

Séminaire Master 2 Recherche HPE
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IV

Le débat britannique
du milieu du dix-neuvième siècle:
La Banque d'Angleterre et
l'acte de Peel de 1844

Débat monétaire britannique

- Currency School (Torrens, Loyd, Norman)
 - Price specie flow mechanism (PSFM)
 - **Règle**: currency principle tel que $\Delta B = \Delta R$
- Free Banking School (Mushet, Gilbart, Wilson)
 - Loi du reflux (compétition) ou PSFM (monopole)
 - **Compétition**
- Banking School (Tooke, Mill, Fullarton)
 - Loi du reflux *mais* instabilité financière
 - **Central banking**: taux d'intérêt fixe et prêt en dernier ressort

Débat monétaire britannique

- Interprétation 1: Règle *versus* discrétion (1970s)
 - Currency school et monétarisme: règle
 - Banking school et keynésianisme: discrétion
- Interpretation 2: Monopole *versus* compétition (1980s)
 - Currency school: monopole d'émission de billets
 - Free banking school: compétition bancaire
- Interpretation 3: (In)stabilité financière
 - Currency school et free banking school: pas de PDR
 - Banking school: Instabilité financière et PDR

Currency School

- Théorie quantitative: M exogène $\rightarrow P$
 - Currency school: $M = \text{Espèces} + \text{Billets de banque}$
 - La circulation des billets de banque doit se comporter comme celle des espèces métalliques
- Soit: le currency principle
 - Circulation d'espèces: ΔR
 - Circulation de billets: ΔB avec $\Delta B = \Delta R$
- Sinon: la price specie flow mechanism
 - Hume (1752)
 - Ricardo (1817)

Currency School

- Price specie flow mechanism: Effet d'un choc monétaire
 - => Hausse de la quantité de monnaie M (exogène)
 - => les agents ont davantage d'encaisse
 - => hausse des dépenses et des prix domestiques
 - => perte de compétitivité
 - => hausse des importations (baisse des exportations)
 - => déficit commercial et règlement en métal-or
 - => baisse de la quantité de monnaie
- Banking School: monnaie endogène, et non exogène
 - Production d'or et/ou balance commerciale excédentaire
 - ➤ Loi du reflux et politique de taux fixe de la banque centrale

Inquiry into the Act of 1844

- The Bank Directors' reports
 - *Memorandum on the Division of the Bank* (February 1844)
 - Clapham (1944, p.179): "the whole skeleton of the Act of 1844."
- Tooke's *Inquiry into the Currency Principle* (March 1844)
 - "a total separation of the business of issue from that of banking [will] 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 Bank (p.124)

Tooke's distinction

1. **The system of union** of the Bank of England, which prevailed before 1844

The classical policy of the Bank (the Old system) featured the fixed interest rate policy

2. **The system of separation** of the Bank of England, which prevailed after 1844

The new policy of the Bank (the Peel system) featured the competitive interest rate policy



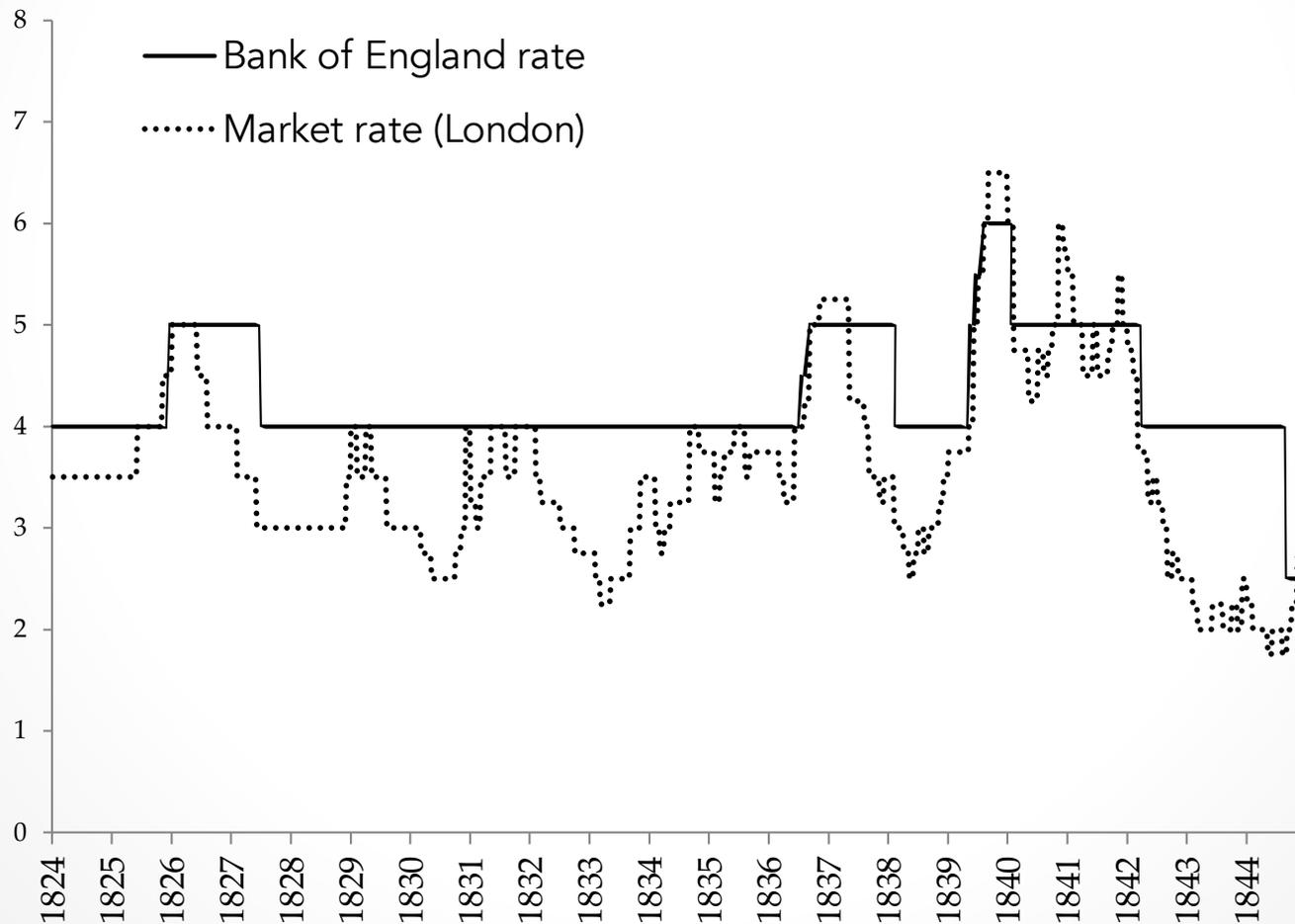
*Table I : Balance sheet of the Bank of England (£),
week of the 29th February 1832*

<i>Bank of England</i>			
Assets		Liabilities	
Reserves	5 293 150	Capital	14 553 000
Government debts	14 686 800	<i>Rest</i>	2 637 760
Public securities	4 134 940	Notes	18 051 710
Private securities	10 897 880	Public Deposits	3 198 730
Others securities	9 166 860	Private Deposits	5 738 430

- *Source* : Parliamentary Papers (1832, appendix n°13, p.30)

The policy of fixed Bank rate

- Bank rate and market rate, 1824-1844 (percent)

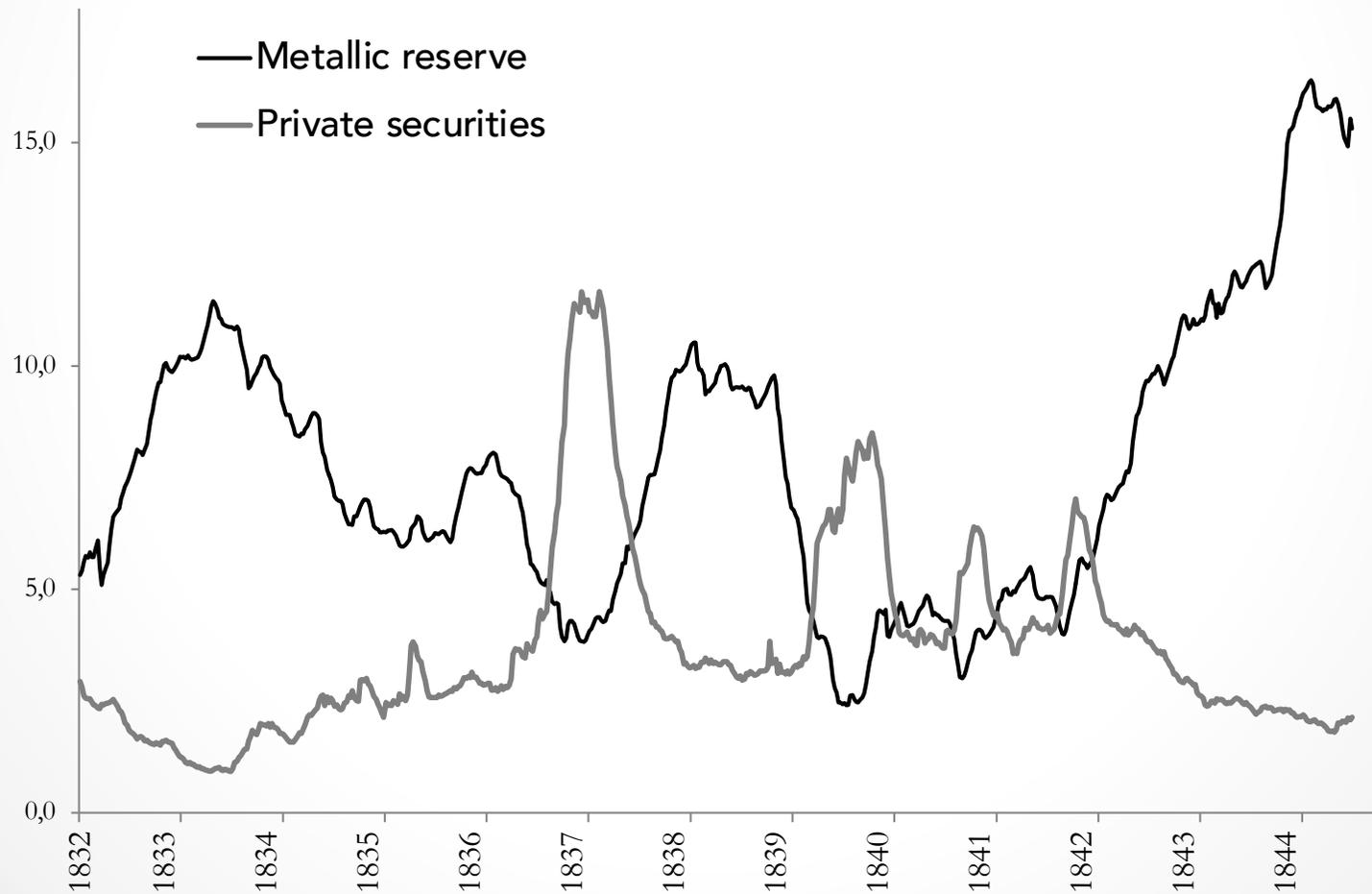


The Bank director under the Old system

- **Horsley Palmer (PP, 1832, q. 170) on Bank rate**
 - “It is not desirable frequently to vary the Bank’s public rate of interest; [...] it [is] preferable that the Bank’s public rate of interest should be above the market, and thereby not interfere with the employment of money” in the market
- **Horsley Palmer (PP, 1832, q. 171) on Bank’s assets**
 - Under normal circumstances, the Bank “had little demand for discount, special cases excepted, for some years past in the London market”.

The assets of the Bank

- Metallic reserve and private securities, 1824-1844, £ millions



The three components of the Act of 1844

1. The monetary component: the rule of issue compelling any banknote issue to vary with the quantity of metallic reserve

- Currency principle: 100% reserve ratio at margin ($\Delta B = \Delta R$)
- Otherwise: price-specie-flow mechanism and monetary crisis

Monetary shock → rise in price level → decline in competitiveness
→ increase (decrease) in imports (exports) → balance-of-trade deficit
→ fall in metallic reserve → fall in price level...

2. The regulatory component: the concentration of the banknote supply leading to the banknote monopoly
3. The first article of the Act: the separation of the Bank into two departments (the issue and discount departments)



*Table II : Balance sheet of the Bank of England (£),
week of September 7th 1844*

<i>Issue Department</i>			
Assets		Liabilities	
Government debts	11 015 100	Notes	28 351 295
Securities	2 984 900		
Gold reserve	12 657 208		
Silver reserve	1 694 087		

- *Source* : Parliamentary Papers (1848, part 2, pp.10-1)

*Table II : Balance sheet of the Bank of England (£),
week of September 7th 1844*

<i>Discount (Banking) Department</i>			
Assets		Liabilities	
Public securities	14 554 834	Capital	14 553 000
Other securities	7 835 616	Rest	3 564 729
Notes in « reserve »	8 175 025	Public deposits	3 630 809
Gold and silver specie	857 765	Other deposits	8 644 348
		Short run debts	1 030 354

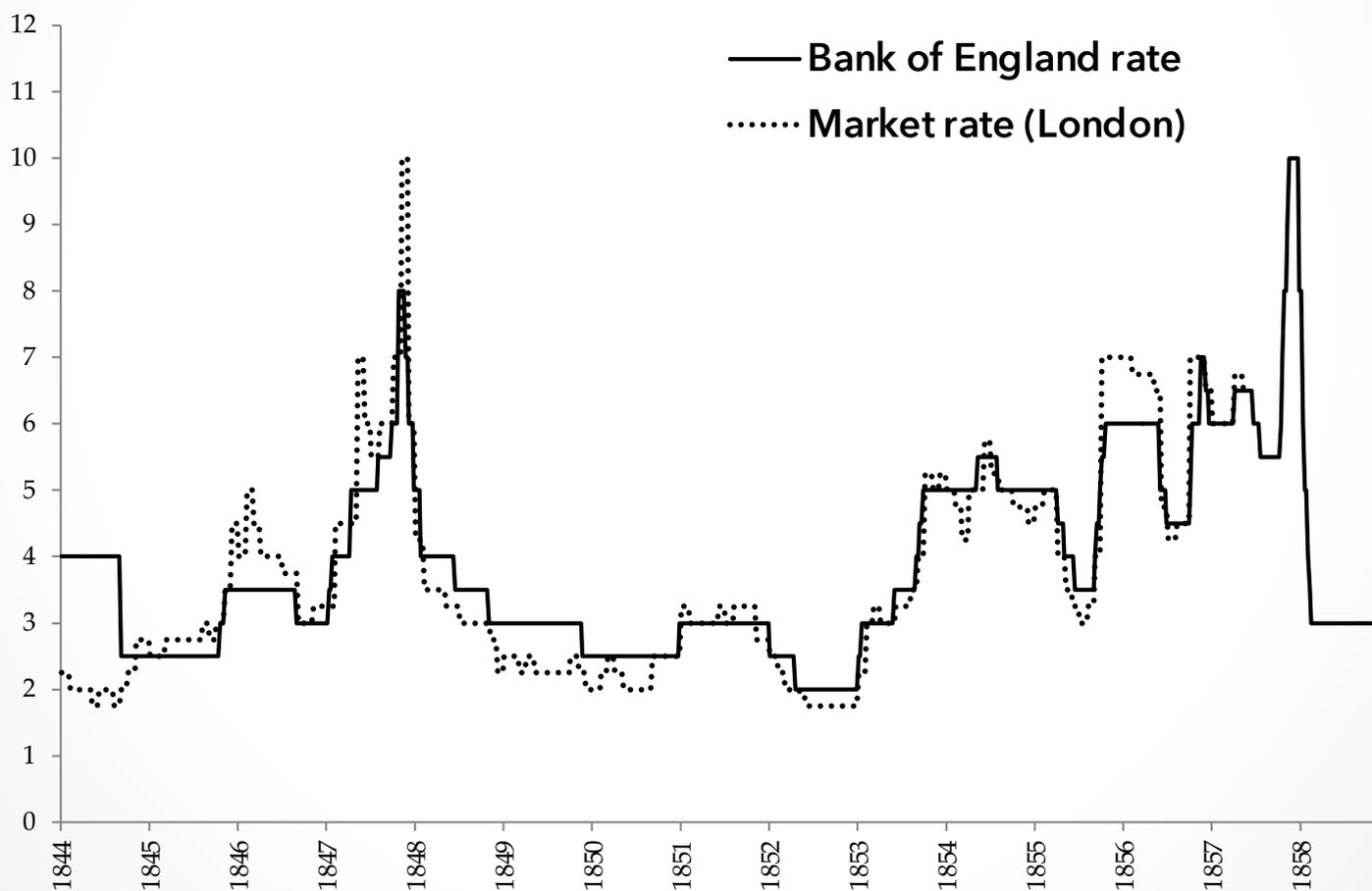
- *Source* : Parliamentary Papers (1848, part 2, pp.10-1)

The “spirit” of the Peel’s Act of 1844

- The Discount department operated like any commercial bank in three ways:
 - It held Bank notes (the banking reserve);
 - It could vary its demand liabilities in the form of deposits without any quantitative restriction;
 - It realized competitive discount operations and set in consequence the Bank rate of discount.
- The Discount department implemented the “new” discount policy in the sense that it broke with the fixed Bank rate policy prevailing before 1844

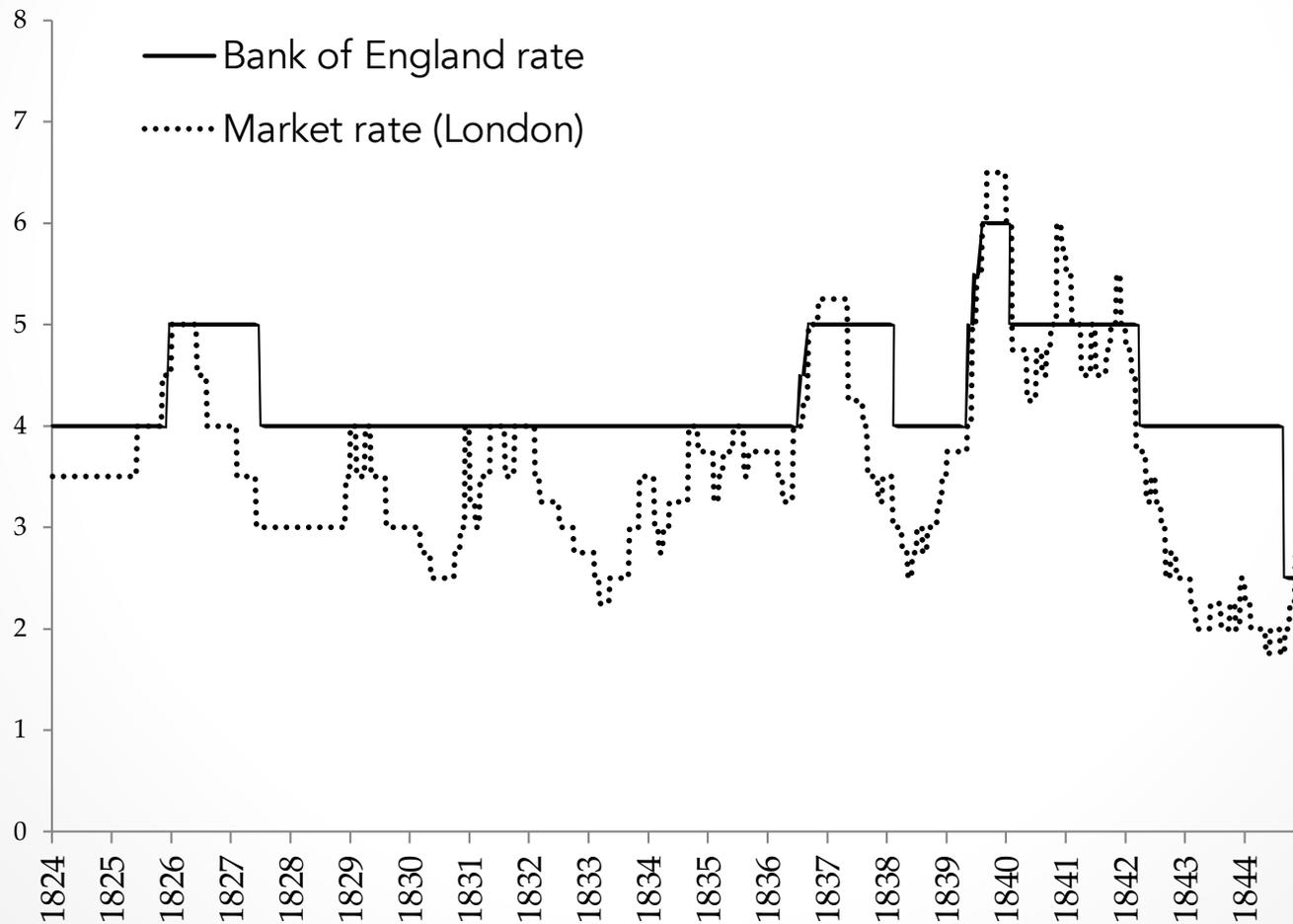
Peel system and “new” Bank rate policy

- Bank rate and market rate, 1844-1856 (percent)



The policy of fixed Bank rate

- Bank rate and market rate, 1824-1844 (percent)



Peel system and “new” Bank rate policy

- James Morris (Parliamentary Papers, 1848, q.487, q.2641)
 - “A reference should be made to the market rate of interest” and “the Bank should assimilate its rate to the market rate”.
 - The Bank policy of fixed interest rate “caused a loss to the Bank” prior to 1844.
- Currency School members and Robert Peel
 - Loyd (PP, 1832, q.3319) was “not aware of any inconvenience” that arose if the Bank policy was “to follow the market rate of interest”, which “seems to be the obvious common sense plan”.
 - Peel (Speech, May 1844, p.38): “With respect to the banking business of the Bank, [...] the principle of competition [...] ought to govern the business of banking.”

The definition of the quantity of money

- **Currency School and the quantity of money**
 - Quantity of money = Gold specie + Bank notes
 - with banknote monopoly of the Bank of England
 - with the rule: $\Delta B = \Delta R$
- **Banking School and the hierarchy of money**
 - Gold specie: ultimate money
 - Bank of England demand liabilities: interbank liquidity
 - Bank notes and demand deposit issued by commercial banks

Peel system and the crisis of 1847

- **Thomas Weguelin Morris (Parliamentary Papers, 1848, q.2641)**
 - The Bank directors “raise the rate” when the metallic reserve was “considerably reduced, or begins to be reduced”;
 - on the other hand, they “*invariably* follow in a decline of the [market] rate” and also “practically follow in a rise”.
- **The reaction function of the Bank under the Peel system**
 - Convertibility motive: to change asymmetrically the Bank rate (only when the metallic reserve decreased)
 - Profitability motive: to follow symmetrically the market rate (after 1844)

Conclusion

- Robert Torrens (1844, p.97) and the *currency school*
 - “Under the proposed system of the regulation of the currency » (that is, under the currency principle and the separation of the Bank), « fluctuations in the rate of interest and in the state of commercial credit, so far as they can result from alterations in the value of the currency, may [...] be taken at *nihil*.”

Conclusion

- Thomas Tooke (1844, p.124) and the *banking school*
 - “A total separation of the business of issue from that of banking [will] produce greater and more abrupt transitions in the rate of interest.”
- Thomas Tooke (1848, Parliamentary Papers, Lords, q. 3088)
 - “Whenever there exist motives to enterprise, whether in the shares of joint stock companies or in Investments of any kind at home or abroad, a low rate of interest tends very considerably to promote and extend the tendency to speculation.”