

Essays on Economics and Society

by JOHN STUART MILL



Introduction by

LORD ROBBINS

Textual Editor

J. M. ROBSON

Associate Professor of English,
Victoria College, University of Toronto

UNIVERSITY OF TORONTO PRESS

ROUTLEDGE & KEGAN PAUL

Contents

*

INTRODUCTION, by Lord Robbins	vii
TEXTUAL INTRODUCTION, by J. M. Robson	xliii
War Expenditure (1824)	1
The Quarterly Review on Political Economy (1825)	23
The Corn Laws (1825)	45
Paper Currency and Commercial Distress (1826)	71
The Silk Trade (1826)	125
The New Corn Law (1827)	141
The Nature, Origin, and Progress of Rent (1828)	161
The Currency Juggle (1833)	181
Corporation and Church Property (1833)	193
Miss Martineau's Summary of Political Economy (1834)	223
Essays on Some Unsettled Questions of Political Economy (1844)	229
Preface, 231	
Of the Laws of Interchange Between Nations, 232	
Of the Influence of Consumption on Production, 262	
On the Words Productive and Unproductive, 280	
On Profits, and Interest, 290	
On the Definition of Political Economy, 309	
The Currency Question (1844)	341
The Claims of Labour (1845)	363
De Quincey's Logic of Political Economy (1845)	391

* *

The Savings of the Middle and Working Classes (1850)	405
The Regulation of the London Water Supply (1851)	431
Newman's Political Economy (1851)	439
The Law of Partnership (1851)	459
The Income and Property Tax (1852)	463

The Bank Acts (1857)	499
The Income and Property Tax (1861)	549
Currency and Banking (1867)	599
Endowments (1869)	613
Thornton on Labour and Its Claims (1869)	631
Leslie on the Land Question (1870)	669
Land Tenure Reform (1871)	687
Property and Taxation (1873)	697
Chapters on Socialism (1879)	703

APPENDICES

Appendix A. McCulloch's Discourse on Political Economy (1825)	757
Appendix B. Petition on Free Trade (1841)	761
Appendix C. Examination Paper in Political Economy (1872)	764
Appendix D. Circular of the Land Tenure Reform Association concerning the Public Lands and Commons Bill (1872)	766
Appendix E. Bibliographic Index of persons and works cited in the <i>Essays</i> , with variants and notes	768

INDEX	833
-------	-----

FACSIMILE. MS fragment of "The Silk Trade" from the British Library of Political and Economic Science	
---	--

facing page 138

THE CURRENCY QUESTION

1844

EDITOR'S NOTE

Westminster Review, XLI (June, 1844), 579–98. Signed “A”; not republished. Original heading: “Art. XI.—1. *An Inquiry into the Currency Principle; the Connexion of the Currency with Prices, and the Expediency of a Separation of Issue from Banking.* By Thomas Tooke, Esq., F.R.S. [London:] Longman, [Brown, Green, and Longmans,] 1844. 2. *An Inquiry into the Practical Working of the Proposed Arrangements for the Renewal of the Charter of the Bank of England, and the Regulation of the Currency. With a Refutation of the Fallacies advanced by Mr. Tooke.* By R. Torrens, Esq., F.R.S. [London:] Smith, Elder, and Co., 1844.” Running head: “The Currency Question.” Identified in JSM’s bibliography as “An article headed ‘The Currency Question’ being a review of pamphlets by Tooke and Torrens on currency, in the *Westminster Review* for June 1844. (No. 2)” (MacMinn, 57). No corrections or variants in Somerville College copy.

The Currency Question

MR. TOOKE is known to all who are conversant with the discussions of the last twenty-five years on commercial topics, as an authority, on all such subjects, of the highest order. Beyond, perhaps, any other man, he brings to the consideration of mercantile phenomena an intimate practical knowledge of the elements upon which they depend, combined with habits of reflecting, or, to give the operation its proper name, of theorizing, which qualify him to discriminate and analyse the influences of those various elements. Owing to this union of qualifications, those who are interested in such inquiries have found in his various publications (and particularly in the "History of Prices,"[*] which is a summary of them all) a scientific explanation of those complex and apparently anomalous phenomena of prices, which the commercial history of the last half century presents in so great abundance, and which, until shown by him to be exemplifications of those very principles and laws with which they seemed to conflict, were perplexing even to those who best understood the subject, and often dangerously misleading to those who did not. The opinions, therefore, of Mr. Tooke upon the questions raised by the new ministerial scheme for the reform of the currency are entitled to an attentive, and, from all who are capable of appreciating what he has previously written, a respectful hearing.*

In the first of the pamphlets^[†] named at the commencement of this

[**A History of Prices, and of the State of the Circulation, from 1793 to 1837.* 2 vols. London: Longman, Orme, Brown, Green, and Longmans, 1838; and *A History of Prices, and of the State of the Circulation, in 1838 and 1839.* London: Longman, Orme, Brown, Green, and Longmans, 1840.]

*We should have deemed it superfluous to re-assert Mr. Tooke's claims to attention, if we were addressing only persons in some degree conversant with the subject; but others may have received an erroneous impression from a flippant attack, continued through two numbers of a weekly paper somewhat extensively read. The assailant, who appears to think that strong writing consists in contemptuous language, has not deemed it necessary to prove himself a competent judge, by either answering or showing that he understands any one of Mr. Tooke's arguments or statements. [See Anon., "Mr. Thomas Tooke on the Currency Principle," and "Currency Crochets," *Examiner*, 13 & 27 Apr., 1844, pp. 226-7, 259-60.]

[†*Inquiry into the Currency Question.*]

article, Mr. Tooke has taken the field against the system of doctrines on which the ministerial measure is founded, and which derives its commonest designation from the names of two of its most distinguished supporters—Mr. Jones Loyd and Mr. Norman.^[*] To represent the other side of the dispute, we have prefixed the latest pamphlet of the indefatigable Colonel Torrens, who was, we believe, the first promulgator of the theory in question, and who has come forward as its champion against “the fallacies advanced by Mr. Tooke.”^[†]

For any influence which further discussion can have upon the decision of parliament, it is evidently useless. Parliament has made up its mind. The measure of Sir R. Peel^[‡] has been received with approbation by nearly all, in parliament and the press, by whom any opinion has been expressed on it; and with acquiescence, if not satisfaction, by the public. There is not the smallest chance of its undergoing material alteration in its way through either house. That the attention, therefore, of thinkers should be directed to the views contained in Mr. Tooke’s pamphlet, is of importance rather as a matter of abstract discussion, essential to the right understanding of commercial phenomena, than with a view to any direct practical result. The question has ceased to be a practical one, and cannot again become so for ten years to come. But it involves highly important questions of theory; the practical bearing of which, as of all theories, far transcends the limits of any single application.

What was affirmed by Cicero of all things with which philosophy is conversant, may be asserted without scruple of the subject of currency—that there is no opinion so absurd as not to have been maintained by some person of reputation. There even appears to be on this subject a peculiar tenacity of error—a perpetual principle of resuscitation in slain absurdity. There are at this day numerous persons who can read and write, and some who think themselves oracles of wisdom, who see no harm in emancipating a paper currency from the restraint of convertibility, and from every definite principle of limitation, provided only that it is grounded on the security of actual property; forgetful that even the *assignats* were issued on no less a security than the principal portion of the soil of France, and that a paper so guaranteed is no more protected from depreciation, if issued in excess, than the land itself would be if offered for sale in unusual quantity. There

[*See, e.g., Loyd, Samuel Jones. *Thoughts on the Separation of the Departments of the Bank of England*. London: Richardson, 1844; Norman, George Warde. *Remarks upon Some Prevalent Errors, with respect to Currency and Banking*. London: Richardson, 1838.]

[†I.e., part of the title of Torrens’ *Inquiry into the Practical Workings*. . . .]

[‡See 7 & 8 Victoria, c. 32.]

are writers of pretension, not only out of Bedlam, but even, we can assure Sir Robert Peel, out of Birmingham, who think it the duty of the legislature periodically to degrade the standard (or to authorize an increase of inconvertible paper exactly equivalent) in proportion as the progress of industry creates an increase of productions and a multiplication of pecuniary transactions. But it is not against these extravagant aberrations that it is now necessary to contend. In the discussions which we are here concerned with, both sides admit, that the proper standard of currency is the precious metals, at an unalterable mint valuation; that a pound (precisely as stated by Sir Robert Peel) should mean a fixed quantity of gold of a given fineness; and that no one who has contracted to pay that given quantity, should be allowed on any pretext to discharge his debt by paying a smaller quantity, or making over paper equivalent to a smaller quantity. Gold is not an ideally perfect standard—a commodity absolutely unchangeable in cost of production; but it approaches nearer to that abstract perfection of a measure of value, than any other production of nature or industry; and if it were far more subject to fluctuation than it is, it would be less so than the policy of a government,—especially one which takes for its principle of guidance “the wants of trade,” which in this case simply means the convenience of debtors.

Assuming then—as conceded by all persons whom it is at present necessary to reason with—that the value of a paper currency must be maintained at par with the coin which it professes to represent, and that to effect this the issuers must be compelled to give coin for their notes whenever demanded; there is an ulterior question, on which those who are entitled to be considered authorities on the principles of the circulating medium, part company. According to one opinion, steadiness of value in a paper currency is sufficiently secured by ready and immediate convertibility. This was, until lately, the prevailing, if not the exclusive doctrine, among those by whom the theory of money had been successfully cultivated. Within the last few years another doctrine has sprung up, of which Colonel Torrens was, as we have said, the originator, Mr. Loyd, Mr. Norman, and Mr. McCulloch among the chief propounders, and to which Sir Robert Peel and his cabinet have become proselytes.

According to this doctrine, the check of convertibility acts too slowly, and admits of great mischief from excess of issues before it begins to operate. Convertibility, it is contended, is a security only against *permanent* depreciation. When an increased issue of paper has sunk the value of the currency below its regular proportion to the currencies of other countries, the exchanges turn, gold becomes an article of export, and, to obtain it, notes are returned upon the Bank. But the increase of issues has, in the

meantime, raised prices; which, when the excess of paper is removed, relapse to their former level. This is already a mischief; it deranges mercantile calculations, creates unexpected gains to some at the expense of others, and adds to the gambling character in a certain degree inherent in all the great operations of commerce. But the evil seldom ends here. All advance of prices tends to encourage speculation; especially when the same cause which creates the advance (being increased issues made by bankers, in the form of increased advances to their customers) occasions, as its very first effect, a reduction of the rate of interest. The conjunction of rising markets and a low rate of interest leads to speculative purchases, by which the rise itself is heightened and prolonged. The rise, however, not being grounded on any permanent cause of increased price (such as a deficiency of supply); in proportion to its continuance, the fall, when the tide turns, is from a greater height, and also to a lower depth. Those who during the rise of prices obtained credit upon the apparently increasing value of the goods which they held, are only enabled to fulfil their engagements by parting with the goods at almost any sacrifice, and prices sink for a time as much below their accustomed rate as they had previously been raised above it.

To avert these evils, in the opinion of Colonel Torrens and Mr. Loyd, and we may now add of Sir Robert Peel, something more than convertibility is necessary. Their remedy is to place the issuers under a legal impossibility of ever increasing their issues (beyond a certain moderate minimum), except in exchange for bullion, which, if refused to them, would probably be sent to the mint and coined. By this contrivance the paper currency is prevented from being arbitrarily increased. It can only, under such a system, be extended, when, if the augmentation were not made, an equivalent increase would probably take place in the portion of the currency which consists of coin.

But it is not enough, according to these authorities, to prevent increase of issues, otherwise than in exchange for bullion; it is also necessary to prevent the currency from being diminished, otherwise than by not re-issuing the notes which are presented for payment. Under the present system, the Bank, when it finds its treasure leaving it, does not remain passive, and allow the exchange of notes for specie to go on until, the needful contraction having been effected, the drain stops of itself. It becomes alarmed, and endeavours by calling in its issues to stop the efflux of bullion in an earlier stage. It diminishes its loans to merchants, depriving them in a period of falling prices of the accustomed accommodation, which is then more than usually necessary. Or it throws some of its securities upon the market, and by absorbing a portion of the capital which is seeking investment, deprives the merchants of an equivalent amount of pecuniary advances. By either process, it raises the rate of interest and increases the

difficulty of obtaining loans, at a period which is already one of pressure; thus heightening all the evils of a commercial revulsion.

By the plan proposed, that of compelling the issuers to keep their securities at a fixed amount, and to let the currency contract or expand only by the exchange of gold for notes and of notes for gold, the paper will, according to this theory, be preserved exactly the same in quantity as the metallic money which would otherwise circulate in its place; this identity of quantity being, it is supposed, indispensable to secure identity of value.

It is generally assumed, as essential to this mode of regulating the currency, that the privilege of issue should be confined to a single establishment. But the rule of holding an unvarying amount of securities, and of issuing notes beyond that amount only in exchange for bullion, might be applied to a multiplicity of issuers; and a scheme for that purpose was, in fact, devised by Colonel Torrens. Sir Robert Peel cuts the knot by prohibiting to the country banks any issues whatever beyond the average of the last two years. He does not apply to them, as he does to the Bank of England, the other half of the proposed system, by preventing arbitrary diminution as well as increase; either because he thinks that in preventing over-issue he has guarded sufficiently against revulsion, or because he deems more minute precautions superfluous in an arrangement which is avowedly preparatory to the suppression of all banks of issue other than the Bank of England.

Under the system thus established, we are confidently told that the calamity of almost periodical recurrence, commonly known by the name of a "commercial crisis," will be greatly diminished both in frequency and in severity. Some permit themselves to use language which at least seems to import that these convulsions will be rendered impossible. Colonel Torrens looks upon the measure as one which "will effectually prevent the recurrence of those commercial revulsions, those cycles of excitement and depression, which as Mr. Loyd has so felicitously explained, result from the alternate expansion and contraction of an ill-regulated circulation."^[*] He admits, indeed, that undue speculation, and the consequent reaction, might prevail to a great extent even under a metallic currency. But he attributes to the measure now proposed, an efficacy in counteracting those evils, sufficient to constitute that measure "the most important and the most salutary, as regards the reform of our monetary system, which has been brought under the consideration of parliament since the act of 1819 for the resumption of cash payments." [*Ibid.*]

We shall examine presently how far the measure deserves to be considered—again in the words of Colonel Torrens—as "the reform of a banking system hitherto, perhaps, the most defective in Europe." [*Ibid.*] But

[*Torrens, *Inquiry*, p. iv.]

whatever may be its recommendations, that of preventing, or even greatly alleviating commercial revulsions, can scarcely be one of them; since commercial revulsions are as frequent and as disastrous where this so bitterly-condemned banking system does not exist. Not to mention Amsterdam or Hamburg, the currency of France differs as little from a purely metallic currency as that of any civilized country can well do in this industrial era. France has no country banks of issue, no notes below twenty pounds (a large sum measured by the standard of French incomes), and nobody has ever imputed to the single issuing body which exists in France, any depreciating action on the currency. Even the custom of making payments by cheques is not yet generally adopted. Metallic money is the common medium of payment. Yet commercial revulsions are as severe, in proportion to the amount of mercantile business, in France as in England, and fill quite as large a space in public discussion and in the meditations of statesmen and of economists. An evil common to all commercial countries, in the ratio of the extent of their transactions, cannot depend upon a cause peculiar to England and the United States. What a currency actually metallic does not prevent, it is impossible that making the paper conform exactly to the variations of a metallic currency can cure.

As the notions of persons unacquainted with trade on what constitutes a commercial crisis are generally rather vague and obscure, we will, before going further, state as distinctly as possible what are its principal characteristics.

A commercial crisis is the recoil of prices, after they have been raised by speculation higher than is warranted by the state of the demand and of the supply. Speculation is almost always set in motion by something which affords apparent grounds for expecting either an extra demand or a deficient supply. But the anticipation may, in the first place, be erroneous; in the second, however rational it may be, the speculation (especially where the prospect of gain is considerable) is very likely to be overdone, each speculator conducting his operations as if he alone knew the circumstances on which the hope of profit is grounded. The rise consequent upon the speculative purchases attracts new speculators, insomuch that, paradoxical as it may appear, the largest purchases are often made at the highest price. But at last it is discovered that the rise has gone beyond the permanent cause for it, and purchases cease, or the holders think it is time to realise their gains. Then the recoil comes; and the price falls to a lower point than that from which it had risen, because the high price has both checked the demand, and, by stimulating production or importation, called forth a larger supply. Besides, many of those who during the high price have contracted engagements, which they trusted to a further rise for giving them the means of fulfilling, are unable to hold on until the crisis is past, but must sell at any sacrifice.

When this series of effects is confined to some one article of commerce, individuals may be ruined, but the mercantile world generally is not disturbed. When, however, as in 1825 and at several other periods in the present century, the opening of new markets, or some expected deficiency of supply extending to various important articles, has set speculation at work in several great departments at once, the spirit is apt to become general, and other commodities rise in price without any reasonable cause whatever. In such cases, the ultimate revulsion is most extensive and calamitous.

As long as the seasons vary, as markets fluctuate, and men miscalculate, or the passion of gain (as in gamblers) over-rides their calculations, so long will these alterations of ebb and flow, these "cycles," as Colonel Torrens calls them, "of excitement and depression,"[*] continue. They are worse in America than in England, because American commerce is conducted in a more gambling spirit; they are worse at Liverpool than in London, for the same reason. But whatever aggravates the natural fluctuations of the markets, or creates fluctuations when they would not otherwise exist, increases both the frequency and the destructiveness of such convulsions. This the corn laws do; and it is one of their principal evils. This it is also affirmed that the currency, as at present regulated, does; and the merit claimed for the system now to be introduced is, that this artificial cause of fluctuation will be cut off.

It is here that Mr. Tooke and the authors of the new scheme are irreconcilably at variance. He denies *in toto* the evils imputed to the existing system.

The imputations are—First: That the banks, by arbitrary extension of their issues, raise prices; and thus create fluctuation, and speculation, and ultimate revulsions, where such would not otherwise exist.

Secondly: That when speculations have commenced from causes unconnected with the banks, they, by extending their issues, concurrently with the rise of prices, prevent the rise from being checked in an early stage. And when the rise of prices, by its operation on the exports and imports, has caused an efflux of gold, they hasten to stop it by a contraction of the currency equal to or beyond the previous expansion; which contraction being effected by a forced operation upon the loan market, aggravates the difficulties of persons already distressed.

Mr. Tooke disputes both these assertions.

He denies that an extension of issues can be arbitrarily made by the banks; or that, if made, it has any necessary tendency to raise prices.

He denies that, when prices are rising, the extension of issues, which frequently takes place simultaneously, retards the action of the causes which tend to check the rise; or that by preventing such increase of issues,

[*Torrens, *Inquiry*, p. iv.]

improvident speculation would be earlier arrested, and the consequent calamities confined within a narrower range.^[*]

It is at once seen that this controversy involves a very important question in the theory of currency; one, indeed, which has not, to our knowledge, been subjected to thorough examination or put precisely in issue before. This question is—With what limitations, if any, the proposition is true that an increase in the quantity of the currency raises prices?

That it is true in some sense and in some circumstances, no one thinks of disputing; but that it is a universal principle, and true without any limitation, may perhaps have been too easily taken for granted.

If—to adopt an illustration sometimes used—every person in England were to awake one morning with a sovereign in his pocket, no one could doubt that the rise of prices would be immediate. All or most would hasten to expend their sovereign, either for pleasure or profit; and as there would be no more commodities to be distributed than before, each would bear a higher price.

On the other hand, suppose that a foreigner lands in England, bringing with him five thousand pounds in gold. This additional purchasing power, being brought into the market, would raise prices, but at first only the prices of those commodities which it was employed in purchasing. It might happen not to be employed in purchasing anything, and then it would not raise prices at all. We scarcely think that any one would contest the possibility, at least, of the case described by Mr. Tooke in the following passage. We quote from his “History of Prices,” because the statement of the same principle in his pamphlet is somewhat more imperfect, and gives an advantage to Colonel Torrens to which we do not think that the merits of the case entitle him:—

That an additional issue by the Bank of a million or of five millions on securities, would, *cæteris paribus*, reduce the market rate of interest, may be granted; but it is not self-evident, or consistent with experience, that prices of commodities would therefore necessarily rise. The persons who obtained such an increased price for their securities as induced them to sell, would doubtless, upon receiving the money, seek some other investment for it. There might not be, nor would it be likely that there should be, anything in the state of supply and demand in the markets for commodities to induce persons not habitually in them nor so disposed, to speculate in goods; while the probability is, and such has been the course of experience, that, as by the supposition the market rate of interest in this country would, by such an operation of the Bank, be depressed below its ordinary rate relatively to other countries, there would be every inducement to the individuals who thus had their capitals disengaged to seek investment in securities abroad, whether public or private. As there would not, by the operation of the Bank, be necessarily any additional induce-

[*Tooke, *Inquiry*, pp. 55 ff.]

ment to export commodities, the capital to be transmitted abroad for such investments would be remitted in bullion. The effect, therefore, of the issue of the million or five millions of bank notes by the Bank, might merely be their return upon the Bank for bullion to be exported. This was, in point of fact, the process in 1834, when the Bank increased its securities by between three and four millions, and reduced its treasure by the same amount; while the markets for commodities, although the rate of interest was low, and the facility of credit complete, were in the most quiescent state possible, and the corn markets falling. (*History of Prices*, vol. iii, pp. 273-4.)

Or suppose another case, of frequent occurrence. A country bank issues an extra amount of notes in advances to farmers, to enable them to hold their corn, in hopes of getting a higher price. With the notes received from the bank the farmer pays his rent, and withholds the corn by the sale of which he would otherwise have paid it. But, for every farmer who has not sold his corn, there is a miller or corn dealer somewhere who has not bought it. The notes which this miller or corn dealer was prepared to pay, he now puts into deposit, or repays to the banker from whom they had been borrowed. By as much as the one is enabled to postpone his sale, by so much does the other his purchase. There may have been not a pound more expended in consequence of the transaction, nor any action on prices, except to render more gradual the rise which was taking place from other causes in the price of corn.

If the declaration of innumerable witnesses merits any confidence, the *modus operandi* of country issues must very often be of this sort. The country bankers unanimously disclaim any arbitrary power over their issues, and declare that in certain states of the markets they *cannot* extend their circulation; if they attempt it, the increase comes back to them, either in deposits or by being presented for payment. They are, it may be said, interested witnesses. But they must mean something by this assertion. It cannot be a mere falsehood. It is confirmed, too, by many persons of the greatest experience, who have no interest in banks of issue,—Mr. Samuel Gurney, for example, and the late Mr. Rothschild.^[*] There must be some fact at the bottom of what is asserted. It may be a fact partially stated or misunderstood, and they may be entirely wrong in their explanation of it. But a fact of some sort there must be. We have not seen, on the other side of the question, any attempt to clear up the difficulty, or show the origin of the supposed mistake. We have met with nothing except a flat denial.

For our own part, we see no incredibility in the assertion of the bankers. We believe it to be in the main correct. It appears to us perfectly consistent with the theory of the subject.

[*See Gurney, and Rothschild, "Evidence taken before the Committee of Secrecy on the Bank of England Charter," *Parliamentary Papers*, 1831-32, VI, pp. 249-69, 381-93.]

The notion that every increase in the amount of the circulating medium must raise prices, proceeds, as it seems to us, upon the erroneous supposition, that an increase of money must be an increase of purchasing power.

The purchasing power which determines prices is of two kinds,—*ultimate* purchasing power, which determines permanent prices; and the portion of that power which is in actual exercise at a given time; this determines the fluctuations of prices.

The ultimate purchasing power of the community is, in the words of Mr. Tooke, “the quantity of money constituting the revenues of the different orders of the state, under the head of rents, profits, salaries, and wages.”[*] We think he should rather have said their “gross incomes,” to include that portion of their receipts which is employed in replacing material, and in renewing machinery and buildings as they wear out. The whole of these incomes is destined to be, and is, expended in purchases, either for personal consumption or for reproduction. The aggregate of money incomes, compared with the whole annual produce of the country, determines general prices, as between the dealer and the consumer. If you add to the currency in a way which increases the aggregate of incomes, you raise prices; but this condition can be satisfied by nothing short of a permanent increase* of the quantity of money in the country; either from an influx of the metals, caused by a diminution in the cost at which they can be produced and imported, or from increased issue of an inconvertible paper currency. We say inconvertible, because it is admitted that of that alone could any increase have the character of permanence.†

But though an extension of issues may not increase the aggregate money incomes of the community, nor raise general prices between dealer and consumer, upon which prices all dealers depend for their ultimate returns, and on the anticipation of which they necessarily ground all their transactions with one another; some may suppose that it must increase the money

[*Tooke, *Inquiry*, p. 71.]

*To be scientifically accurate, it must be admitted that if the increased issues were made in advances to employers of labour (for instance, in a loan to a manufacturer, who expends them in the direct payment of wages to his work-people), there would be, to that extent, as long as the expenditure was going on, an increase of the aggregate money income of the community, and hence a corresponding rise of prices. But this supposition is not applicable to our present currency, of which the smallest notes are of too high a denomination to be employed, in any extent worth considering, for the payment of wages.

†We may add, with Mr. Tooke [*Inquiry*, pp. 68 ff.], that the issues of a *Government* paper, even when not permanent, will raise prices; because Governments usually issue their paper in purchases for consumption. If issued to pay off a portion of the national debt, we believe they would have no such effect.

demand for commodities at the particular moment; because the person who obtains the bank notes does so for the purpose of using them, and may be supposed to bring them immediately into the market and make purchases to their full extent.

This opinion seems to us to rest upon a great misconception of what constitutes the money demand for a commodity.

It seems to be thought by many people that the purchase of commodities implies the direct transfer of so much money from hand to hand in return for so much produce; and that the limit to the possible demand for a commodity at any moment, is the quantity of money then and there waiting to be exchanged for it.* With this mode of thinking it is no wonder that any one should suppose that whenever you add to the money at that place physically present, you add as much to the demand, and consequently to the price. But this is a very inadequate notion indeed of what constitutes purchasing power.

The purchasing power of an individual at any moment is not measured by the money actually in his pocket, whether we mean by money the metals, or include bank notes. It consists, first, of the money in his possession; secondly, of the money at his banker's, and all other money due to him and payable on demand; thirdly, of whatever credit he happens to possess. To the full measure of this three-fold amount he has the power of purchase. How much he will employ of this power, depends upon his necessities, or, in the present case, upon his expectations of profit. Whatever portion of it he does employ, constitutes his demand for commodities, and determines the extent to which he will act upon price.

Now, of these three elements of money demand, the first alone is grounded upon a corresponding amount of money actually *in esse*. The second, or the deposit at his banker's, is in part grounded upon actual money, namely, to the extent of about one-third, that being the proportion

*There is (as it seems to us) an almost whimsical exemplification of this common fallacy in Colonel Torrens's pamphlet, which we have not room to extract, but which those who wish to refer to it may find in pages 10-17. Having assumed, for the purposes of his argument, that Birmingham has a metallic currency composed of one million sovereigns, he says [p. 10], "consequently the prices of commodities within the district would be governed by the power of effecting purchases to an amount not exceeding 1,000,000*l.*," forgetting that the million sovereigns may serve, by successive payments, to represent and circulate incomes to the amount of many millions, and that it is this, and not the one million of sovereigns, which constitutes the purchasing power of the community. We admire the ingenuity and polemical acuteness of Colonel Torrens, which have never been more highly manifested than in this pamphlet; but we think in this particular instance he will find, on reconsideration, that he has built an elaborate superstructure upon a foundation of sand.

which prudent bankers profess to keep in their coffers to meet the drafts of their depositors. The third element of money demand, namely credit, has no basis of actually existing money at all. It is an additional money demand, created over and above that which is constituted by all the money in actual circulation. But it is exactly as operative upon prices as the money itself, provided the possessor chooses to make use of the purchasing power which it confers. This explains why periods of general confidence, when large prospects of gain seem to be opening themselves, and when there is a disposition among dealers to employ not only all their money but all or much of their credit in enlarging their operations, are attended with so great a rise of general prices. The effect is sometimes ascribed to the bills of exchange and other transferable paper which these transactions generate, and which are said to perform the functions of currency. Those who use this language mistake the effect for the cause. Bills of exchange are mere evidences of credit. The credit itself is the operating cause. It is manifest that when buyers are willing to employ their credit as well as their money in making purchases, their demand for commodities becomes so much greater, and prices must rise. They would rise if no such thing as a transferable acknowledgment of debt had ever been known in the country.

We may observe, parenthetically, that these considerations remove the puzzle which has been made of whether deposits, and cheques, and bills of exchange, are to be considered as money. With those who think that money alone confers power of purchase, these questions are very pertinent. When they ask whether deposits, or whether anything else, is money, they mean, does it operate on money prices? If it does, they think it a necessary consequence that it should be called money. But when once it is clearly seen that credit, so far as employed in the purchase of commodities, operates upon prices in exactly the same degree as money, the question what forms of credit should be called money, becomes extremely unimportant. It would probably be best that no form whatever should be so called.

If the views now stated be sound, it seems not easy to understand how an increased creation of the written evidences of credit called bank notes, can, of itself, create an additional demand, or occasion a rise of price. Admitting bank notes to be money (which is, in truth, a mere question of language), what does the person do who issues them, but take so much from the third element of purchasing power, namely credit, and add it to the first element, money in hand—making no addition whatever to the total amount? More properly, he merely converts so much credit from an unwritten into a written, and from a cumbrous into a convenient, form. Bank notes are to credit precisely what coin is to bullion; the same thing,

merely rendered portable and minutely divisible. We cannot perceive that they add anything, either to the aggregate of purchasing power, or to the portion of that power in actual exercise. The person to whom the notes are advanced is proved by that very fact to have credit, and his requiring the advance proves that to that extent he intends to use his credit in making purchases. Is it supposed that having credit, and intending to buy goods by means of it, he will be disabled from doing so because a banker is prohibited from one particular mode of giving him credit?*

It must be conceded, and Mr. Tooke does fully concede,^[*] that if bankers, urged by competition or caught by the contagious confidence of speculative times, make advances to persons who otherwise have *not* credit and cannot give good security, in that case the foregoing arguments do not apply. To that extent they do create a new purchasing power, a new demand, and, as its consequence, a rise of price. The American banks did raise prices by reckless advances; by lending money to persons who could not repay them. No one is more aware of this than Mr. Tooke. It is not, however, by their notes, as such, that banks thus misconduct themselves. Imprudent advances of their deposits, or of their private capital, or imprudent indorsement and guarantee of the engagements of their customers, have precisely the same effect. All extension of credit, legitimate or illegitimate, tends, in proportion as it is made use of, to a rise of price. And all contraction of credit produces an equivalent collapse.

That bank notes, as such, have any peculiar power on prices, we see no reason whatever to believe: and we hold with Mr. Tooke, that when they are increased, their increase is a consequence of a rise of prices, not a cause.^[†] It is a known fact that the country issues almost invariably increase when the prices of agricultural produce are rising. The reason is, that the buyers, having larger payments to make, apply for more notes to make them with, it being the custom in the provision and cattle markets not to buy on credit, but to pay immediately in bank notes. A rise of other prices does not necessarily lead to increased issues; because, in almost all other transactions between dealers, bank notes are already superseded by cheques, or book credits; and these would soon be introduced into the markets for agricultural produce, if the obtaining bank notes were rendered difficult. Even the small quantity of bank notes which are employed at the clearing house or elsewhere, to effect the ultimate liquidation of these cheques and credits by the payment of balances, might, as Mr. Tooke remarks,^[†] have their place supplied by exchequer bills (as in Scotland), or by drafts on the Bank of England.

Whether the credit which necessarily exists in a commercial country

*See note, *infra*, page 358.

[†E.g., *ibid.*, pp. 76, 123-4.]

[*E.g., *Inquiry*, pp. 81-2.]

[†E.g., *ibid.*, pp. 22, 32.]

assumes the form of bank notes or no, is, in short, a mere matter of convenience. In whatever form or vesture the credit is given, its influence on price is the same. He who has credit, and desires to employ it in purchases, will find the means of doing so without bank notes, and will act upon prices accordingly; while if he does not think the time favourable for making purchases, even having the notes in his possession will not induce him to do it; he will either keep them by him until they are wanted, or they will go into deposit.

It appears, then, that any increase of issues which is likely to take place under the present system of convertibility, is in itself quite inoperative to raise prices,* and cannot, therefore, be an exciting cause of commercial revulsions; but that a spirit of speculation, or an undue extension of credit, does raise prices, and raises them equally whether bank notes are generated by it or not; and that by preventing the increase of bank notes during such periods, nothing would be done to check the rise, since it is not bank notes which, as it is sometimes expressed, *sustain* prices, but the state of credit generally. No mode of regulating bank notes would either arrest the rise, or moderate the subsequent revulsion, which is always proportional.

There is, however, one way in which the present administration of the currency does heighten the evils of a commercial revulsion. The rise of prices in periods of exaggerated confidence checks exportation and greatly increases importation. A balance has to be paid in gold, and this is demanded from the Bank. To stop the drain, it hastily contracts its issues, that is, it sells securities and diminishes its loans, thus aggravating, in a period of difficulty, the already existing pressure upon the loan market; and this, it is urged, will be prevented by the ministerial measure, since the bank will not be permitted to contract its issues, except by not re-issuing the notes which have been returned to it for payment. But, as Mr. Tooke remarks,^[*] to attain this object it is only necessary that the bank should habitually hold so large a reserve of bullion as will admit of allowing any probable drain to proceed until it has reached its limits. Whatever amount of reserve is needed for this purpose will be equally necessary on the plan of Sir Robert Peel, since the bullion, against which all notes beyond the fixed amount of securities are to be issued, must be sufficient to meet the

*We say *likely* to take place—not any increase which *can* take place; because there have been instances, both with joint-stock banks and private bankers, of imprudent advances, on insufficient security, resembling, on a smaller scale, the gigantic mismanagement of the American banks. These must have tended, as we have already admitted, to raise prices: and though it was not peculiarly in their character of issuers that the banks thus misconducted themselves, their issues, no doubt, enabled them to do so on a larger scale.

[*See *Inquiry*, pp. 108 ff.]

greatest drain which can ever be supposed to occur. We shall see presently that, in reality, the amount of reserve which would suffice on Mr. Tooke's plan will not be sufficient on Sir Robert Peel's.

We think, then—although with unfeigned diffidence, considering the high authorities by which we are opposed—that the reasons urged in recommendation of the contemplated changes, and in proof of the theory on which they rest, are all untenable, and that the system about to be adopted is in no way preferable to the present system, if improved as Mr. Tooke proposes, by making it imperative on the Bank to keep a larger reserve of bullion. But though not preferable, whether it is in any way inferior is another consideration. That question must be determined, not by its effects on price, for these we believe to be null, but by its operation upon the rate of interest, for that is real. Fluctuations of price do not, we believe, depend upon bank issues; but the operations of banks, as of other money-lenders, of course act upon the loan market, or as it is improperly called, the money market; in other words, upon the rate of interest, and what is almost synonymous, the prices of securities.

Mr. Tooke does not share the common opinion, that increased issues, by lowering the rate of interest, operate as a stimulus to speculation. He thinks it a vulgar error

That a facility of borrowing at a low rate of interest, not only confers the power of purchasing, but affords the inducement, applies the *stimulus* to speculation in commodities. If by facility of borrowing be meant a laxity of regard to security for repayment on the part of the lender, there is every probability that money so borrowed will be hazardously, if not recklessly employed; and whether in the purchase of shares, or of foreign securities, or of merchandize, or in any other mode of adventure or enterprise, or in mere personal expenditure, is a matter of chance, depending on the disposition and views of the borrower. Such borrowers are not *stimulated* to purchase commodities speculatively, merely because they can borrow on low terms; they are but too happy if they can borrow at all. But to suppose that persons entitled to credit are likely to be induced—*stimulated* is the favourite term—by the mere circumstance of a low rate of interest, to enter into speculations in commodities (using the term speculation in its obnoxious sense), argues a want of knowledge of the motives which lead to such speculations. These are seldom, if ever, entered into with borrowed capital, except with a view to so great an advance of price, and to be realized within so moderate a space of time, as to render the rate of interest or discount a matter of comparatively trifling consideration. (Pp. 81–2.)

The truth is, that the power of purchase by persons having capital and credit is much beyond anything that those who are unacquainted practically with speculative markets have any idea of. (P. 79.)

A person having the reputation of capital enough for his regular business, and enjoying good credit in his trade, if he takes a sanguine view of the prospect of a rise of price of the article in which he deals, and is favoured by

circumstances in the outset and progress of his speculation, may effect purchases to an extent perfectly enormous, compared with his capital.* (P. 136.)

But why should this purchasing power be directed to the purchase of commodities, if there was nothing in the state of supply relatively to the rate of consumption, to afford the prospect of gain on the necessary eventual resale? The error is in supposing the *disposition* or *will* to be co-extensive with the power. The limit to the motive for the exercise of the power is in the prospect of resale with a profit. (P. 79.)

But although the issues of banks may not have the effect imputed to them, of stimulating speculation by lowering the rate of interest, there is no doubt that the mode of issuing and the mode of recalling them may and does produce *fluctuations* in the loan market.

Fluctuation is an evil in the interest of loans, as well as in the prices of commodities; and that is the best banking system (solvency and convertibility being first provided for) under which there is least liability to such fluctuations.

*Mr. Tooke illustrates this statement by some most remarkable instances, which we append, because they are also illustrative of what has formerly been said on the immense purchasing power which may be exercised, and the great rise of prices which may be produced, by credit not represented by bank notes, or even bills of exchange.

Among the earliest speculators for an advance in the price of tea, in consequence of our dispute with China in 1839, were several retail grocers and tea dealers. There was a general disposition among the trade to get into stock, that is, to lay in at once a quantity which would meet the probable demand from their customers for several months to come. Some, however, among them, more sanguine and adventurous than the rest, availed themselves of their credit with the importers and wholesale dealers, for purchasing quantities much beyond the estimated demand in their own business. As the purchases were made in the first instance ostensibly, and perhaps really, for the legitimate purposes and within the limits of their regular business, the parties were enabled to buy without the condition of any deposit; whereas speculators, known to be such, are required to pay 2*l.* per chest to cover any probable difference of price which might arise before the expiration of the prompt, which, for this article, is three months. *Without, therefore, the outlay of a single farthing of actual capital or currency in any shape*, they made purchases to a considerable extent; and, with the profit realised on the re-sale of a part of these purchases, they were enabled to pay the deposit on further quantities when required, as was the case when the extent of the purchases attracted attention.

In this way, the speculation went on at advancing prices (100 per cent. and upwards), till nearly the expiration of the prompt, and if at that time circumstances had been such as to justify the apprehension which at one time prevailed, that all future supplies would be cut off, the prices might have still further advanced, and, at any rate, not have retrograded. In this case, the speculators might have realised, if not all the profit they had anticipated, a very handsome sum, upon which they might have been enabled to extend their business greatly, or to retire from it altogether, with a reputation for great sagacity in thus making their fortune. But instead of this favourable result, it so happened that two or three cargoes of tea which had been transhipped were admitted, contrary to expectation, to entry on their arrival here, and it was found that further indirect shipments were in progress. Thus the supply was increased beyond the calculation of the speculators; and, at the same

In this respect it is Mr. Tooke's opinion that the system about to be introduced is decidedly inferior to the old:—

That a total separation of the business of issue from that of banking is calculated to produce greater and more abrupt transitions in the rate of interest, and in the state of credit, than the present system of union of the departments. (P. 124.)

The ground of this opinion deserves attention.

It is a fact, attested by experience, that a drain of gold upon the Bank for exportation takes place in most cases mainly by drawing out deposits. As, in the proposed system, there is nothing to cause any change in this respect, we must suppose that this would still be the case, and that the demand for gold would be first felt by the deposit department.

Now, under the present arrangements, in case of a run upon the deposits, the Bank has to rely, not only on the portion of reserve which it retains, like other bankers, against the deposits themselves, but also on the gold in reserve on account of its notes. Until all the gold in the possession of the Bank is exhausted, it is in no danger of stopping payment. But under the proposed system the department of deposit must rest upon its own resources. The reserve in the deposit department could derive no aid from the issue department, while it would have to bear the first brunt of the whole action intended to be exercised through it upon the latter. As it would be prohibited from meeting this demand by creating more notes, or even by having the notes which it paid out, and which then went to the

time, the consumption had been diminished by the high price. There was, consequently, a violent reaction on the market; the speculators were unable to sell without such a sacrifice as disabled them from fulfilling their engagements, and several of them consequently failed. Among these, one was mentioned who, having a capital not exceeding 1,200*l.*, which was locked up in his business, had contrived to buy 4,000 chests, value above 80,000*l.*, the loss upon which was about 16,000*l.*

The other example which I have to give is that of the operation on the corn market between 1838 and 1842. There was an instance of a person who, when he entered on his extensive speculations, was, as it appeared by the subsequent examination of his affairs, possessed of a capital not exceeding 5,000*l.*, but being successful in the outset, and favoured by circumstances in the progress of his operations, he contrived to make purchases to such an extent, that when he stopped payment his engagements were found to amount to between 500,000*l.* and 600,000*l.* Other instances might be cited of parties, without any capital at all, who, by dint of mere credit, were enabled, while the aspect of the market favoured their views, to make purchases to a very great extent.

And be it observed, that these speculations, involving enormous purchases, on little or no capital, were carried on in 1839 and 1840, when the money market was in its most contracted state; or when, according to modern phraseology, there was the greatest scarcity of money. (Pp. 137–8.)

Sir Robert Peel talks of preventing credit from being converted into money. What, by being converted into money, could it do, more than was done in these instances?

issue department for gold, returned to it; either the reserve of the deposit department alone will require to be as great as is now requisite for the deposits and issues together, or it will be obliged to suspend its discounts and sell its securities much earlier and more abruptly than is necessary under the present mixed system. If the demand for gold were to the extent of three or four millions, no "merchant, banker, or money dealer," says Mr. Tooke,

Could for a moment have a doubt as to the extremity of pressure which it would cause. I am most intimately persuaded that it would be within the mark to suppose that a rate of discount (assuming that the doors of the Bank and the ears of the directors were irrevocably closed against all applications) of twenty per cent. and upwards, would in many cases be submitted to, and sacrifices of goods, if any large proportion were held on credit, would be made at a still greater loss. And after all, it might be a question whether even this effort of the Bank on its securities would be effectual in restoring its reserve in sufficient time to meet the exigency.

While the circulating department was still abundantly provided with gold, the deposit department might have no alternative but to stop payment.

And all this inconvenience may have been purely gratuitous, as a sacrifice to the currency principle; because the utmost demand for gold might have been satisfied by an export of 3,000,000*l.* or 4,000,000*l.*, which, under a system of issuing and banking, would have been attended, as in the instances of 1828-29, and 1831-32, with no inconvenience whatever. (Pp. 109-10, 111.)

Indeed, if the purpose for which the new arrangements are intended is to be carried out, the deposit department must in any case begin selling its securities the moment a drain upon it commences; because if it does not, the notes which will be returned to the issue department in exchange for gold will not have been taken from those in circulation among the public, but from the reserve in the deposit department; and the cherished object of making the currency vary in quantity exactly as would be the case with a metallic currency will not be effected.

We have now stated partly, in the words of Mr. Tooke, partly and more often in our own, the grounds on which, in common with him, we have adopted the following conclusions:—

That the proposed changes in the mode of regulating the currency will be attended with none of the advantages predicted; that, so far as intended to guard against the danger of over-issue, they are precautions against a chimerical evil; that the real evil of commercial vicissitudes, of "cycles of excitement and depression,"[*] is not touched by them, nor by any regulations which can be adopted for bank notes or other mere instruments of credit; and that in what Mr. Tooke justly calls (next to solvency and

[*See Torrens, *Inquiry*, p. iv; cf. Tooke, *Inquiry*, p. 55.]

convertibility) "the main difference between one banking system and another," namely, "the greater or less liability to abrupt changes in the rate of interest and in the state of commercial credit,"[*] the present arrangements, under the condition of a larger bank reserve, have a decided advantage over the new system.

We have left ourselves little room for any observations on Colonel Torrens's reply to Mr. Tooke.

Colonel Torrens is one of the first living economists, and, as he says of Mr. Tooke, "can afford to lose some reputation by his present publication,"[†] though we do not think that such a result is to be apprehended. In clearness and precision of statement, and in that closeness of discussion which is a great part both of argumentative power and of dialectical dexterity, Colonel Torrens has never more distinguished himself. Not a single exposed point in his adversary escapes him; and on some minor questions we think he has successfully answered Mr. Tooke. That we cannot entertain a similar opinion of his main argument, we have sufficiently shown: and the grounds of our difference have been so fully explained as to dispense, we hope, with any detailed controversy.

[*Tooke, *Inquiry*, p. 106.]

[†Torrens, *Inquiry*, p. 55.]