motive power. The proper regulation of credit, therefore, which must always remain an individual

matter, subject only to the control of judgment, common sense and an intelligent regard for the welfare of the whole community, is seen to be one of the most difficult, delicate and far-reaching functions of our whole complex modern life. Upon it must always depend in no small degree the nature, extent and permanence of our civilization itself.