BANK MONOPOLY THE CAUSE OF COMMERCIAL CRISES

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THE

CAUSE OF COMMERCIAL CRISES

BY

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OF APPLEBY, WIGTOWNSHIRE

WITH

INTRODUCTION AND NOTES

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"I want to know how liberty can be refused in banking, when it is established in everything else?"—M. MICHEL CHEVALIER.

"We have never been able to discover any good ground for the powerful objections which appear to exist in the minds of a large portion of even the most uncompromising free-traders against the application of the principles of free competition to banking, and especially to the issue of notes payable on demand."—MR JAMES WILSON, M.P.

INTRODUCTION.

THE tract which forms the principal part of this publication was read at the Glasgow meeting of the Social Science Association in 1860. Although the occasion required compression, and thus necessitated some omissions and some peculiarities of form, it is thought that it may be profitably communicated to a larger audience, and the author has permitted me to publish it with such notes as appear to illustrate his views. I have wished to impose this duty on myself, not merely in order to relieve him from a labour which his health and engagements forbade him to undertake, but because I am myself convinced of the truth and importance of the principles he inculcates. Had time permitted, there might have been some advantage in rewriting and enlarging the work, so as to embrace many topics which were omitted or too briefly discussed. But we have judged that the present state of the commercial world, with signs of war on the horizon, with gold leaving the Bank, and discount at 8 per cent, calls for suggestions which at a more prosperous time might fall on inattentive ears. I have attempted by notes and references to supplement as far as possible the brief summary presented in the tract. I cannot but think, however, that in some respects the advantages of this brevity exceed its defects; for it presents the salient points of the author's system unencumbered by superfluous proof or illustration, and free from the affectation of science which disfigures so many writings on this subject.

That commerce should be exempt from the vicissitudes which are the heritage of other mundane concerns, would be a futile hope. Here too, even more than elsewhere, we should have reason for regret did the world keep "a stable, changeless state." Nor is it to be supposed that the men who have written with knowledge and ability on this subject, and the statesmen who have dealt in an enlightened spirit with such affairs, have failed to acknowledge that the course of commercial transactions cannot under any system run smooth for ever. There is a tendency, however, to press this truth to a dangerous extreme, and to suppose that the periodical return of mercantile panics is a condition of every society in which commerce and manufactures are the prevailing interests. Still the phenomena of a crisis are neither so rare nor so unnoticed in our time that men have neglected to ask, "How can such things be?" But it has happened, not unnaturally, that inquiries have generally been directed to special circumstances—that the most conspicuous event of the time has been taken to be the cause of the evil, and that the circumstances of the particular crisis have been discussed, rather than the qualities which are common to all crises. Even where general principles have been sought for and a radical cure attempted, ancient prejudices and imperfect inductions have led to conclusions either defective or erroneous. The diagnosis has been incorrect, and the real seat of the disease has remained unknown. Legislation has got into a groove, out of which neither scientific observation nor the hard teaching of experience has been able to rescue it.

The chief or only object that has secured the attention of British legislators has been the Bank-Note circulation. The position which the Bank of England attained early in last century through its services to the State, the importance bestowed on its issues when for a quarter of a century they constituted the only money in the country, and the astuteness and zeal with which bankers have managed the policy of the nation on a subject peculiarly capable of being made obscure, and with which they alone were supposed to be familiar, have created and sustained a notion that the welfare of the country depends on the regulation and incessant care of the issues of bank-notes. The most conspicuous instance of this error is the Act of 1844. Its chief feature—the appointment of a numerical limit to the issues of the Bank of England —was justified by Sir Robert Peel only on the ground that the mechanical working of the Act would prevent the recurrence of the emergencies in which that restriction would fetter the restorative action of the Bank. "It was intended," said its author, "to prevent (so far as legislation can prevent) the recurrence of those evils from which we suffered in 1825, 1836, and 1839." This expectation has been disappointed. Unhappily, instead of preventing commercial storms, it has only insured their return and increased their violence, and it has been suspended whenever affairs have become critical. Thus it has happened that, to use the words of a French economist, "Il ne fonctionne que quand son action est nulle; semblable à un frein au repos dont la moindre pression, loin de modérer le mouvement, menace de tout faire éclater."* If, instead of studying each crisis as it arose, and studying it under the guidance of the men whose theories are refuted by experience, economists and legislators had turned their attention honestly to the constant and characteristic circumstances which precede and accompany all crises, we should have been convinced ere this, not only that the Bank Acts of 1844 were mischievous, but that our whole banking legislation can be amended only by being repealed.

It is true, as has been said, that lengthened experience has produced a general belief that crises are

* Juglar, *Des Crises commerc.* Intr., p. iv. Paris: Guillaumin, 1862.

periodical and inevitable, that they are in some degree a condition of the advancement of commerce and industry. It may be rash to predict a time when general mercantile depression shall be unknown; it is doubtless insane to expect to avert the possibility of individual failures, or even every degree of popular excitement and overtrading; but the very regularity of recurring panics, and the uniformity of their symptoms, awaken a hope of discovering some causes, which being removed, they shall become less frequent and less terrible. In the following pages such a cause is detected in the banking laws of this country. It is shown that disturbances in trade are best prevented by allowing natural laws to operate freely, and that they are aggravated or accelerated by human interference.

On one point there is probably complete agreement of opinion between the advocates of the present system and ourselves—viz., in attributing commercial crises to over-speculation. But when we go a step farther we diverge, and trace this over-speculation to the laws which they defend. The favourite doctrine of the *Times* and its followers is, that the mania for speculation is a disease to which human nature is subject, and which can be removed or alleviated only by moral appliances. Be it so; but when a moral disease affects a whole community, it is natural to ask what contagion has brought it there, what causes have predisposed to it, what influences of food, or climate, or soil have augmented its fury and extended its range. If all history consists of the working of laws—that is, if every event is the result of particular causes which men may hope to trace out with some degree of exactness—then, surely, we shall not rest satisfied with calling every outbreak of this malady an evil incident to humanity. Physicians seek, with more or less success, to explain the recurrence of epidemics; and shall economists despair of accounting for the periodicity of this widespread frenzy? The doctrine of crises popularly exhibited in the following pages differs from the ordinary theories in proving that it is bank monopoly that makes their return inevitable; and that, while they have occurred both before and since 1844, the legislation of that year has made their recurrence more regular and their action more severe.

In seeking a cause for crises, it is folly to fix upon what has not uniformly preceded them, on what cannot be shown to have any connection with them. But this is precisely what the advocates of bank restriction did in ascribing monetary convulsions to an over-issue of bank-notes, the variation of which is proved by returns to have been for thirty years perfectly insignificant. It is here shown that certain other kinds of currency have been so enlarged before crises as to account sufficiently for all the phenomena, and this enlargement is traced to its origin in an unnatural condition of the trade in gold and credit. It is shown that the Bank of England is compelled to store up gold in her cellars when the country does not need it; that this superfluity lowers interest, gives undue facility in obtaining discounts, and *thus excites overtrading;* that this overtrading raises the price of goods, and lowers the value of our domestic currency, thus necessarily leading to the export of sovereigns as a commodity of trade; that this operation, under the present artificial system, continues unchecked till the reduction of our metallic stock forces a sudden cessation of mercantile accommodation and a collapse of credit, when the curative action of crisis becomes necessary to raise the value of currency and save the Bank. It is shown, finally, that the introduction of this superfluous gold, and the consequent overtrading and rise of prices which precede and provoke a crisis, can be effectually prevented by the mere repeal of restrictive laws and the adoption of a system of free banking, nearly the same as that which existed in Scotland till 1845, and which now flourishes in Canada and Australia.

The cardinal points on which the doctrines of the following tract depend are these:—

1. The whole views are supported by the direct authority of Adam Smith,* and may also be fairly deduced from the doctrines of the greatest master of economical science, Ricardo.† They are also in accordance with the principles laid down in the Report of

* A most discriminating critic, Professor Wilson, wrote in the *Noctes Ambrosianæ*, April 1829,—"Adam Smith was perhaps the greatest political economist the world has yet produced, Ricardo excepted."

† See Note I.

the BULLION COMMITTEE of 1810,* from which Lord Overstone and the Bank party have wandered so far. In regard to the Act of 1844 (which forms, however, but a part of the system assailed), we also appeal to the arguments and authority of Mr Mill and Mr Tooke.

2. Bank-notes are not money, nor are they even the most potent engine in producing the variations in prices which affect the movements of the precious metals.† They are, on the contrary, as very little reflection should suffice to show, the most useful, and, in a natural condition of monetary affairs, the most harmless form of credit. The "currency principle," which requires their number in circulation to be exactly equal to the coin which would circulate if they did not exist, assumes them to exercise a greater power upon prices than other documents of credit. That principle is a mistaken attempt to secure the proper proportion between prices, credit and capital—between mercantile discounts and the money which is their only safe foundation. These ought to rise and fall together. If, say the "currency party," a metallic currency increases more rapidly than the capital which it is its office to circulate, nature provides a remedy—it is immediately exported. But a paper currency cannot be exported; if the commodities disappear, if the capital on which it is based is destroyed, the paper remains, but is

* See Note I.

† See p. 23, Note IX. MILL, P. E. II. 187, 192 sqq.

worthless. Let it therefore be a maxim, they say, from which no deviation shall be allowed, that the number of notes in circulation shall always be exactly equal to the coin which would be in circulation if they did not exist. The principle is only complete and logical, however absurd, if it be stated thus—that *all forms of paper credit* should always be exactly equal to the coin which would be in existence if they did not exist.

3. It is common to ascribe all movements of the precious metals to the balance of trade; and this is generally stated as a sufficient answer to the proposition here maintained, that the export of bullion is caused by a depreciation, or (to speak more exactly) by a fall in the value of our domestic currency. It might have been thought that the old theory according to which the excess of imports above exports is always paid by an exportation of the precious metals, and *vice versa*, had gone out long ago with "the mercantile system" of which it was a part. But the phrase "balance of trade" is still vaguely supposed to explain all the fluctuations of our metallic stock, and in particular the drain of silver to the East, which has of late been a puzzle to economists. The truth is, that the precious metals are to be "considered as forming," in the words of the Report of the Bullion Committee (p. 31), "a part of the general mass of the exported and imported articles, and as transferred according to the state both of the supply and the demand." As that Committee argued that because

the fall which the exchanges at that time suffered greatly exceeded the limit fixed by the cost of transporting specie, therefore that fall resulted not from the balance of trade, but from a change in the relative value of the domestic currency (*ibid.*, p. 34) ; so it is here demonstrated that the movements of bullion are to be accounted for in the same way by an unperceived disparity between its value as currency and its value as a commercial commodity. This disparity is caused by the operation of the Bank Acts, and produces importations and exportations of bullion which are altogether abnormal, unnecessary, and mischievous.

Without anticipating too much the argument and authorities in the text, these views may be here illustrated by tracing the circumstances which preceded the crisis of 1857, as established before the Select Committee of 1857-8, and by following up the history to the present time.

At the crisis in 1847, prices fell in a few weeks from 20 to 30 per cent, raising in the same proportion the relative value of British currency; in consequence of which gold flowed back into the Bank of England, which had no power to refuse it, till it accumulated to nearly £22,000,000. This influx of gold, which was perhaps aggravated by the discoveries of gold in America and Australia, was far beyond the wants of the country. The notes received in exchange for it swelled the deposits in the joint-stock banks, and thus, by increasing the funds seeking for employment in discounting, stimulated speculation, again raised prices and wages in this country, and correspondingly lowered the value of our domestic currency. This prepared the way for a crisis upon the first untoward circumstances arising to carry off our depreciated sovereigns, and the special circumstance which led to the crisis in 1857 was probably the export of silver to the East. In a few years after the Australian gold-discoveries, the *annual* export of silver from Europe to the East rapidly increased from £1,000,000, till, in 1857, it was above £20,000,000.* The popular idea that this unprecedented export of silver was caused merely by the balance of trade, is a gross and palpable fallacy. Bullion is now as much an article of trade as silk or tea. From special circumstances, silver was abstracted from the currencies of the continents of Europe and America at less than its commercial value as bullion; and being carried to the East as the best market for silver, silk and tea were taken at high prices to balance this profitable trade in silver. This abstraction of silver from Europe arose from the very same disparity between the value of the metal as coin and its commercial value as bullion, which at certain times draws gold from the currency of England. In France this disparity is transparent. Every one knows that a gold napoleon and 20 silver francs were equivalent in currency,

* As to shipments of silver to the East, see TOOKE, *Hist. of Prices*, App. xxiii., vol. vi. p. 712 sqq.; Table (C) in Suppl. to the *Economist* of Feb. 20, 1864. See Note XX.

while their commercial value as bullion was notoriously different. The necessary result was, that silver flowed away from France, and the cheap gold of England found its way across the Channel in exchange for it. A continuous heavy drain of gold from the Bank of England followed. So long as this demand was draining off merely the superfluity of gold in the Bank of England, even the interest of money was not affected; and although afterwards interest rose, the foreign demand for gold did not, under our system of banking and credit, produce the slightest effect on its actual value in exchange for commodities, as it ought to have done (see below, p. 29, sq.) Thus a commercial crisis became necessary to check the drain and prevent a stoppage of cash payments.

When the crisis had done its work in the ruin of individuals and the stoppage of the drain of gold from the Bank by a forced and sudden reduction of the value of property throughout the country—that is, by a sudden rise relatively in the value of gold—then, of course, gold flowed rapidly back to the Bank. It accumulated there, and was converted into our then enhanced British currency, again to create speculation, to raise prices, and lower the value of currency. We are now in this inflated state, calmed a little temporarily by the late rise of interest, but still ripe for another crisis as soon as any adverse circumstances shall cause a demand for gold abroad. Whether it shall be a war in Europe, peace in America, with a return to cash payments in that country, or a bad harvest at home, another commercial crisis is certain and imminent, unless we can yet be saved by abrogating our present banking laws, and adopting free-trade principles in banking, as we have already done in other branches of commerce.

It is impossible, even after a very partial and imperfect study of this subject, not to perceive that the main prop of the Bank of England's monopoly, or rather restriction, is a nervous and superstitious terror of finding it gone, and not knowing what is to take its place.* No doubt there is an advantage to some part of the public in having a refuge in the commercial tempest. But it must be asked first, whether no other refuge, whether a greater number of equally secure refuges, may not be provided? Nay, whether it is not possible to prevent the recurrence of the tornadoes which desolate the mercantile world? These questions are answered in the following paper.

But another question has often been asked: Do we not pay too much for the security afforded by the Bank of England? The perfect solvency of the Bank, the inviolability of its credit, has been regarded as the only

* Sir Robert Peel said, at the renewal of the Bank Charter in 1833, "that it was expedient for the public interest that there should be but one bank of issue in the metropolis, in order that it might be enabled to exercise an undivided control over the issue of paper, and *give facilities to commerce in times of difficulty and alarm*, which it could not give with the same effect if it were subject to the rivalry of another establishment."—HANSARD, 3d Ser., vol. xviii. p. 1336; Cf. *Speech of* Mr HUSKISSON on going into committee on alteration of Bank Acts in 1826. *Evid. of Mr* MILL *before Com. of House of Commons* 1857, p. 205.

object to be secured; and men who have lived always in the atmosphere of Lombard Street, and imbibed the traditions of three generations of bankers, are not very seriously to be blamed if they have fancied that this security is to be found only in the mechanical action of restrictive laws. But is it necessary that the stability of the Bank should be obtained by sacrificing greater interests and producing enormous distress? Hear the answers of her own friends. In 1847, Lord Overstone said before the Lords' Committee on Commercial Distress:* "Such is the peculiar relation in which the Bank of England, from its capital and resources, stands towards the public, that I am rather inclined to think that the Bank could save itself at almost any point, and that the danger is rather of the extraordinary derangement which that effort would throw upon public affairs, than that the Bank itself would actually stop payment." And again: "The power of the Bank to save itself at the last extremity, though at the expense of the public, is prodigious." By the Commons' Committee of the same session† the same witness was asked—"The Act of 1844 was supposed to have released the Bank from any necessity of attending to the public interests, and it was supposed that the Bank was at liberty, practically, to look to its own profits, and not to the general interest of the public; was that your impression of the operation of the Act?" He re-

* *Evidence*, p. 179, qu. 1579; *Tracts*, &c., p. 553.
† *Ibid.*, p. 397, qu. 5192; *Tracts*, &c., p. 613.

plied—"In a certain sense of the word, I think that is correct: it is desirable so to organise all public institutions, that, looking to their own interests wisely and discreetly, and taking a sufficiently comprehensive view of them, will be the best course, not only for their own, but for the public interests also. At the same time, the Bank, from the great magnitude of its resources and transactions, stands in a peculiar position. The Bank, to whatever extremity it may allow its banking means to be reduced, can, by the very magnitude of its operations, in the last extremity, make an effort which is almost sure to protect itself; but that effort will entail upon the community very serious consequences, and produce very great mischief: in that respect the Bank seems to me to differ considerably from all private concerns. *If I mismanage my private bank, I am ruined; but the public sustain little inconvenience; but if the Bank of England commits some great mistake, the Bank can save itself, while it spreads extensive injury throughout the community;* in that respect I think it differs in an important sense from a private concern."

It is true that the best security for public prosperity is such organisation of public institutions and of society at large, that the care of individuals for their own interests will tend to promote those of all; and perfect freedom of action to individuals is admitted to be in general the best means of obtaining this. But this principle is overlooked in regard to banking;

and not only is it overlooked, but Lord Overstone points out, and it is shown more fully hereafter, that the very contrivances which are intended to make the Bank of England safe, powerful, and beneficial to all, place its interests in direct antagonism to those of the whole community.

BANK MONOPOLY

THE

CAUSE OF COMMERCIAL CRISES.

No popular error has appeared in more various forms, or has more vigorously withstood the progress of enlightened opinion, than the belief in the omnipotence of human legislation. Although our age and country have happily been free from the more terrible consequences of this delusion, yet, in some matters of great social interest, many of us have witnessed long and doubtful contests between the advocates of complex human laws, and the assertors of "Heaven's easy, artless, unencumbered plan." In spite of deep-rooted prejudices and powerful interests, we have seen monopolies, bounties, and other devices by which kings and parliaments sought to stimulate, and succeeded in misdirecting the industry of nations, fall before the advancing intelligence of the age. But in the well-grounded exultation which we yet indulge at the decisive victories of *Free Trade*, it is too often forgotten that the field is not yet cleared. One of the race of giants remains to be slain. Stripped, indeed, of many of its privileges, *the Bank of England* (Note II.), aided partly by the supposed mystery of the theories on which it founds its pretensions, and partly by the supineness or pusillanimity of the mercantile classes, still succeeds in holding its baneful monopoly.

In Scotland the public mind is prepared to perceive and condemn the absurdities of English banking legislation; but in England the habits and prejudices of London bankers and merchants (Note III.) and the reverence they entertain towards "The Bank," have raised a barrier around that last and most pernicious of monopolies which it is difficult even for truth and sad experience to beat down. It is amusing to find in *The Times*, the principal defender of the Bank of England's monopoly, the following observations, in May 1861, in reference to the opposition in the French Senate by Admiral Desfosses and others to the late commercial treaty. It says:—"It is melancholy to see how entirely habits and prejudices can triumph over the most evident facts and the plainest principles of science. The fishing trade in France is subject to numerous and vexatious regulations, the parasitical torments which invariably follow protection and prohibition. Thus, for instance, the regulations prevent the fishermen from having sufficient salt for curing their fish, prevent them from curing their fish on board their boats, and prescribe, with truly paternal folly, the manning of their boats and the number of their nets." We hope to prove that these observations are in every particular exactly applicable to the present state of banking in London, with this aggravation, that the results of "paternal folly" in our bank regulations are infinitely more pernicious than that of the French in the matter referred to, and that the legislative sin (Note IV.) on this side of the Channel is greater, in so far as it is committed with the knowledge and actual experience of the benefits of freedom in other branches of trade.

Admitting, as all must admit, that the Charter of the Bank of England (Note V.) and the virtual monopoly of the Scotch banks (Note VIII.), are restrictions upon the trade in money, I propose to show that the grounds on which their exemption from the operation of the principles of free trade is defended are futile, and that evils can be traced to bank monopoly as vast, if not as evident, as any that were removed by the Free Trade legislation of 1846. It has often been impudently and most unjustly asserted that the advocates of monetary or banking reform are seeking only for greater ease in the money market, in order to gratify a desire for speculation. It will not be difficult to show to intelligent and unprejudiced men that the speculative excitement and over-trading that precede every crisis are principally due to the bank restrictions and the disregard by our legislators of the laws appointed by Providence to regulate human transactions ; and that bank monopoly is the direct cause, at one time, of unnatural credit and speculation, and at another time of monetary and commercial crisis, with all the great social evils which are admitted to attend it.

The ground on which, according to Mr Mill, it appears desirable to maintain one great bank of issue is, "that there may be one body responsible for maintaining a reserve of the precious metals sufficient to meet any drains that can reasonably be expected. By disseminating this responsibility among a number of banks," he holds, "it is prevented from operating efficaciously upon any; or, if it be still enforced against one, that reserves of the metals retained by all the others are capital kept idle in pure waste, which may be dispensed with by allowing them at their option to pay in Bank of England notes."* We should not for one moment listen to a proposition to secure a steady supply of bread, wool, or cotton by establishing one great store under the protection of Government; and it will be easily shown that the requirements of trade and the prudence of self-interest, if left to their own free action, will steadily and most economically maintain a sufficient reserve of bullion, which monopoly has failed to do.

It is interesting to see, on the other hand, how clearly Adam Smith discerned, eighty years ago, the great law of free banking:—" If bankers," says Dr

* *Pol. Econ.*, vol. ii. p. 216.

Smith, "are restrained from issuing any circulating bank-notes for less than a certain sum, and if they are subject to the obligation of an immediate and unconditional payment of such bank-notes as presented, their trade may, with safety to the public, be rendered in all other respects perfectly free. The late multiplication of banking companies, an event by which many people have been much alarmed, instead of diminishing, increases the security of the public. It obliges all of them to be more circumspect in their conduct, and, by not extending their currency beyond the due proportion to their cash, to guard themselves against those malicious runs which the rivalship of so many competitors is always ready to bring upon them. It restrains the circulation of each particular bank within a narrower circle, and reduces their circulating notes to a smaller number. This free competition, too, obliges all bankers to be more liberal in their dealings with their customers, lest their rivals carry them away. In general, if any branch of trade or any division of labour be advantageous to the public, the freer and more general the competition, it will always be the more so."* What I have to say may be regarded as almost a commentary on these words of the great economist, or as a confirmation of their truth from the subsequent history of banking.

In the first place I will remark in general that two facts proved before the select committees of the House of Commons show that legislation upon this

* *Wealth of Nations*, B. ii. c. 2, p. 145 (M'Culloch's edition).

subject should not be left, as hitherto, entirely in the hands of the banking interest; and demand, even if they stood alone, the most careful consideration and energetic action of the merchants of Great Britain. The dividends of the Bank of England under its admitted monopoly, are always greatest in times of commercial distress (Note VI.), and some of the London Joint-Stock Banks have divided the extraordinary dividends of 25 and 30 per cent, realised chiefly from the discounts they are enabled to exact from commercial men (Note VII.) Further, prior to 1845 banking in Scotland was perfectly free, and the Scotch system had ever been warmly eulogised by the most eminent English statesmen; but it will be remembered that in consequence of Sir Robert Peel's latest monetary legislation in 1845, the sixteen banks then existing (now reduced to fourteen) have since been enabled to monopolise the whole banking business of Scotland. Under their virtual monopoly, resolutions have been adopted from time to time at meetings of delegates of the privileged banks held in Edinburgh, fixing rates not only for interest of money lodged and of money lent, but also a scale of charges for every kind of banking business. These resolutions are printed, signed, and transmitted to all bank agents over Scotland, and no bank agent is at liberty to transact business with his best customer at lower rates than those fixed by the united banks (Note VIII.) This is a very curious system for the year 1860. On no sound principle of economic science can it be argued that in banking alone we are to take a retrograde course, and place that trade which is the very heart and centre of our commercial life, under the control of exclusive and interested corporations. Certainly merchants ought not to allow bankers enjoying these enormous profits and exclusive privileges, to be the sole advisers of our statesmen in banking legislation.

The fundamental error of those who argue in favour of bank restriction is the assumption that the power of issuing notes is a power of creating money, and ought therefore to be subject to the control of Government. Bank-notes are not money more than cheques or bank-bills are. These are all only economical and convenient substitutes for money, but the only real money or cash in this country is gold. The assumption that bank-notes are money (Note IX.), and the excessive influence on prices attributed to the amount of notes in circulation, have misdirected the inquiries of statesmen and economists. The investigations of the parliamentary committees of 1847 and 1857-8 (as in 1825), were specially addressed by the terms of their appointment to the influence of the issues of bank-notes in causing commercial distress. Although their reports were inconclusive (Note X.), because they searched for the cause of the evil in the wrong quarter and failed to discover it, yet the information they procured proves that the issue of bank-notes, if convertible into bullion, has not the effects currently ascribed to it. The following table, taken from these reports, connects crisis and all its evils directly with excessive fluctuations of bullion :—

	Total Circulation of Bank of England 31st August.	Average Circulation of Branch Banks of Bank of England.	The Circulation of Scotch Banks.	The Bullion in Bank 31st August.	Total aggregate Circulation.
In 1852	21,645,260	6,944,452	3,307,750	21,998,640	31,897,462
1853	24,028,600	7,811,507	3,746,294	16,871,700	35,536,401
1854	20,875,040	7,380,214	3,962,576	13,533,290	32,217,830
1855	21,119,880	7,042,241	4,048,716	15,149,590	32,310,837
1856	21,055,030	6,975,406	4,005,484	12,387,100	32,035,930
1857	19,995,940	7,009,300	4,236,430	Oct. 11,641,610	31,191,627
Nov. 18	21,406,000		4,186,387	Nov. 6,484,000	

The lowest amounts of bullion in the Bank of England were at periods of severe crisis—

31st December 1825, . .	£1,261,000
7th February 1837, . . .	3,831,000
3d December 1839, . . .	2,406,000
23d October 1847, . . .	8,313,000
18th November 1857, . .	6,484,000

We here see, as plainly as figures can show, that while the bank-note circulation has been comparatively steady (Note XI.), the greatest variations take place in the reserves of bullion, and that excess of bullion invariably precedes periods of excessive speculation, as scarcity of bullion has always immediately preceded a crisis ; thus directly connecting speculation and crisis with the fluctuations of bullion, and not with the issue of notes.

Another common error which has overshadowed and concealed the real source of evil in our banking and currency system, is the popular impression that the exchanges are entirely governed by the balance of trade. The fact that the exchanges and the export of the precious metals are not entirely regulated by the balance of trade, is established in a very striking manner by the report of the celebrated Bullion Committee of 1810 ; a committee in which we find Francis Horner, Spencer Percival, Tierney, Huskisson, Thornton, and other great names. The witnesses then examined generally ascribed the fall of the exchanges (nearly 16 per cent below par) and the high price of gold (£4, 10s. per oz.) "to the balance of trade," that is, to the commercial relation of this country with the Continent, and to the circumstances of the imports and payments of subsidies having exceeded the exports. But the enlightened members of that committee proved by the witnesses themselves, against their wishes and prejudices, that the difference of exchange resulting from the state of trade and payments between two countries, must ever be limited by the expense of conveying and insuring the precious metals from one country to another. They therefore in their report held it to be clearly demonstrated that the extraordinary fall in the exchanges in 1810, which was very greatly beyond that limit, resulted not from the state of trade, but from a change in the relative value of our domestic currency. So of late the Act of 1844 has at times drawn into the Bank of England a very large amount of bullion, perhaps *eight or ten millions more than the wants of the country required,* the effect of which has been to lower the rate of interest to 2 and 2½ per cent, a rate not known before the Act of 1844, to stimulate speculation, and raise prices, thus correspondingly *lowering the value of our domestic currency.* In place of serving, as intended, *to maintain* an adequate supply of bullion, this diminution of the value of our domestic currency has naturally led, by turning the exchanges against us, to an export of gold from this country, and a periodical scarcity of bullion. This circumstance, and the ease with which silver, by its depreciation in the currency of France, was drained off from that country in exchange for our gold, were more important elements in affecting exchanges (see Note XX.), and the movement of the precious metals before the crisis of 1857, than the balance of general trade. If any faith can be put in published returns, the trade of this country up to autumn 1857 was in a sound condition, and there ought to have been no unfavourable balance to produce the crisis of that year.* A derangement of the *bullion trade,* arising from a change in the relative value of gold and silver, operating upon the unsound banking and currency systems of Europe, affords an explanation of that extraordinary movement of gold from this country, and of silver to the East, which led to the money panic and commercial crisis of 1857.

The question then arises, What are the causes of the fluctuation of bullion, or whether there are any

* The prosperity of the country up to 1857 is strongly insisted on by Lord Overstone and the other witnesses before the Committee of 1857.

peculiar circumstances affecting the movements of gold bullion which do not affect other commodities in regard to which no such excessive variations are observed? Gold bullion has been made the standard of value in this country; but for this purpose it would have been sufficient to enact that a pound sterling shall be .25682 oz. of gold of the standard fineness, in the same way as the standard measures of weight or extension are fixed. Under such a simple enactment, as will hereafter be shown, gold bullion would have remained subject to the natural laws of demand and supply, which would have secured a steady supply, commensurate to the wants of the country, and a steady value instead of the *present fluctuating value.* But our Legislature, with the "paternal folly" for which the powerful defender of bank monopoly (*The Times*) blamed the French protectionists, would not allow these simple natural laws to work. To secure, as was thought, a steady and abundant supply of gold, there is given to the importer of gold the privilege of having his bullion coined at the public expense; and the Bank of England is likewise bound to receive all the gold bullion which may be offered to it, and to give bank-notes for it, at the fixed rate of £3, 17s. 9d. per oz. (Note XII.) The Bank is of course also bound to return, or in effect to supply, all gold wanted, thus making the Bank of England the great national store for gold. It is generally contended that this arrangement neither gives any advantage to the importer of gold, nor imposes any hardship on the

Bank, as the Bank has only to restore at one time the gold which had been deposited with them at another. This, however, is a gross fallacy, arising from not perceiving that while *the price* of gold is fixed, its abundance and scarcity, and of course *its value* in exchange for other commodities, is from various circumstances constantly changing. Hence, as will be shown more fully hereafter, bullion is poured into the Bank when it is abundant and cheap, and drawn rapidly from it when it is scarce and of course more valuable. Speculation is thus unnaturally stimulated by an over-abundance of gold and a very low rate of interest at one time, and crises are produced by scarcity of gold and high rates of interest at another. I will show that gold may be the standard of value without these evils, if the Legislature will only withdraw restrictions, and leave the natural laws of demand and supply to regulate the supply of bullion as of other things.

The first principle of a monetary system is, *that the value of the circulation or currency,* which is simply the counters with which the business of the country is carried on, *shall steadily correspond with the value of the bullion which is adopted as the standard.* But the Bank's unlimited obligation to give notes for all gold offered, enables the importer to convert the commodity bullion into British currency at a value having no reference to the increasing or diminishing supply of bullion.* Gold bullion is thus not subject to the law of demand and supply, which regulates,

* See Addendum, p. 43.

with sure but gentle influence, the value of all other commodities. Two things are of the essence of all legitimate commerce: that the parties to a transaction should have liberty to enter into it or not at pleasure, and that they should be free to fix the terms. It is on these that the operation of the law of demand and supply depends; and if the one condition fail, it is only the more necessary that the other should have full efficacy. If the price of gold bullion in British currency is *necessarily fixed*, the regulation of its supply must rest entirely on the power of rejection—the very thing which the law excludes. The legitimate effect of large importation is to lower the value of the article imported; but the compulsory reception of gold by the Bank prevents this, and unnaturally keeps up the local value of bullion imported to the previously existing value of British currency, instead of allowing the value of currency to sink naturally with the increased supply and diminishing value of bullion.

That the derangement of the trade in bullion and the disparity in the world's market between bullion and British currency, which are *a priori* to be expected from such a regulation, do actually arise, is abundantly proved in the evidence given before the select committees. It will be granted by all intelligent economists, that the real value of British notes or sovereigns can be shown only by the quantity of general commodities which they will purchase; that is, by prices in general (Note XIII.)

Mr Hubbard, a director of the Bank of England, who formerly held Sir Robert Peel's sound doctrine (Note XIV.), that prices ought to rise or fall as the supply of bullion increases or diminishes, said before the Committee of 1857, "The action (of bullion) upon prices I totally disbelieve. Fourteen years ago I happened to have occasion to investigate that subject, and to my surprise (for I confess I held the theory previously) I found that there was not a single fact to be alleged in its favour. A table which I drew up gives the most substantial refutation to that idea. It will be seen," says Mr Hubbard, "by looking at fifteen main articles of value in this country, that the variations in their prices between 1834 and 1844 not only do not follow the movement of bullion, but that in many instances they are totally at variance with it."* Mr Hubbard subsequently compiled a table of prices for the ten years from 1844 to 1853, and the result is exactly similar. "There is not," he says, "the slightest affinity to be traced between the movements of bullion on the one hand and the prices of commodities on the other."† These tables will be found in the Appendix to the Report on the Bank Acts, by the Committee appointed in 1857.‡ To the same effect is the evidence of Mr Newmarch, Mr Weguelin, and Lord Overstone, § fully confirmed by a table of prices produced to the Committee of 1858 by Mr Torr of

* *Evidence*, p. 219. † *Ibid.*, pp. 290, 291.
‡ *Ibid.*, pp. 290, 291. § *Ibid.*, pp. 90, 98, 125, 351.

Liverpool.* It is thus evident that both before and since the Act of 1844 the value of British notes and sovereigns, as shown by the prices of all commodities, has failed to correspond with the fluctuations and commercial value of gold bullion. Our monetary system, therefore, is defective, in so far as it utterly fails to realise the essential requisite of identity in the value of gold bullion and British currency; and, in particular, the Act of 1844, which was intended by its authors to effect this identity, has been of no avail (Note XV.)

I have thus established, by the evidence of both the friends and opponents of the Bank Law, the important fact that, although the *price* of gold is fixed, the *value* of sovereigns and other forms of British currency, under which I include alike bank-notes, cheques, and bills, does not steadily correspond, or rise and fall, with the supply and value of gold. This disparity between British currency and the commercial value of bullion, of course deranges the trade in bullion, and is full of evil. Upon great importations of gold British currency is above par—that is, purchases more British stock or goods than the quantity of bullion it represents is commercially worth; and, so long as this continues, bullion is poured rapidly and irresistibly into the Bank till a plethora of gold is produced. The readiness with which discounts may be obtained then unduly stimulates speculation; which, after some

* *Evidence before Committee of* 1858, p. 325.

time, raises the prices of commodities—that is, depresses the value of currency till it is below par; when *sovereigns*, being of less value than bullion, become a profitable article of export. Then begins a drain of gold from the Bank; but, although this after some time raises interest, it has no immediate effect upon the prices of goods, or on the actual value of British currency or mercantile credit. Merchants will not at once contract their operations, but will rather pay a higher rate of interest than submit to sell off at a loss. It is *credit* or the *power of discount*, and neither the issue of notes nor the rate of interest, which effectually and permanently influences prices (Note XVI.) As proved by Mr Hubbard and others, the value or purchasing power of money does not immediately rise on the departure of bullion, but at last, upon an absolute privation of bullion and destruction of credit, panic takes place; and then, when discounts cannot *be got on any terms*, prices fall in a week from 20 to 40 per cent, and the value of British currency having, of course, then as suddenly risen, bullion correspondingly flows into the country in a full torrent, and is converted into currency. In other things price and value are identical; but, from the price of gold being fixed, it has been generally overlooked that its value is ever changing with foreign demand and supply. Merchants will always export what is cheapest. A bill-broker in Penang sends his bills to his broker in London, to be returned in silver or in other merchandise, or to invest for a time in stock, as may at the time be most profitable. Gold bullion leaves a country not to balance trade, but because, under an unsound currency system, a disparity arises between sovereigns and gold, and still more between francs and silver, which at certain times makes it profitable to export bullion rather than other goods. Hence, when Australian gold took the place of silver in the currency of France, the annual export of silver to the East increased from less than a million to twenty millions of pounds sterling in 1857 (Note XX.)

If time and the scope of this paper permitted, I could show that in 1857, when gold left us, our manufacturing industry and exports were unprecedentedly large, and the balance of trade could not naturally have been against us; that since the gold discoveries in our colonies, interest as well as wages and the prices of food—all-important elements of successful industry—have been higher in this country than in neighbouring states; and that the fate of Spain after the discoveries of the precious metals (Note XVII.) in her colonies, under a vain system of legislative restriction, must soon be the fate of England unless we correct our banking and monetary system, and allow natural laws to operate freely on the movements of bullion.

It is an extraordinary fact that the evils of the present monetary system arise from the very means used to prevent them. They arise mainly from the separation of power and responsibility so carefully imposed by Act of Parliament. Not only in the Bank of England is there a strict and impassable barrier raised up by legislation between the issue and banking departments, but, over and above this, the latter has only a small share of the banking business of the country. The bank of issue is bound to maintain a large reserve of gold, but the business for which that reserve ought to be a basis is chiefly transacted by other establishments, whose transactions regulate the movement of bullion. The total amount of discounts by the Bank of England is seldom more than £9,000,000,* which is probably not above one-tenth of the total discounts in London. Some idea of the amount of discounts by the joint-stock banks and discount-houses may be formed from the fact that the deposits with the former amounted in 1857 to £43,100,724,† while Mr Hodgson, M.P., a director of the Bank of England, estimates that "there was in London at the beginning of October 1857 between £70,000,000 and £80,000,000 bearing interest, held either at call or at seven days' notice,"‡ the greater part of which was employed in mercantile discounts.§ Hence it is generally admitted throughout the evidence before the Committees of 1857 and 1858 that the Bank has little power in regulating the rate of interest, but has simply to follow the market rate.|| The Bank of England alone

* See *Report of* 1858, *App.* p. 399, 400.
† *Report* 1858, p. 5. *Evidence*, p. 70.
‡ *Evidence*, p. 259. § *Ibid.*, p. 71.
|| See *Indices*, *s. v.* *Rate of Interest.*

is responsible for keeping a reserve of bullion, but it is chiefly the joint-stock banks and discount-houses that carry on the trade in money for which this reserve forms the basis, and these parties not being themselves holders of gold, their transactions are not directly affected by its departure. *The responsibility of holding gold bullion is practically laid on the issue department of the Bank of England, while the other department of the Bank, and the London banks and discount-houses, transact that trade in money which, to a great extent, governs the value and movements of sovereigns* (Note XVIII.)

In the present system we behold crowded together all the evils and errors which a perverted ingenuity can devise. We see the importer of gold gain an unfair advantage in being allowed to force his goods on a customer who is deprived of all option either as to quantity or price. We see the Bank indemnified by a pernicious monopoly; and as, when bank monopoly was still more rampant, a number of dwarf banks sprang up under its deadly shade, a large proportion of which collapsed in 1826, so now, to meet the demands of trade, we have seen arise in London the joint-stock banks discounting to an enormous extent on small capitals, and realising extravagant dividends of 15, 20, and 25 per cent. These banks have indeed done good service in collecting and distributing capital, but they can do this service safely and with real advantage to the country only if they possess, under free banking, *equal privileges and* *equal responsibilities with the Bank of England* (Note XIX.) Under free banking every bank would be obliged to hold the gold required for the basis of its own trade in money, and would thus feel sensitively in its own coffers all the pulsations of commerce, and would not have to regulate its undertakings by watching the health or sickness of a third party. Banks would, as Adam Smith says, be obliged to be circumspect, and take care not to extend their circulation (or their discounts) beyond due proportion to their own cash or bullion, and thus discounts (or trade in money) and prices of goods would both be directly controlled by the movements of bullion. During the French war, bank-notes, in consequence of their not being convertible into gold, were the offending part of the currency; but, since a return to cash payments, they have been perfectly steady in amount, innocuous, and useful. All the evils of subsequent times have arisen from over-issue of the other forms of currency—bank cheques and bills. Such over-issue arises from the same cause as the former over-issue of notes—viz., the want of direct and sufficient connection with gold as their basis. Those who deal in money, and give that credit which is the foundation of bank-cheques and the other forms of currency used in the large transactions of commerce, do not themselves hold gold as the basis of their trade. The Legislature has thought proper to make one great bank of issue and one great store for gold, and money-dealers look to the Bank of

England to keep a supply of gold, instead of being obliged to regulate their transactious by the gold in their own separate coffers. Under such a system, over-issues of credit currency in bank cheques and bills naturally take place. In the present case, as in the former, a disparity arises between currency and bullion, and leads to export of the metallic part of the depreciated currency—an export which resulted during the suspension of cash payments in a total abstraction of gold from the currency, and, in the present state of things, in successive crises rendered necessary to save the Bank and maintain cash payments. So completely fails Mr Mill's argument for imposing the responsibility of maintaining the supply of bullion upon one privileged bank.

We shall now state a very simple remedy for evils, the existence and fearful amount of which are now generally admitted. There is in these days a presumption against every departure from perfect freedom in matters of commerce, and I have now shown in regard to bank restriction that this presumption is more than established, even on the evidence of bank protectionists. To establish a sound monetary system, all that is required of the Legislature is to fix that a pound sterling shall be .25682 oz. of gold of the standard fineness. The standard of value would thus be fixed in the same way and on the same principles as the standards of weight and measure. In the one case as in the other the public will have no difficulty, if left in perfect freedom, in applying the standard to its own transactions, but unwise legislative restrictions, as already shown, totally derange the trade in bullion, and produce great unsteadiness in its supply and value, while *steadiness in a standard is so much wanted.* The interference of Government, even to the extent of exacting securities for issues, has been attended in America with the worst consequences. By inducing an unnatural confidence, it multiplies an inferior class of banks unable to bear the trial of monetary pressure, and not ashamed to stop cash payments. In the United States any parties who can get credit to purchase a few thousand pounds of Government stock are enabled to set up a bank and issue notes. In New York State alone there are about sixty banks, and in Massachusetts even a greater number, all issuing notes. These would never have obtained circulation for their notes, or their present status and power for mischief, if the public did not know that the Government held these deceptive securities. In England, as was the case in Scotland prior to 1845, with simple freedom from monopoly and legislative interference, a few great banks would no doubt be established in the metropolis and great towns, having branches throughout the country, with such large capitals and on such a basis as would give perfect confidence to the public, and secure circulation for their notes in all parts of the kingdom. For the very existence of such institutions there would be required an innate stability which banks propped up by legislation can never possess. To meet, however, the doubts and prejudices of the sticklers for a national bank of issue, and the timorous, we should say, let the free banks be taken bound to hold Government stock and bullion to the amount of their issues, and we should then have exactly the system which has worked with such perfect success in Canada and Australia.

Under a system of free banking, notes would not be a legal tender, and gold would remain the standard, and the only money. The currency would consist of silver coins for small payments, bank-notes of one pound and upwards, bank drafts and bills. By a tax on the issue of notes, Government would draw by simple and unobjectionable means the share of the profit of the circulation to which it is entitled. Gold would be tested and coined at the Mint, but there is no good reason for the Government either bearing the expense of coinage or providing storage and a market for gold bullion. An importer would find it more marketable if tested and coined, and should both pay the expense of coinage and find his own market for the article in which he trades. Banking companies would pay gold to all demanding it, for each pound either a sovereign or .25682 oz. of gold; but they would find means to secure to themselves a power to judge of the time and terms, as well as the quantity of gold, whether in bullion or coin, which they will receive. They might, for example, have all obligations to themselves payable in paper currency, in order to prevent gold beyond their wants from being forced on them through the circulation. Upon a sudden and great importation of gold, the holders would not then be enabled to throw it upon the banks, as at present, without limit and beyond its commercial value. They must carry it where it is wanted, or they might offer it at somewhat less than £3, 17s. 9d. per oz., and still realise, in purchasing British goods, the full commercial value of their bullion. So after a political or commercial convulsion, the hoarder of gold would be in the same position as the holder of iron or lead, and could get from the bank, or in the market, only a diminished commercial value. This would be quite fair; for while the banks would not be obliged to receive bullion unless they wished it, the holders would be under no obligation to take less than the full value of the commodity. The former, however, might at such times be induced to add to their stores of gold, thereby naturally keeping currency at par with the increased supply of bullion; but they could effectually resist such a pressure of gold upon them as would unnaturally depreciate the currency, stimulate speculation, and lead to revulsion and crisis. Free banks would pay interest on all the gold received, and this would be an additional reason why they should not, as the Bank of England now does, receive eight or ten millions more than the country wants, the effect of which is, by raising prices of British goods, to prepare for another crisis.

A drain of bullion would also be prevented with equal ease and certainty. All the banks being at the same time dealers in bullion and in discounts, *and holding only the quantity of bullion required as the basis of their own trade,* would at once feel the withdrawal of gold from their several coffers, and be all *constrained immediately, without reference either to their issues or deposits,* to reduce the amount of their discounts in proportion to the cash they hold. This would gently check speculation and naturally lower prices, correspondingly raising the value of British currency, and by thus maintaining currency steadily at par with gold, would check timeously and gently, but effectually, the export of bullion. The inducement to the export of gold being thus removed, goods in place of gold would be exported to balance trade, and monetary and commercial crisis would in all probability be completely prevented.

You have now before you an important passage of Dr Adam Smith, together with a variety of facts which show that meddling legislation, in direct opposition to the principles which he promulgated, has been the cause of excessive fluctuations of bullion, and of that ever-recurring commercial distress which so materially affects the prosperity and happiness of all classes. The disparity between bullion and gold currency is no new doctrine. Ricardo, the enlightened adviser of Peel, in his measure of 1819, anticipated that such might arise, and advocated a pure paper currency, convertible into certain weights of bullion as a preventive. Living in the atmosphere of the

Bank of England, Ricardo did not, indeed, realise Adam Smith's principle of free banking; but, to secure against such disparity, at least on one side, by enforcing a sufficient issue of notes, proposed the unfortunate substitute of binding the Government bank to receive all gold, and to issue notes for it. The scheme of the great modern financier—like all expediency amendments of a system fundamentally wrong—has signally failed. But the facts now submitted go very far to show that, if we adopt the free banking principles of the great economist of the last century, we shall find them as full of good as his free-trading principles, now happily in operation, which were so long strenuously resisted by Sir Robert Peel and other intelligent men. In conclusion, our successors will no doubt look back with wonder at the unnatural mystery with which in this age men have managed to surround this subject. It will be found by-and-by, when the progress of opinion shall have compelled Parliament to repeal the present Bank Acts, that the benefits which will result from free banking will be not less than those we have reaped from free trade in corn; and in the one case no less than the other, will the soundness of the doctrine of Dr Adam Smith be fully confirmed.

ADDENDUM.

The following extract from *Monetary and Commercial Crisis an Avoidable Evil*, by the same author, (London: Letts, Son, & Co., 1859), shows the same disparity between currency and bullion in a still clearer light. It refers more especially to the power of coining gold bullion, which has of course the same effects as the obligation laid upon the Bank to give notes for all gold offered. (See *supra*, pp. 11-15, 39, Note XII.)

"Sir Robert Peel, prior to 1844, saw correctly that the value of gold in currency, supplemented as it is by bank-notes and drafts, merchants' bills, &c., did not instantly and steadily correspond with the supply of gold or its value in the world's market, and he tried vainly to correct the evil by the Act of 1844. If that great practical statesman had been spared to see the marked features of the late crisis of 1857, he would, with his usual openness to conviction, have acknowledged the inefficiency of his measure, and been enabled to trace the evil to its main source—viz., to the extraneous value which the *coinage* and *currency* of gold and silver gives, for a time, in particular countries, to these special commodities as current coin.

"The ancient idea was that coinage might be used to give a value to the precious metals greater than their value as simple commodities; and kings and states, with a view to gain, frequently issued coins debased in quality, or under the proper weight. Such coins passed into circulation at their nominal value; and, with the limited trade of those days, the currency was not, for a long time, felt to be depreciated.

"The modern currency principle goes to the opposite extreme, holding that coinage has no effect on the value of the precious metals, and that a sovereign is, in no respect and at no time, different from its corresponding weight of bullion; or that our mixed gold and paper currency must always be at par in value with gold bullion.

"The ancient and modern ideas of coinage are both unsound. The one allowed too much effect to coinage, and the other allows too little. It is evident that the debased coins of former ages went out from the mint into circulation at their full nominal value. *For a time* the currency value of such coins was not affected, and consequently they were not then at par with the market value of the bullion they contained. The currency was debased, but coinage forced it upon the public at its nominal value, and the state pocketed the profit. It was only after a time that it came to its true value, and was perceived to be depreciated.

"In exactly the same way in our own day, upon a large importation of gold, its value naturally falls in the world's market; but, by coinage, it is thrown out upon the British public at the previous current value. *The importer derives the profit which the state formerly received by the coinage of a depreciated metal.* The value of gold in currency thus does not *instantly* correspond with the lower value of bullion arising from a great importation. Gold in coin and gold bullion are therefore for a time not at par, and holders of bullion can, at such seasons, convert it *with profit* into British currency—gold then accumulates in the Bank of England—the rate of interest becomes low, and speculation is unduly stimulated. After a time the value of gold in currency falls, as appears in the increased prices of all commodities, and comes to be at par with bullion, when the further accumulation of gold ceases. But a large quantity having found its way to the stores of the Bank of England, still presses upon the circulation, and the currency value of gold then falls *below* par—that is, below the value of bullion in the world's market. It is then drained from us, by a natural law of trade, more rapidly than it was formerly pressed upon us; and in 1857 this drain continued uninterrupted, and *without at all affecting the value of our currency,* till an absolute want of gold produced monetary convulsion and commercial crisis.

"From what has been said, it is clear that gold bullion and our gold currency are two very different things, and are not steadily at par with each other. The British currency system incorrectly supposes gold bullion and coined gold to be essentially the same, and hence have sprung the errors and evils of currency legislation. If statesmen would only consider and understand this want of parity of gold bullion and *coined* gold, the mystery of the currency question would disappear. They would perceive that, under our present law, when currency—that is, coined gold—is more valuable than bullion, the latter can, with profit to the importer, be *forced* upon the Bank or Mint, and converted into currency; and again, upon a revulsion, when bullion becomes more valuable than currency, sovereigns can with profit be carried off and sold as bullion. This, of course, causes an abnormal fluctuation of bullion, while we can only look on in utter helplessness, stupidly wondering at the *mysterious* and *uncontrollable* character of currency. To illustrate this, assume Scotland to be a separate kingdom, with a steady circulation of £4,000,000 in bank-notes, and the banks having in store as much gold as they judge necessary to secure the convertibility of their notes. Suppose a vessel to arrive with £2,000,000 of gold. Under the present English law, the Bank of Scotland would have to take all this gold and issue notes for it, or the importer could get it coined and issued as sovereigns at a value unaffected at the time by the excessive importation; thereby causing repletion of gold, depreciation of the currency below par, and, in the end, panic and commercial crisis. Under the proposed system, this bullion could not be forced on Scotland through the circulation, but must find its way, like any other commodity of trade, to the best markets, at its fair commercial value."

NOTES.

NOTE I.—INTRODUCTION, p. 7.

Extracts from Ricardo and the Report of the Bullion Committee.

[THE following paragraphs show not that Mr Ricardo's views were uniformly and consistently in harmony with those here evolved, but that he held principles and opinions which, had he lived, would probably, with the lessons of experience and observation, have brought him to the same conclusions.]

"Experience shows that neither a state nor a bank ever have had the unrestricted power of issuing paper money without abusing that power: in all states, therefore, the issue of paper money ought to be under some check and control; and none seems so proper for that purpose as that of subjecting the issuers of paper money to the obligation of paying their notes either in gold coin or bullion."—*Principles of Political Economy and Taxation*, chap. xxvii. (*On Currency and Banks*); M'Culloch's edition, p. 215.

"A currency is in its most perfect state when it consists wholly of paper money, but of paper money of an equal value with the gold which it professes to represent. The use of paper instead of gold substitutes the cheapest in place of the most expensive medium, and enables the country, without loss to any individual, to exchange all the gold which it before used for this purpose for raw materials, utensils, and food; by the use of which, both its wealth and its enjoyments are increased." —*Ibid.*, p. 218

"When the number of transactions increase in any country from its increasing opulence and industry—bullion remaining at the same value, and the economy in the use of money also continuing unaltered—the value of money will rise on account of the increased use which will be made of it, and will continue permanently above the value of bullion, unless the quantity be increased, either by the addition of paper, or by procuring bullion to be coined into money. There will be more commodities bought and sold, but at lower prices; so that the same money will still be adequate to the increased number of transactions, by passing in each transaction at a higher value. The value of money, then, does not wholly depend upon its absolute quantity, but on its quantity relatively to the payments which it has to accomplish; and the same effects would follow from either of two causes—from increasing the uses for money one-tenth, or from diminishing its quantity one-tenth; for in either case its value would rise one-tenth. . . .

"The value of money and the amount of payments remaining the same, the quantity of money required must depend on the degree of economy practised in the use of it. If no payments were made by cheques on bankers, by means of which money is merely written off one account and added to another, and that to the amount of millions daily, with few or no bank-notes or coin passing, it is obvious that considerably more currency would be required, or, which is the same in its effects, the same money would pass at a greatly increased value, and would, therefore, be adequate to the additional amount of payments.

"Whenever merchants, then, have a want of confidence in each other, which disinclines them to deal on credit, or to accept in payment each other's cheques, notes, or bills, more money, whether it be paper or metallic money, is in demand; and the advantage of a paper circulation, when established on correct principles, is, that this additional quantity can be presently supplied without occasioning any variation in the value of the whole currency, either as compared with bullion or with any other commodity; whereas, with a system of metallic currency, this additional quantity cannot be so readily supplied; and when it is finally supplied, the whole of the currency, as well as bullion, has acquired an increased value."—*Proposals for an Economical and Secure Currency*, Sect. I.; *Works*, M'Culloch's edition, p. 398-400.

"The price of a commodity is its exchangeable value in money only.

"The value of a commodity is estimated by the quantity of other things generally for which it will exchange.

"The price of a commodity may rise while its value falls, and *vice versâ*. A hat may rise from twenty to thirty shillings in price, but thirty shillings may not procure so much tea, sugar, coffee, and all other things, as twenty shillings did before, consequently a hat cannot procure so much. The hat, then, has fallen in value, though it has increased in price.

"Nothing is so easy to ascertain as a variation of price, nothing so difficult as a variation of value; indeed, without an invariable measure of value, and none such exists, it is impossible to ascertain it with any certainty or precision.

"A hat may exchange for less of tea, sugar, and coffee than before, but, at the same time, it may exchange for more of hardware, shoes, stockings, &c.; and the difference of the comparative value of these commodities may either arise from a stationary value of one, and a rise, though in different degrees, of the other two; or a stationary value in one, and a fall in the value of the other two; or they may have all varied at the same time.

"If we say that value should be measured by the enjoyments which the exchange of the commodity can procure for its owner, we are still as much at a loss as ever to estimate value, because two persons may derive very different degrees of enjoyment from the possession of the same commodity. In the above instance, a hat would appear to have fallen in value to him whose enjoyments consisted in tea, coffee, and sugar; while it would appear to have risen in value to him who preferred shoes, stockings, and hardware.

"Commodities generally, then, can never become a standard to regulate the quantity and value of money; and although some inconveniences attend the standard which we have adopted—namely, gold and silver—from the variations to which they are subject as commodities, these are trivial, indeed, compared to those which we should have to bear if we adopted the plan recommended" [of a currency without a specific standard].—*Proposals for an Economical and Secure Currency*, Sect. II., p. 401.

"A well-regulated paper currency is so great an improvement in commerce, that I should greatly regret if prejudice should induce us to return to a system of less utility. The introduction of the precious metals for the purposes of money may with truth be considered as one of the most important steps towards the improvement of commerce and the arts of civilised life ; but it is no less true, that, with the advancement of knowledge and science, we discover that it would be another improvement to banish them again from the employment to which, during a less enlightened period, they had been so advantageously applied.

"If the Bank should be again called upon to pay their notes in specie, the effect would be to lessen greatly the profits of the Bank, without a corresponding gain to any other part of the community. If those who use one and two, and even five pound notes, should have their option of using guineas, there can be little doubt which they would prefer ; and thus, to indulge a mere caprice, a most expensive medium would be substituted for one of little value.

"Besides the loss to the Bank, which must be considered as a loss to the community, general wealth being made up of individual riches, the state would be subjected to the useless expense of coinage, and, on every fall of the exchange, guineas would be melted and exported.

"To secure the public against any other variations in the value of the currency than those to which the standard itself is subject, and, at the same time, to carry on the circulation with a medium the least expensive, is to attain the most perfect state to which a currency can be brought ; and we should possess all these advantages by subjecting the Bank to the delivery of uncoined gold or silver at the Mint standard and price, in exchange for their notes, instead of the delivery of guineas ; by which means paper would never fall below the value of bullion without being followed by a reduction of its quantity.* To prevent the rise of paper above the value of bullion, the Bank should be also obliged to give their paper in exchange for standard gold at the price of £3, 17s. per ounce. Not to give too much trouble to the Bank, the quantity of gold to be demanded in exchange for paper at the Mint price of £3, 17s. 10½d., or the quantity to be sold to the Bank at £3,

* With convertibility a depreciation of paper is simply impossible. —ED.

17s., should never be less than twenty ounces. In other words, the Bank should be obliged to purchase any quantity of gold that was offered them, not less than twenty ounces, at £3, 17s. per ounce, and to sell any quantity that might be demanded at £3, 17s. 10½d. While they have the power of regulating the quantity of their paper, there is no possible inconvenience that could result to them from such a regulation.

"The most perfect liberty should be given, at the same time, to export or import every description of bullion. These transactions in bullion would be very few in number if the Bank regulated their loans and issues of paper by the criterion which I have so often mentioned—namely, the price of standard bullion—without attending to the absolute quantity of paper in circulation.

"The object which I have in view would be in a great measure attained if the Bank were obliged to deliver uncoined bullion in exchange for their notes at the Mint price and standard; though they were not under the necessity of purchasing any quantity of bullion offered them at the prices to be fixed, particularly if the Mint were to continue open to the public for the coinage of Money: for that regulation is merely suggested to prevent the value of money from varying from the value of bullion more than the trifling difference between the prices at which the Bank should buy and sell, and which would be an approximation to that uniformity in its value which is acknowledged to be so desirable.

"If the Bank capriciously limited the quantity of their paper, they would raise its value; and gold might appear to fall below the limits at which I propose the Bank should purchase. Gold, in that case, might be carried to the Mint, and the money returned from thence being added to the circulation, would have the effect of lowering its value, and making it again conform to the standard; but it would neither be done so safely, so economically, nor so expeditiously as by the means which I have proposed; against which the Bank can have no objection to offer, as it is for their interest to furnish the circulation with paper, rather than oblige others to furnish it with coin."—*Proposals for an Economical and Secure Currency,* Sect. IV., p. 404-406.

BULLION COMMITTEE.

"So long as the paper of the Bank was convertible into specie at the will of the holder, it was enough both for the safety of the Bank and for the public interest in what regarded its circulating medium, that the Directors attended only to the character and quality of the bills discounted as real ones, and payable at fixed and short periods. They could not much exceed the proper bounds in respect of the quantity and amount of bills discounted, so as thereby to produce an excess of their paper in circulation, without quickly finding that the surplus returned upon themselves in demand for specie."—*Report of the Bullion Committee*, p. 53.

"When the currency consists entirely of the precious metals, or of paper convertible at will into the precious metals, the natural process of commerce, by establishing exchanges among all the different countries of the world, adjusts, in every particular country, the proportion of circulating medium to its actual occasions, according to that supply of the precious metals which the mines furnish to the general market of the world. The proportion, which is thus adjusted and maintained by the natural operation of commerce, cannot be adjusted by any human wisdom or skill."—*Ibid.*, p. 58.

"They will conclude their observations on this part of the subject, by observing, that in proportion as they most fully agree with Dr Adam Smith, and all the most able writers and statesmen of this country, in considering a paper circulation, constantly convertible into specie, as one of the greatest practical improvements which can be made in the political and domestic economy of any state, and in viewing the establishment of the country banks, issuing such paper as a most valuable and essential branch of that improvement in this kingdom ; in the same proportion is your Committee anxious to revert as speedily as possible to the former practice and state of things in this respect ; convinced, on the one hand, that anything like a permanent and systematic departure from that practice must ultimately lead to results which, among other attendant calamities, would be destructive of the system itself ; and on the other, that such an event would be the more to be deprecated, as it is only in a country like this, where good faith, both public and private, is held so high, and where, under the happy union of liberty and law, property, and securities of every description by which it is represented, are equally protected against the encroachments of power and the violence of popular commotion, that the advantages of this system, unaccompanied with any of its dangers, can be permanently enjoyed, and carried to their fullest extent."—*Ibid.*, p. 72.

"Your Committee, therefore, having very anxiously and deliberately considered this subject, report it to the House as their opinion that the system of the circulating medium of this country ought to be brought back with as much speed as is compatible with a wise and necessary caution to the original principle of cash payments, at the option of the holder of bank paper.

"Your Committee have understood that remedies, or palliatives of a different nature, have been projected—such as a compulsory limitation of the amount of bank advances and discounts during the continuance of the suspension, or a compulsory limitation, during the same period, of the rate of bank profits and dividends, by carrying the surplus of profits above that rate to the public account. But, in the judgment of your Committee, such indirect schemes for palliating the possible evils resulting from the suspension of cash payments would prove wholly inadequate for that purpose, because the necessary proportion could never be adjusted, and, if once fixed, might aggravate very much the inconveniences of a temporary pressure ; and even if their efficacy could be made to appear, they would be objectionable, as a most hurtful and improper interference with the rights of commercial property."—*Ibid.*, pp. 74, 75.

NOTE II.

"*The Bank of England*," &c., p. 18.—Objections somewhat different apply to the exclusive privileges granted to other banks in this country under the guise of restriction, but the monopoly of the Bank of England is the principal subject of this paper. The restrictions on banking in Scotland and Ireland (see Note VIII.) no doubt clog the enterprise and impede the progress of these countries ; but the monopoly of the Bank of England is not only the real origin of crises in this empire, but it deranges the bullion trade of the world.

NOTE III.

"London Bankers and Merchants," p. 18.—The present system is probably indebted for its continuance to the influence of the former class. The support or toleration it meets with from merchants is to be explained only by the fact that many of that class are so dependent on banks and bankers (a dependence which is secured and perpetuated by every impediment to the establishment of competing banks), that they dare not strenuously urge any reform that would interfere with the interests of their patrons. The advantages derived by bankers from the present system are admitted by a London banker of more than fifty years' experience, in his evidence before the Committee of 1857.

Qu. 4488.—"How do you think that the Act of 1844 has operated? If I were to answer you as a banker, I should say that it has operated exceedingly well, for it has afforded a rich harvest to bankers and capitalists of all kinds. But it has operated very badly to the honest, industrious tradesman, who requires steadiness in the rate of discount that he may be enabled to make his arrangements with confidence: it must distress that class very much indeed. For large capitalists and bankers, it is evident (there is no occasion to disguise the thing) that it has operated exceedingly well; it has made money-lending a most profitable pursuit for them."

And see four following questions (p. 438).

Qu. 4610.—"In fact, if the interests of commerce were considered rather than those of money, do you think it would be expedient to get rid of a system under which commerce is kept in a constant state of apprehension, and subject to occasional paralysis? It would be desirable to get rid of it, or to modify it, so as to take the mischievous part away from it; whether it is capable of that, I am sure I do not know."

. . . . . .

4612.—"Do you think that commercial men, if they had been consulted, would have invented such a system as this? Certainly not.

4613.—"You think it is a system which must have been invented by money-dealers, rather than by commercial men? Yes, it is the system of most commercial men to require very great freedom in all their transactions, as being the most profitable course which they can take."

And see Qu. 4614, 4615, 4616.

While we entirely differ from many of the theories maintained by Mr Twells, we have ventured to give these quotations as disinterested testimony by a shrewd and practical banker to *facts* which stand in no need of confirmation to any one who is engaged in trade.—*Cf. Evid. of Mr Sampson Lloyd, before the Com. of* 1858, p. 178.

NOTE IV.—Page 19.

"In questions of money, mistakes, when sanctioned by Government, resolve themselves of necessity into injuries, falling on this or that legitimate interest, into injustice or iniquity more or less disastrous in its consequences."—M. CHEVALIER *On the probable Fall in the Value of Gold*, p. 19. (Mr Cobden's transl.)

NOTE V.—Page 19.

The Preamble of the Bank Act of 1844 runs thus: "Whereas it is expedient to regulate the issue of bills or notes payable on demand; and whereas an Act was passed in the fourth year of his late Majesty King William IV., intituled 'An Act for giving to the Corporation of the Governor and Company of the Bank of England certain privileges for a limited period, under certain conditions; and it is expedient that the privileges of *exclusive banking* therein mentioned should be continued to the said Governor and Company, with such alterations as are herein contained upon certain conditions, &c.'"

§ X. It is enacted, "That from and after the passing of this Act, no person other than a banker, who on the 6th day of May 1844 was lawfully issuing his own bank-notes, shall make or issue bank-notes in any part of the United Kingdom." Upon this section, Mr Sampson S. Lloyd of Birmingham, himself a banker privileged by the Act, observes: "Though it is against my interest to say so, I think it is unjust to give a monopoly to the existing banks of issue. I cannot see why I should be permitted to issue notes as a banker, merely because I issued them in 1844."—*Evid.*, 1858, p. 178. And again, "I quite disapprove of giving a monopoly to certain banks of issuing notes, and of denying the power to other banks which did not issue notes in 1844. It is based on no sound principle whatever." —*Ibid.*, p. 201.

NOTE VI.—Page 22.

Dividends of Bank of England.

The Bank of England dividend for the year ending February 28th, 1858, in which the crisis of 1857 occurred, and during which the rate of discount varied from 5½ to 10 and 11 per cent, was 11 per cent. In 1852, when the rate of discount was 2 and 2½ per cent, the dividend was only 7½ per cent. See the evidence of Mr Neave, Governor of the Bank, before Committee of House of Commons in 1858, p. 56, where it is shown that the Bank's profits rise and fall with the rate of interest; and are greatest when the distress of the mercantile community is most intense. The same witness (p. 42) presents us with the picture of the Bank discounting to the amount of £1,200,000 a-day at 10 per cent, at the height of the panic, in the firm conviction that the Government would come to their aid by a relaxation of the Act of 1844.

NOTE VII.—Page 22.

Dividends of Joint-Stock Banks.

A managing director of a London joint-stock bank admitted in conversation with the writer the soundness of many of the views expressed in these pages, but remarked that while he was drawing a dividend of 25 per cent, he had no reason to complain of the present system. It is a generally recognised fact that the profits of joint-stock banks, as well as those of the Bank of England, are highest in times when money is scarce, and mercantile men in a state of anxiety. So, to take a recent instance, their large dividends in the latter half of 1863 (a fourth higher than in the first six months of the year), are accounted for by the *Economist*, January 30, 1864.

NOTE VIII.—Page 22.

Scotch Banks.

By the Act 8 and 9 Vict., c. 38, it was enacted that every banker claiming to be entitled to issue bank-notes in Scotland, should within a month give notice of his claim to the Commissioners of Stamps and Taxes, who should proceed to ascertain the average amount of his notes in circulation during the year preceding the first of May 1845, and certify under their hands the amount so ascertained: "and it shall be lawful for every such banker to continue to issue his own bank-notes after the sixth day of December 1845, to the extent of the amount so certified, and of the amount of gold and silver coin held by such banker at the head office or principal place of issue of such banker, in the proportion and manner hereinafter mentioned, but not to any further extent; and from and after the sixth day of December 1845 it shall not be lawful for any banker to make or issue bank-notes in *Scotland*, save and except only such bankers as shall have obtained such certificate from the Commissioners of Stamps and Taxes."

The effect of the restrictions imposed by this and the other clauses of the Act is summed up by Mr Gilbart, in his *Logic of Banking*, p. 519, by saying that they confirm a doctrine which statesmen are slow to learn, that restrictions upon banks are taxes on the public.

At the present time, when interest at the Bank of England is wavering between 6 and 8 per cent, and Scotch banks exact the same rates from commercial men, there is in Edinburgh a greater superabundance of money seeking permanent investments than has ever been known. In despair of finding the usual investments for his client's money, an agent writes to a number of railway companies, asking on what terms they will take money on debenture. The answer is, at 3½ per cent on loans for three to five years, $3\frac{3}{4}$ per cent for seven years, and 4 per cent for ten years. Yet the banks exact 7 and 8 per cent from their mercantile customers, themselves paying only 3 per cent on deposits, and 4 per cent on balances of current accounts. About the time of the crisis of 1857 bank-agents in the country received orders from their head-offices to raise their rate of discount as soon as a rise in the Bank of England rate was announced, but not to lower it without instructions. This state of matters creates a degree of dissatisfaction in Scotland, and produces attempts to remedy the inconvenience by proposals for new banks and discounting houses with their headquarters in London. In Glasgow much of the business of discounting commercial bills is already done by the agents of London bill-brokers, and the amount of custom thus withdrawn from the banks will doubtless increase every year, as they become more inadequate to the wants of the country, and as their management becomes more inert under the influence of the monopoly they enjoy. As yet, however, they flourish on their monopoly, and the public discontent, though already marked, is not yet profound enough to make them see it to be their interest to return to the state of freedom which existed before 1845,—a freedom in which they reached the stately proportions they now present, and but for which they would never have outgrown the puny dimensions of the majority of English country banks.

NOTE IX.—Page 23.

Bank-Notes not Money.

The advocates of the existing state of things insist strongly on an alleged distinction, or difference in kind, between bank-notes and other forms of paper credit;* they denounce very justly the error of those who give bills, cash credits, &c., the same rank and power as gold; but in the same breath they them-

* This is made the main feature of his system by Lord Overstone in a passage in his Evidence before the Commons' Committee of 1857, Quest. 3648, p. 328, which contains the most deliberate and authoritative statement of his principles.

selves commit the same error with regard to bank-notes. There is this much of truth in their view, that of all substitutes for money bank-notes are practically the most perfect. There is in general no doubt of their immediate convertibility into coin; they perform most effieiently its principal functions, and they are in many respects more convenient. But, above all, they are most nearly equivalent with coin in law—it might almost be said, indeed, that the doctrine in question is the child of legal theory. A most able and learned writer, Mr M'Culloch,* actually quotes Lord Mansfield's exposition of a point of law as supporting his economical dogma. It is much the same as if we were to quote the same Judge's decision in Somerset's case as establishing the descent of the human race from a single stock. In truth, the difference between coin and bank-notes is more radical and important than the difference between bank-notes and other forms of credit. Money is that which, possessing a value of its own, serves as a measure of other values. All paper substitutes for it are alike in this, that they have no intrinsic value; they are valuable only as they have reference to a money-value, and they differ from one another in efficiency according as their convertibility is more or less certain, and their form more or less convenient. Coin and bank-notes *differ in kind*, while bank-notes and bills *differ in degree only*. Coin is a real value; bank-notes and bills are promises to pay coin; but the former is the promise of an immediate payment, and therefore has less risk than the latter, which is generally the promise of a deferred payment. The exaggerated importance ascribed in all late currency discussions to the issues of bank-notes arises from this confusion between them and gold coin; a much more natural confusion some time ago than now. When the art of banking was in a less advanced stage, coin and its most approved surrogate fulfilled a vastly more important office in all mercantile transactions. It was only in 1772 that cheques began to be used in London, and the practice of paying debts and settling balances by this means 'has been of very gradual growth.† Notes and gold were, therefore, at the end of the last and beginning of the present century, naturally supposed to be the correct index of

* *Select Collection of Tracts on Paper Currency and Banking* (printed for Lord Overstone), pref. p. 6.

† See *Report of Bullion Com.*, pp. 63, 64.

the purchasing power of the country—the capital which regulates prices. After the suspension of cash payments they became the only money in the country, and thus acquired a *prestige* which the efforts of modern bankers have succeeded in maintaining to this day. But the return to cash payments in 1819, and the many improvements in banking since effected, have destroyed their influence on prices, and diminished their usefulness. The real business of the country is now transacted by means of private paper. Notes are now only small change or counters for paying accounts and settling balances: they have therefore little or no influence on prices, all large transactions which really affect prices being settled by bills or cheques. Where formerly a bank, in discounting a bill or making an advance to a customer, would have used the opportunity to issue a quantity of its own notes, it now merely writes down a sum to his credit in its books, and he operates on it by drafts. The requirements of commerce would have led to this result in any case; but the necessity of obtaining discounts on the part of the mercantile public, and the restrictions placed on the issue of notes, have originated a class of discount banks distinct from the banks of issue. Discounting, as a separate business, has advanced most rapidly in London, where banking is most restricted; but as in the progress of the nation the system stereotyped in 1844 becomes more and more insufficient, discount banks may be expected to multiply in all parts of the country (see Note VIII., *fin.*) The mischiefs which attend this separation of the functions of banking and discounting appear in the text. The first principle of Lord Overstone's theory (*Evid.*, 1857, p. 328, Qu. 3648) is, "that the supply of the current coin—that is, the money of the realm"—(and money is explained to include bank-notes)—"ought to be entirely separated from banking business, which is, simply trading in money, borrowing at a low rate and lending at a higher rate." The absurdity of this dogma is shown in the text by the consequences which flow from the irresponsible power given by the system founded on it to dealers in money, or more properly in credit, whose operations are the real motives of the fluctuations of bullion, but are not affected by these fluctuations till they have caused a crisis and panic. The interests of the country imperatively require that those who carry on so important a trade as banking shall not be exempted from the ordinary check of feeling in their own coffers the variations in the supply and value of the commodity in which they deal. It is virtually to exempt them from this responsibility if we bid them look to the gold in the Bank, a stock which is not theirs, and the diminution of which does not touch their interests. Committees of Parliament used to complain that the Bank of England did not with sufficient attention watch the foreign exchanges in order to regulate their bank-note issues, and at last the Act of 1844 was contrived in order to substitute a mechanical contrivance for this vigilance. When those who give discounts shall be subjected to the natural necessity of observing the ebb and flow of bullion (from which they are now relieved), the first and most important step will be taken towards the establishment of a sound monetary system.

When writers of this school speak more carefully, they make notes and gold identical only in their effects. Thus, Mr M'Culloch says, "Our bank-notes are not, strictly speaking, money, but only substitutes for money. Inasmuch, however, as no doubt is entertained of their immediate convertibility into coins, and as they perform some of the principal functions of the latter, and are in many respects more commodious, *they are practically held to be money.*" This view appears in its highest "*practical*" manifestation in the Act of 1844. So far as our argument is concerned, the error consists in assuming that bank-notes and gold alone form the currency, or *fund which acts on prices,* leaving out of view the operation on prices of credit in the form of bills, cheques, &c. The amount of advances is the immediate cause of a rise or fall of prices, and that *ought* to correspond with the supply of money—*i.e.*, gold. It is here shown that the present system causes a want of correspondence between the quantity of gold and discounts and prices. See p. 29. M. CHEVALIER thus criticises the definition of money adopted by the authors of the Act of 1844 :—

"A statesman who has contributed more than any person to restore, after the peace of 1815, the monetary system of Great Britain, Sir Robert Peel, has himself given the imposing support of his authority to a definition of money which would include in it the bank-note. This definition has originated in a school of public writers (*publicistes*), who entertain on the subject of banks peculiar opinions, which we will make known in the following volume of this course. The consequences which this school draws from its definition would extend very far.

"If bank-notes are held to be as money in the strict sense of the word, money is a sign or symbol. The distance between the sign and the object represented here is small, for it is but to go to the bank to obtain gold in exchange for the notes. It is not, however, sufficient that this difference should be abstracted and the assimilation consecrated. Between a bank-note payable on demand, and coin or specie, there is a very close connection, but there is not identity ; and if identity were admitted as a principle, it could only be as the consequence of a fatal confusion.

"Those persons who insist that bank-notes should be held to be money have never been able to trace a line of demarcation, which should be clear and distinct, between a bank-note and a bill of exchange. If it be said that the bank-note passes from hand to hand without endorsement, it may be answered that this is the case with bills of exchange blank-endorsed. If the circumstance be relied upon that it circulates without examination, except in the case of the public being warned of a forgery, the answer is that such is not always the course of actual business ; for assuredly precautions are taken as regards notes for the large sums which, in countries where there are many banks, as in England and America, pass current among merchants, and serve for certain special transactions. It is at the utmost as regards the smaller notes that the unfortunate habit has been contracted of such excessive confidence. If it be contended, as sometimes it has been, that the bill of exchange is attended with the inconvenience of not commanding its amount in coin except in a specified place, the reply would be that it is absolutely the same with a bank-note. As to the characteristic which has been sometimes indicated, that the bank-note is in a round sum, it is not worthy of notice. One of the writers who has taken the most prominent part in maintaining the opinion which I am here combating, in order to draw consequences from it applicable to the mechanism of banks in Great Britain, is Col. Torrens, who seems to have thought that he had discovered a characteristic difference between the bank-note and the bill of exchange, in saying that a payment was made once for all from the moment that the seller had received bank-notes from the buyer, but that if the buyer made the payment by a bill of exchange, emanating from himself or a third party, he would, nevertheless, not be absolved from the debt until the bill of exchange, having become due, should have been paid ; in other words, the bank-note would possess for the discharge of a debt a special power which would be wanting to the bill of exchange. The distinction which Col. Torrens thus draws is not admissible.

"It might at once be objected, that if the bill of exchange has been remitted in blank—that is, without the endorsement of the buyer—the seller must hold himself to be paid, although the bill should not be discharged when due.

"But we will set aside this observation, however strongly it serves to prove the assimilation of the bank-note to the blank endorsed bill of exchange.

"The argument of Col. Torrens is not more to the point (*topique*), than if he had maintained that with a bill of exchange at one month's date, a transaction being sooner closed than with one at three months' date, the bill of exchange at one month should not be considered as an obligation or title (*titre*) of the same nature as one at three months. A bank-note may perfectly well be considered as a bill of exchange or any commercial obligation whatever, which becomes due on the day or the hour on which it is delivered ; for I can, at the moment of its being delivered to me, receive the amount at the bank from which it emanates ; and this is precisely the reason why, as long as the bank has not suspended its payments in cash, the creditor who has received bank-notes in payment will be and ought to be held as being paid ; the same as one who has received bills of exchange, and who, having kept them to the moment of their *échéance*, shall have received the value of them in coin. But if, after having been paid in bank-notes, I do not think proper to go to the bank to claim payment in cash, and that some days afterwards the bank stops payment, the tribunals will not allow me to have recourse against the debtor who has remitted to me these bank-notes, because they would equally decide against any other creditors who had omitted to present them till after they had become due, and that the issuer should have failed subsequently to that time.

"In like manner, if I have received payment in bank-notes to-day, and it should be proved that the bank had suspended its payments in specie, the tribunals would grant me recourse against my debtor, just as they would decide that the debt to me was not discharged if he had given me bills of exchange which, when due, had been dishonoured.

"The similarity, therefore, between the bank-note and the bill of exchange remains untouched (*intacte*). On the contrary, between the bank-note and money there are profound differences, which, in 1810, Huskisson placed in strong relief, as follows :—

"'It is of the essence of money to possess *intrinsic value.* Paper currency has obviously no intrinsic value. A promissory note, under whatever form or from whatever source it may come, *represents* value. It does so inasmuch as it is an undertaking to pay in money the sum for which it is issued. The money or coin of a country is so much of its capital. Paper currency is no part of the capital of a country ; it is so much circulating credit. Whoever buys, gives ; whoever sells, receives such a quantity of pure gold or silver as is equivalent to the article bought or sold ; or if he gives or receives paper instead of money, he gives or receives that which is valuable only as it stipulates the payment of a given quantity of gold or silver. So long as this engagement is punctually fulfilled, paper will of course pass current with the coin with which it is constantly interchangeable. Both money, however, and paper promissory of money, are common measures and representatives of the value of all commodities. But money alone is the universal equivalent,—paper currency is the representative of that money.'

"All that can in truth be said to distinguish the bank-notes from other promises to pay, reduces itself to these very vague expressions, that it circulates much more easily among the non-commercial public. And moreover, is this greater facility of circulation of the very essence of the bank-note ? Certainly not. The bank-note is a promise which is generally more readily accepted, because the solvency of the establishment from which it emanates is better known, and that the promise itself bears marks (*signes*) which admit of its origin being more promptly and more certainly recognised. But, in the first place, it is not true that bank-notes pass altogether like coin. Let those who think so go and make the experiment among the hills of Auvergne, or even at the gates of Paris, or in the plains of La Beauce. Then, again, as between bank-note and bank-note, they do not all enjoy the same confidence. In short, if the firm of Rothschild issued its acceptances in a form calculated to guarantee their authenticity in Paris and in London, would not the public receive them in preference to the notes of certain banks? It is well known that in England private bankers issue notes as the Bank of England does. At a time not far removed, a custom had arisen in some counties of England, in Lancashire especially, of taking and giving bills of exchange in payment even for small sums, a few pounds sterling; they were of all sizes, and the notes of the local banks did not succeed in supplanting them.

"In conclusion, the bank-note enters into the class of paper credit, of circulating fiduciary obligations. It is accepted only in virtue of a feeling of confidence, just as a mercantile obligation (*un effet de commerce*), a draft on a banker, or a bill of exchange on a merchant. It circulates by favour of the credit which the public reposes in the bank. M. Storch is right in calling it a *billet de confiance*, and that English writers class it among *promissory notes*, or promises to pay.

"The bank-note enters into the more general category of instruments of credit. I say more general, because this includes not only mercantile obligations like bills of exchange which pass from hand to hand, but contracts or promises which play a great part, and which remain outside of the circulation. Such are deposits in account-current, which are not represented in the hands of the depositor or of anybody else, an obligation (*titre*) which does not admit of being issued into circulation; such as the credit opened in favour of an individual by a banker, or in the books of a bank, the portion of the credit which he has not yet used, and which nevertheless figures as an asset of this individual, does not present itself in any form which can be circulated."—*Cours d'Economie Politique fait au Collége de France*, par Michel Chevalier. (La Monnaie), Section I. chap. IV. Paris, 1850.—(As quoted by Messrs Tooke and Newmarch, *Hist. of Prices*, App. xiii., vol. vi. p. 616.) See MILL, *Pol. Econ.*, B. III. c. XI. The passage quoted by M. Chevalier from Mr HUSKISSON, occurs in *The Question concerning the Depreciation of our Paper Currency Stated and Examined*, 1810, reprinted by Lord Overstone and Mr M'Culloch in their *Collection of Scarce and*

Valuable Tracts on Paper Currency, &c., p. 579, seq. London: 1857.

An able writer, M. Victor Bonnet, in the *Revue des Deux Mondes* of Jan. 1, 1864, opposing the issue of a large quantity of notes by the Bank of France in order to relieve the money market, points out very forcibly the relative importance of this and other kinds of credit. Although we differ from his opinions in regard to the expediency of having a central bank of issue, and of guarding against the over-issue of notes by legistive enactments—although he exaggerates the danger of bank-note issues from not perceiving the check which a system of freedom would provide, and overlooks the greater risk which arises from the irresponsibility of dealers in other kinds of credit—his article is a favourable specimen of the way in which the present discussion is now conducted in France.

NOTE X.—Page 23.

The Committees of 1857 *and* 1848.

It was vain to expect that a Committee consisting, as that of 1857-8 did, of an equal number of men of opposite schools and interests, should arrive at any valuable conclusion on so difficult a subject as that embraced in the terms of their appointment—viz., "To inquire into the operation of the Bank Act of 1844, and of the Bank Acts for Ireland and Scotland of 1845; and to inquire into the causes of the recent commercial distress, and how far it has been affected by the laws for regulating the issue of bank-notes payable on demand." The Committee confessed its own incapacity and the futility of its labours when it reported, sec. 60, p. xxiii.: "For the opinions of the most eminent writers on the subject of the Currency, your Committee refer to the evidence taken in 1857. It is interesting in the highest degree to all who make the scientific study of the most abstruse questions of political economy their pursuit. *But a review of the evidence would appear necessarily to involve subjects of controversy on which your Committee would not be able to arrive at any conclusion without much difference of opinion, and they are therefore desirous* *of excluding these subjects from their report.*" Arguing in support of the foregone conclusion of the majority, the Committee proceed to quote the names of "the eminent writers" whose views they so anxiously exclude from the report, and, appealing to their authority in support of á truism, they disingenuously represent them as supporting, in part at least, the opinions which they themselves adopt. "That the public welfare in times of commercial disaster requires the maintenance of an adequate supply of bullion at the Bank, is the opinion of Mr Tooke, Mr Newmarch, and Mr Mill,* as well as of Lord Overstone, Mr Norman, and Mr Hubbard.† That the supply necessarily maintained in the coffers of that establishment, under the provisions of the Act of 1844, is greater than that which was ever maintained under circumstances of pressure in former times, is a fact beyond dispute." Then, ignoring the opinions of independent and enlightened economists, the report gives a review of the evidence of the Bank Directors and the advocates of the Act of 1844, and states that the Committee had not attempted to ascertain whether the Act regulated the circulation in the most perfect manner possible, but whether it secured the main object for which it was intended (sec. 66, p. xxv.) Strange that the failure of the Act to prevent those fluctuations with a view to which it was passed should not open men's eyes to its evils. (See Note XV.)

In regard to the Committee on Commercial Distress in 1848, the late Mr Hume, a member of the Committee, wrote to the author: "If you refer to the proceedings of the Committee on Commercial Distress of 1848, you will see that my draft report goes further than you do in blaming the Committee. I show that the report of the Committee, carried by one vote, was contrary to the evidence before the Committee, and through the combination of Sir Robert Peel and Lord John Russell, and the absence of other members of the Committee, the pressure of the 1844 Acts has been continued." Another member of the Committee wrote: "The Committee of the House of Com-

* Who admit, as every reasonable man does, the necessity of a bullion basis for the monetary system, but all disapprove of the Act of 1844, and differ *toto cœlo* from its authors in regard to the effect of bank-notes on prices.

† The first the inventor of the "currency principle," and the two others Directors of the Bank of England.

mons of 1848 was a packed committee—packed for the object of propping the Act of 1844. We did our best who were of the minority. It was indeed a nicely balanced committee, and reserving only a majority of one or two for Government, but that was enough." Mr Cayley said, "The Committee of 1848 examined seventeen witnesses, and only four of them approved of the Act of 1844—viz., the Governor of the Bank at the time the Act passed, Lord Overstone, and the Governor and Deputy-Governor of the Bank in 1848."

NOTE XI.—Page 23.

Circulation of Bank-Notes.

Nothing is more striking, in the attentive study of the statistics of banking, than the small variations that take place in the amount of bank-notes in circulation. Few better illustrations of this can be found than a table prepared by Lord Overstone, and produced in his evidence on banks of issue in 1840.—See LORD OVERSTONE'S *Tracts*, p. 351. The table and evidence show that, from January 1834 to April 1837, bullion decreased from £9,948,000 to £4,070,000, and that the aggregate circulation of bank-notes varied from £28,368,000 to £29,463,000, but with no intelligible relation to the variations of bullion. From April 1837 to April 1838, bullion rose from £4,071,000 to £10,126,000, and bank-notes varied from £28,856,000 during the rise, to £29,911,000 at the time of full treasure, the fluctuations again having no perceptible relation to the amount of bullion. From April 1838 to December 1839, bullion fell to £2,887,000, and notes varied from £31,029,000, after the treasure had begun to flow out, to £28,154,000 very soon after it reached the lowest ebb. The variations still appear to have no perceptible proportion, and Lord Overstone in his evidence (Qu. 2699) denies that there was any relation of causality in this instance, and ascribes both the contraction of circulation and the return of gold in 1840 to alarm on the part of the public.

NOTE XII.—Page 27.

7 & 8 Victoria, c. iv., "And be it enacted, that from and after the 31st August 1844, all persons shall be entitled to demand, from the issue department of the Bank of England, Bank of England notes in exchange for gold bullion at the rate of £3, 17s. 9d. per ounce of standard gold." We quote this, because we find that commercial men who have not studied the details of the Bank Act will hardly believe that so absurd a law has a place in our Statute-book. It enables any one who imports even a mountain of Australian gold to demand for it from the Bank British currency at the rate of £3, 17s. 9d. It finds for him not only a purchaser, but a price. No sophistry can disguise the fact that the man who receives for his commodities Bank of England notes, with which he can purchase what he pleases, has made a sale at a certain figure. The only excuse for the clause is, that by the law as it stood before, the importer of gold could have it coined at public expense, and could in this way throw it into the currency without check. The Act of 1844 has at least the merit of exposing conspicuously a defect inherent in any system in which the freedom of trade in gold and in discount is hampered, and the operation of the natural laws of supply and demand obstructed and perverted by legislative enactments. See as to this clause the letter of Mr Dobree, quoted in Note XV.

NOTE XIII.—Page 29.

Every change in the value of money which affects prices must evidently "affect all goods equally, and raise or lower their prices universally"—(A. Smith, *Wealth of Nations*). If, then, our mixed currency of gold and bank-notes varies, as the currency principle requires, precisely as a currency entirely metallic would do, every increase or decrease in the value of bullion, which can be shown only by its movements from one country to another, ought through the currency to cause a corresponding fall or rise in the prices of all commodities. The facts and figures which are here referred to prove that the supply of bullion has no correspondence with general prices in this country. But these prices must depend on British currency; therefore British currency does not vary in value with the fluctuations of bullion.

NOTE XIV.—Page 30.

The principle laid down by Sir Robert Peel was, that while the *price* of gold, as the British standard of money, must necessarily be fixed, its *value* in exchange for general commodities should vary with the abundance or scarcity of gold bullion, and regulate the export and import of that commodity. This is no doubt a sound principle; but Sir Robert Peel, seeing that it did not steadily operate under our artificial restrictive system, attempted to make it more effective by the Act of 1844. At that time he had not adopted the Free-Trade views which, a few years later, he borrowed from his political opponents; and the evil which he sought to remove, and which really arose from bank restriction, or the monopoly which legislation had given to the Bank of England, he perpetuated and aggravated by *increased restrictions.* He was prematurely cut off without an opportunity of seeing his mistake, and correcting it by treating banking and trade in bullion as he had treated the landowners and trade in corn. Since his death, some of his friends, who formerly approved of that principle, now deny its existence *in toto,* in place of considering, as their great leader would probably have done, why a principle unquestionably sound in itself has failed to operate.

NOTE XV.—Page 31.

Failure of Act of 1844. *Variations in Rate of Interest and in Amount of Discounts.*

See letter of Mr Bonamy Dobree, then a Director and afterwards Governor of the Bank of England, in the *Report on the Bank Acts,* 1858, Part II., p. 21, 5th November 1856.

"It has always appeared to me that the main object of the framers of the Act of 1844 was to secure the convertibility of the bank-note, and so to arrange as that the influx of gold bullion should have the same action and effect on the circulation of the country as would be produced were it actually in coin, instead of being represented by notes; and, secondly, to guard against violent fluctuations in the value of money.

"Now, in my opinion, this latter object has failed to be attained by the Act of 1844.

"The gold bullion has oscillated between £8,000,000 and £22,000,000, whilst the active notes have ranged between £17,000,000 and £24,000,000; thus showing a variation between the extreme points of £14,000,000 in the first, and only £7,000,000 in the last case; and these last referred to amounts were exceptional, the ordinary range being £18,000,000 and £22,000,000, or a difference of but £4,000,000 in place of £14,000,000.

"The consequence of this has been that, in periods of overabundance of gold bullion, the reserve of notes in the Bank's till has risen to £14,700,000 notwithstanding simultaneous efforts to force the issue, and to lower thereby the rate of discount: thus giving a great impetus to speculation, and enhancing the value both of securities and produce: when, on the other hand, a drain of gold bullion has set in, and the reserve of notes fallen to under £2,000,000, this has been attempted to be met by a rapid increase in the rates of discount, causing severe pressure in the mercantile interest, and followed by a marked decline in the value of the funds and of all securities, as well as in the price of all commodities.

"Those violent and sudden ebbs and flows—of which there have been various recurrences during the past twelve years, evidenced, in my opinion, by forty variations in the rates of discount, from 2 per cent, the lowest, to 8 per cent, the highest; whilst in the previous ten years there were but ten changes, between 2½ per cent, the lowest, and 6 per cent, the highest—could not have been foreseen, I think, by the promoters of the Act of 1844, and act very prejudicially upon the trading community, for whose particular benefit and safeguard the Act would seem to have been specially framed.

"One remedy, in my mind, would be found by relieving the Bank from the obligation of buying all gold bullion in exchange for notes at £3, 17s. 9d. per ounce.

"Were the obligation removed, gold in seasons of plethora would find its own market value, or it would be taken to the Mint to be coined ; and in this latter case the redundant circulation of the country would consist in coined gold, and not in Bank of England paper, as at present."

It will be kept in mind that in November 1857, a year after the date of this letter, the rate of interest at the Bank rose to *ten* per cent, making an extreme variation of eight per cent. See in reference to the excessive frequency of the variations of interest at the Bank (as many as 60 from 1844 to 1857, "while in the same space of time before 1844 they certainly did not amount to a dozen"), Mr Newmarch's *Evidence before Committee of* 1857, pp. 118, 120, 127, 128, 131, 166 ; Mr Mill's *Evidence, ibid.*, pp. 179, 200. Perhaps the result of the evidence of these two gentlemen may be stated thus ;—that the competition of so vast and overgrown an institution as the Bank of England with other discounters, a competition which (they hold) did not exist to the same extent before 1844, has far more serious effects on the market, and requires to be regulated with more care and on other principles than the business of a private bank or money-dealer. This is, in fact, though it is not so stated by them, an argument not merely against the Act of 1844, but against any privileged bank. If, therefore, such fluctuations be an evil, Lord Overstone cannot improve the case of the Bank monopolists by his contention (*Evidence*, 1857, p. 333, sqq.), that the variations of the rate of interest were as frequent before 1844 as since that year. At all events, he has not shown that the variations were equal in amount in the two periods. The question whether or not frequent and large variations in the rate of interest are, or are not, injurious to the community, is one which might be thought not to admit of doubt or discussion (see Mr Ricardo, *Proposals*, &c., *Works*, p. 397). There was a difference of opinion among the witnesses examined by the Committee of 1857-8, but it will be found that only bankers speak in the negative. One enlightened banker, indeed, held them to be injurious, and summarised their effect in a single sentence :—

"Qu. 2571.—You do not then approve of that clause in the Act of 1844 which compels the Bank to buy gold whether it wants it or not?—I have never been able to see any satisfactory reason for it.

"Qu. 2572.—Do you see any evil arising from it?—I think that rapid and excessive oscillations in the rate of discount are in themselves an evil; I think that an exceedingly low rate of discount stimulates well-meaning persons into enterprise frequently beyond their means, and that an exceeding stringency in the rate of discount causes frightful sacrifices of property; there is no doubt about that, I think."—*Evidence of Mr Sampson Samuel Lloyd of Birmingham, before Committee of* 1858, p. 178. See on this subject the *Evidence of Mr Slater*, 1858, p. 164; Mr SLATER'S *Reasons for an Alteration in the Legal Tender and a Reform in the Currency*, pp. 9, 10 (4th ed., 1861), an able and suggestive, if not quite satisfactory, work; and Report proposed by Mr CAYLEY in *Proceedings of Commons' Committee* 1858, p. lxvi. sq., with the *Evidence of* Mr MILL there cited.

The rate of interest is, however, of slight importance in comparison with the amount of discounts, which is here shown from the best authority to be the true regulator of prices and the supply of bullion. The amount of the advances of the Bank on mercantile securities is shown to be greatest at the very time when the rate of interest is highest.—TABLE produced by Mr HUBBARD, *Evidence before Committee of* 1857, p. 259.) This phenomenon is indeed alleged to arise from the difficulty at such times of getting discounts from other bankers; but it does not appear that their advances are diminished (see *Evidence of* Mr CHAPMAN, of the House of Messrs Overend, Gurney, & Co., *before Committee of* 1857, p. 464, *seq.*), but rather that the total loans to merchants are increased. It thus appears that at the very time when the Bank is raising the rate of discount in order to check a drain of bullion, it is at the same time an accomplice, if not the chief offender, in increasing those advances which are far more powerful in causing that drain than the rise of the rate of interest can be in checking it. A rise of interest has a temporary influence on the exchanges, but a reduction of the amount of discounts, and consequently of prices, by raising the value of our currency, would have a real and permanent effect in checking the export of the metallic part of our currency.

NOTE XVI.—Page 32.

Influence of Credit on Prices.

This great truth is acknowledged with more or less qualification by all the best modern writers on political economy. It is clearly demonstrated in Mr H. D. MACLEOD'S works, which have lately received the commendation and adhesion of M. Chevalier. In 1844 it was forcibly stated, but in vain, by Mr Fullarton in his book on *The Regulation of Currencies*, and by Mr Charles Buller in the House of Commons. The following passage is quoted from the speech of that lamented politician, on the second reading of the Act of 1844. After remarking on the tendency of Sir R. Peel's legislation—viz., to take country banks in detail that he might break them like a bundle of sticks—he said: "It appeared to him to be a most unsound principle to attempt to limit speculation by limiting a particular form of credit. The only effect of that attempt would be, that people would have recourse to some other form of credit, in all probability of a much less secure character. There was a phrase very generally made use of in discussions on this subject, which appeared to him to be the source of very considerable error—he meant the phrase 'paper money.' It seemed to him that the phrase paper money was inconsistent with the proper meaning of the word money, because, so far as he understood the word money, it meant some particular commodity, possessing intrinsic value in itself, which mankind by common consent had adopted as a medium of exchange. In this country, gold had been adopted as the standard, because gold had an intrinsic value in itself; but the term money could hardly be deliberately applied to anything which did not possess intrinsic value. Paper was merely a form of credit highly useful because tangible and easily transmissible, but still only a form of credit. This distinction was important, because it distinguished the case of bank paper from the circumstances which lowered the value of money. Gold and silver money, like any other commodity, depended, in the first place, for its value on the cost of producing it; and, secondly, on the proportion of demand and supply. If you double the quantity of gold and silver in the countries where they are the standard of exchange, you lessen their value proportionally. But paper money, having no intrinsic value in itself, depended for its value entirely on the gold and silver which it represented, and must be taken on precisely the same footing as bills of exchange or cheques on your banker, as simplified forms of credit and account. He did not understand how it could be imagined that by checking the issue of bank-notes in the country you did anything beyond checking that particular form of credit; and it was clear to him that by checking that particular form of credit you in no degree checked the disposition to speculate and give credit; all you did was to drive people to resort to some other form of credit. Really, to hear some honourable gentlemen, any one would suppose that all the great speculations in this country had been carried on simply and solely by means of bank-notes, and that all that was needed to stop speculation was to stop the issue of notes, whereas bank-notes formed but a very small part of the paper circulation of the country. He had in his hand an account of the quantity of bills of exchange in circulation at a particular period of several successive years, derived from a work of very great accuracy and authority; and he found that while, in 1839 for example, the amount of bank paper was between £26,000,000 and £27,000,000, the amount of bills of exchange in circulation at one time in the same year was £132,123,000, or five times the amount of the bank-notes. It was therefore quite absurd," &c. &c. . . . .

"You hear of £3,000,000 being done in one day at the clearing-house, and of only £200,000 of this being actually passed: this at once showed what proportion bank-notes bear to the circulation. Suppose you were to put an end altogether to the English country notes, and Irish and Scotch, depend upon it there was something in the credit system, in the speculative transactions of this great country, which had its roots deeper than any Legislature or any Government could reach. The whole matter depended on the simple question of supply and demand—upon the disposition of mankind to speculate; and so long as seasons remained uncertain, so long as various circumstances continued from time to time to arise, interfering between supply and demand, so long as men were fools enough to speculate unwisely, and others were fools enough to give credit unwisely, so long would all the disadvantages and evils of unwise speculation and unwise credit continue to be experienced, without being at all obviated, as some honourable gentlemen seemed to think, by putting down country bank-notes."

The following extract from *Observations on the Currency*, by Mr SLATER, was read by him to the Committee of 1858 (*Evid.*, p. 165). It gives a clear notion of the relative proportion of bank-notes and other kinds of circulation.

Analysis of the Description of Money which form £1,000,000 of Currency.

"To prove how little of real money—that is, of *Bank of England notes and gold*—enters into the operations of trade, it may be interesting as well as conclusive on that point to refer to the analysis of a continuous course of commercial transactions, extending over several millions yearly, and which may be considered as a fair example of the general trade of the country. The proportions of receipts and payments are reduced to the scale of *one million only*, during the year 1856, and are as under,—viz.,

RECEIPTS.

In Bankers' Drafts & Mercantile Bills of Exchange payable after date ..	£533,596	
In Cheques on Bankers, payable on demand	357,715	
In Country Bankers' Notes	9,627	
		£900,938
In Bank of England Notes...............	£68,554	
In Gold	28,089	
In Silver and Copper.....................	1,486	
In Post-office Orders	933	
		99,062
		£1,000,000

PAYMENTS.

By Bills of Exchange payable after date.........		£302,674
By Cheques on London Bankers		663,672
		£966,346
Bank of England Notes	£22,743	
By Gold	9,427	
By Silver and Copper	1,484	
		33,654
		£1,000,000

"These results may be taken as an illustration of trade in London, in those great branches where capital and credit may be supposed to have their free action; and they may be presumed to exemplify the ramifications of the currency amongst traders generally throughout the United Kingdom. It is here manifest that of the money received, Bank of England notes amount to less than 7 per cent, and gold and silver to only 3 per cent of the currency; and of the payments made, Bank of England notes are but 2 per cent, and gold and silver only 1 per cent of the currency. On the other hand, payments are received on a ratio of about 90 per cent, and are made at nearly 97 per cent, of that portion of the currency *which is formed of the credit and capital of the people themselves!* It is scarcely possible to produce more powerful evidence to establish the necessity for correcting that overwhelming influence which the Bank of England exercises over the whole money operations of the kingdom."

NOTE XVII.—Page 33.

ROBERTSON, in his *History of America*, says:—"According to principles of computation which appear to be extremely moderate, the quantity of gold and silver that has been regularly entered in the ports of Spain is equal in value to £4,000,000 sterling annually, reckoning from the year 1492, in which America was discovered, to the present time (1774). This, in 283 years, amounts to £1132,000,000. Immense as this sum is, the Spanish writers contend that as much more ought to be added to it, in consideration of treasure which has been extracted from the mines and imported fraudulently into Spain without paying duty to the king. By this account, Spain has drawn from the New World a supply of wealth amounting at least to £2000,000,000 sterling.*

"But though mines are the chief object of the Spaniards, and the precious metals which these yield form the principal articles in their commerce with America, the fertile countries which they possess there abound with other commodities of

* Correct this estimate by those of Mr Jacob and Mr Tooke. See *Hist. of Prices*, vol. vi. p. 358 sqq.

such value or scarcity as to attract a considerable degree of attention. . . . .

"When the importation into Spain of those various articles from her colonies first became active and considerable, her interior industry and manufactures were in a state so prosperous that with the product of these she was able both to purchase the commodities of the New World and to answer its growing demands. Under the reigns of Ferdinand and Isabella and Charles V., Spain was one of the most industrious countries in Europe. Her manufactures in wool and flax and silk were so extensive as not only to furnish what was sufficient for her own consumption, but to afford a surplus for exportation. Nor was the state of the Spanish marine at this period less flourishing than that of its manufactures. In the beginning of the sixteenth century, Spain is said to have possessed above one thousand merchant ships, a number probably far superior to that of any nation in Europe in that age. By the aid which foreign trade and domestic industry gave reciprocally to each other in their progress, the augmentation of both must have been rapid and extensive, and Spain might have received the same accession of opulence and vigour from her acquisitions in the New World that other powers have derived from their colonies there.

"But various causes prevented this. The same thing happens to nations as to individuals. Wealth which flows in gradually, and with moderate increase, feeds and nourishes that activity which is friendly to commerce, and calls it forth into vigorous and well-conducted exertions; but when opulence pours in suddenly, and with too full a stream, it overturns all sober plans of industry, and brings along with it a taste for what is wild and extravagant and daring in business or in action. Such was the great and sudden augmentation of power and revenue that the possession of America brought into Spain, and some symptoms of its pernicious influence upon the political operations of that monarchy soon began to appear. The Spaniards, like their monarchs, intoxicated with the wealth which poured in annually upon them, deserted the paths of industry to which they had been accustomed, and repaired with eagerness to those regions from which this opulence issued. By this rage of emigration another drain was opened, and the strength of the colonies augmented by exhausting that of the mother-country. All those emigrants, as well as the adventurers who had at first settled in America, depended absolutely upon Spain for almost every article of necessary consumption. Engaged in more alluring and lucrative pursuits, or *prevented by restraints which government imposed*, they could not turn their own attention towards establishing the manufactures requisite for comfortable subsistence. They received (as I have observed in another place) their clothing, their furniture—whatever ministers to the ease or luxury of life, and even their instruments of labour—from Europe. Spain, thinned of people and decreasing in industry, was unable to supply their growing demands. She had recourse to her neighbours. The manufactures of the Low Countries, of England, of France, and of Italy, which her wants called into existence or animated with new vivacity, furnished in abundance whatever she required. In vain did the fundamental law concerning the exclusion of foreigners from trade with America oppose this innovation. Necessity, more powerful than any statute, defeated its operation, and constrained the Spaniards themselves to concur in eluding it. In a short time not above a twentieth part of the commodities exported to America was of Spanish growth or fabric. All the rest was the property of foreign merchants, though entered in the name of Spaniards. The treasure of the New World may be said henceforward not to have belonged to Spain. Before it reached Europe it was anticipated as the price of goods purchased from foreigners. That wealth which, by an internal circulation, would have spread through each vein of industry, and have conveyed life and movement to every branch of manufacture, flowed out of the kingdom with such a rapid course as neither enriched nor animated it."

Comp. Macleod, *Pol. Econ.*, p. 91. "When the proportion of the currency in one country greatly exceeds that of its neighbours, it is a very great evil, because the cost of producing anything in that country is so much higher than in the neighbouring ones, that it is far cheaper to import goods than to produce them at home, and so native industry languishes and dies. It was this cause (joined to others of which it is not necessary to speak here) that destroyed the industry, and with it the power, of Spain," &c. Mr Macleod holds that in England "the currency is more abundant in proportion to the services it can command than in Continental countries; so that the same evil consequences would be manifested here, unless means were taken to counteract them; and this is done by diminishing the cost of production by the use of machinery," &c. See RICARDO, *Pol. Econ.*, chap. xvi.

The evils referred to will be effectually prevented by abrogating the laws which, by enabling importers of gold to convert it into British currency, seek to attract into this country more gold than we require. Free trade will draw into the country as much of the commodity gold as the legitimate wants of the country require, and will cause to be rejected and sent elsewhere that excess which now, periodically accumulating in the Bank of England, depreciates our currency, and unnaturally raises prices and wages.

NOTE XVIII.—Page 35.

Before the passing of the Bank Restriction Act, it was a matter of great scandal with the "currency" party, that country banks did not enlarge and contract their issues of notes in harmony with the variations of treasure in the Bank of England. Sir Robert Peel quotes the evidence of country bankers (Mr Hobhouse and Mr Stuckey) to this effect, and repeats the accusation he had learned from the London bankers at whose feet he sat, that the country banks regulate the issues "by prices rather than by a reference to the exchanges."—See Sir R. Peel's *Speeches on Renewal of the Bank Charter*, pp. 29, 31.

Lord Overstone repeatedly points out the power of the country banks to neutralise all the efforts of the Bank of England to contract the circulation during a drain of bullion. He saw perfectly well, in respect to note issues, that the provincial bankers were not to be blamed for acting simply according to the dictates of worldly prudence, instead of quixotically watching the ebb and flow of the Bank of England's treasure. The Act of 1844 provided a mechanical check upon all issues, but no one has yet attempted *to regulate credits.* When in those pages the evils of commercial crises are ascribed to the granters of undue credit, it is the system that is blamed, not the individuals,—the system that refuses to discounters the wholesome and necessary check of being themselves holders of gold, of themselves feeling the varying influences of the exchanges. The words of Lord Overstone with regard to country issues may be applied to the present case with slight variation: "Certainly in the case before us the course pursued by a highly respectable and important class is the natural, we might say the necessary, result of the laws under which they act. The Legislature has given to the country issuers the formidable power of creating *money* (mark the word), and at the same time has opened before them the whole field of private interest in which to exercise that power: it has laid down no rule to guide them in the right course, nor any motive to induce them to follow it. When individuals pursue their own interests without violating the laws of their country or the just rights of their neighbours, they are beyond the reach of censure; and if in this natural and legitimate course of procedure their measures militate against the public interest, the fault rests not with them, but with the laws within whose limits and under whose sanction they are acting; it is by reforming the latter, and not by dealing out censures against the former, that the true remedy must be sought. The most stern maintainer of the doctrines of the bullionists, if placed in the same circumstances with the country issuers, would act as they have acted. Their measures are the result of motives common to human nature under all circumstances, and which it is the appropriate business of wise legislation so to control and direct as to render them productive of public as much as of individual advantage. When this result is not attained, we are necessarily involved in the dilemma of being obliged to blame the acts, while we can find no just fault with the agents. We love the offender, yet condemn the offence."—*Remarks on the Management of the Circulation*, 1840—*Tracts*, p. 110. Lord Overstone wished the law to guide and supply motives for following the right path. All that is now required is that the law shall abstain from withdrawing discounters from the operation of the ordinary economical laws which act upon the prudence of other men. Lord Overstone boasts that under the present system banking is free, by which he only means that *discounting* is free. The time will come when the public will perceive, in spite of his Lordship's eloquent sophistry and browbeating, that while the freedom of banking in its larger and proper sense is safe and beneficial, the freedom of discounting divorced from banking is in the highest degree mischievous. The system of 1844 would be innocuous (if then), only if the Bank of England, or rather the State, were declared the only discount-house, as it is the only great holder of bullion.

NOTE XIX.—Page 36.

Perhaps the responsibility of the Bank of England itself in regard to discounts is now a rather doubtful quantity. So complete is the separation between its two departments, that the banking department would appear not to be sufficiently controlled in the amount of its discounts by the quantity of bullion in the issue department. Its good conduct hitherto is due probably more to its traditions and its responsibility as a great national institution, than to a real and effective interest of its own. In 1847, and 1857 too, it was asserted that it had competed for discounts more than formerly.

NOTE XX.

Export of Silver to the East.

The following passage is taken from Mr Stanley Jevons's able work on *The Fall in the Value of Gold* (Stanford, 1863), p. 33-37 :—

"It will probably be asked, If prices in general have risen 10 per cent, or thereabouts, how is it with the price of silver? This metal is as good a standard of value as gold; by some it is thought to be better. Ought we not to find every change in the value of gold exactly indicated in the price of silver? This question has at once presented itself to every one who turned his attention to the subject. It is, I conceive, because the question has not been in general rightly answered, that the depreciation of gold has been so much doubted.

"In the first place, it is far from true that no change has taken place in the price of silver. In tables or diagrams already given, we see that a permanent rise of at least 3 per cent has taken place. Before the year 1850, the price might be said to stand permanently below 60 pence, or 5 shillings the standard ounce troy. During the year 1850 a sudden rise took place, and the change has proved so permanent that only one monthly quotation (May 1852) has since been below 60 pence. It is true that the rise has not been progressive; having attained an elevation of about 3½ per cent in 1854 over the old level, the price has remained nearly stationary, and even slightly fallen back since 1859. That the gold price of silver should remain stationary has, however, been accounted for by M. Chevalier, though I must point out a great oversight in that writer's view of the matter.

"By a French law of the 7 Germinal, year 11 of the Revolution, an attempt was made to combine gold and silver in the French currency. It was enacted that silver or gold might be used at discretion in any payment, in the proportion of 15½ parts of silver for 1 part of gold. The law adopted the proportion of values which silver and gold had long possessed, and continued to possess for some 50 years longer. But this proportion, as we have shown, was altered to the extent of 3 per cent, about the year 1850, so that 15½ ounces of silver became more valuable than the ounce of gold for which they were legally payable as money in France. Thus it became cheaper to pay in gold in France, and to pay the silver of France away in foreign payments. And so long as there is much silver coin current in France, and the law of the year 11 holds, it will be possible for merchants, by importing gold against silver, to gain the difference of the natural and the legal rates of value in France, *minus* charges of carriage, insurance, &c. Very correctly M. Chevalier argues that so long as this state of things lasts, it will be impossible at London, Brussels, Hamburg, or even at New York, or any other great centre of commerce, for gold to fall in value much below that of 15½ times its weight of silver. On these grounds he calls the French silver currency a *parachute which retards the fall of the value of gold.* Here is the great oversight. The French currency may and does prevent gold from falling much below its old *relative value to silver,* but it cannot prevent either gold or silver from falling in value. The inevitable conclusion drawn from my tables of prices is, that gold has fallen say 9 per cent; silver has risen in value compared with gold 3 per cent; the difference, 6 *per cent, must necessarily represent the depreciation of silver.* Nor is it hard to see that, from the change of the French currency, silver must participate temporarily in the fall of gold.

"The moment the abundance of the Australian and Californian gold has altered the relative values of gold and silver by a certain amount, it becomes profitable for French merchants to buy up with silver *all* gold they can get at or below this new rate, on the one condition that other countries will take French silver in return. One hundred millions of gold flowing into France cause an overflow of one hundred millions of silver out of France. This vast supply of silver is just as unusual, sudden, and superfluous, as the supplies of gold from Australia and California. France, in absorbing the new gold, pours out silver just as if it had come from newly-discovered silver mines of extraordinary richness. There can be but one result. The value of silver must fall before the new and unusual supplies can be disposed of. Suppose it to fall so that silver and gold nearly resume their old relative values. The substitution of gold for silver in France is now no longer profitable. Gold accumulates on the London and other markets, and therefore again begins to fall in value. This cannot proceed far without it again becoming profitable to substitute gold for silver in France. Gold is again readily absorbed; silver again becomes superfluous and depreciated. Gold and silver thus alternately accumulate upon the markets of the world, and their values alternately fall down to the point at which it becomes possible to dispose of the one or other metal in foreign markets, especially in India. What is here described as taking place by steps, may also take place continuously and simultaneously. The superabundance of gold flowing into France causes a superabundance of silver to flow out, just as a stream flowing into one end of a reservoir that is already full causes an equal stream to flow out at another part. Both metals are depreciated in company, and nearly as much as gold alone would have fallen had the French currency law not existed. Not quite so low, indeed, because by that law it is now possible to dispose of the new gold either by direct use, or indirectly by disposing of French silver at its reduced value, and putting gold in its place.

"There is nothing new or strange in this sympathy between the values of two articles. Any two articles which can be used more or less one in the place of the other, vary in price together. A comparative abundance of either article causes it to overflow into channels of consumption usually filled by the other. When wheat is cheap, it is lavishly used as fodder for horses, stock, for distilling, and a variety of other uses to which inferior kinds of grain or other produce are usually applied. Thus the cheapness of wheat causes most other kinds of agricultural produce to be cheap, and similarly of other groups of commodities.

"These effects of the French currency law are far from being indicated by theory only. The tables already given show by the force of facts that the price of silver has not risen so much by some 6 per cent as the prices of 117 other articles. *This constitutes a depreciation of silver.* On the other hand, statistics of undoubted accuracy show that in 1859 about £100,000,000 of gold had been absorbed by France, a large amount of silver being given out. Previously to the year 1852, the annual imports of silver into France had exceeded the exports. In that year, which immediately succeeded the change in the price of silver, the stream turned, and the exports have since constantly exceeded the imports by a large amount. These facts are shown by the following data in M. Chevalier's *Essay*, p. 47.

1846,	Excess of *Imports*	of silver	into France,	£1,870,868
1847	"	"	"	2,145,163
1848	"	"	"	8,557,338
1849	"	"	"	9,782,708
1850	"	"	"	2,615,378
1851	"	"	"	3,117,959
1852,	Excess of *Exports*	of silver	from France,	108,690
1853	"	"	"	4,675,418
1854	"	"	"	6,547,751
1855	"	"	"	7,886,385
1856	"	"	"	11,342,932
1857	"	"	"	14,500,835

"The large amount of silver thus thrown upon European markets has been disposed of in Eastern markets, thus causing, as I think, that remarkable drain of silver to the East which for eight or ten years back has excited so much surprise in the commercial world. Some excellent writers have attributed this drain to the balance of trade between Europe and India, as disturbed by the transmission of English capital to railway works in India. The drain of precious metals, thus accounted for, then serves to explain the supposed fact that the precious metals have not fallen in value here. It would be extremely difficult, if not impossible, to prove or disprove anything *a priori*, by the balance of trade between Europe and the East. But having shown, upon a wide basis of facts, that both gold and silver are depreciated here, I am much more inclined to regard this depreciation as the cause of the Eastern drain. The fall in the value of silver, compared with most other goods, makes it more profitable to pay for Eastern produce with silver bullion than with our manufactures, silver being always acceptable among Asiatic nations."

THE END.

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