HEA III 1790-1870, ch. 7: Money, Credit, and Cycles

#1. England's Problems

688 ".. few modern economists would look to men of practical affairs and especially to bankers for help in their analytic task or even consider them as authorities on the principles of their own business. But this situation developed in the next period. In the one under survey, it was the practitioners who were in the van of the analytic advance, and research workers of different types were in most cases content to take their clues from them.

With most of the leading performers we are already acquainted, especially with Ricardo, Malthus, Senior, Tooke, Torrens and J. S. Mill.
689/ A small number/of others will be introduced as we go along. But Henry Thornton (1760-1815) must be saluted at once. He was a banker, M. P., philanthropist,... and a leading figure in the influential group of Evangelicals known as the Clapham Sect. His Enquiry into the Nature and Effects of the Paper Credit of Great Britain (1802; Library of Economics reprint, 1939) is an amazing performance. The product of work.. extended about over six years during which the author's energy was largely absorbed by business and political pursuits, not faultless in detail and not fully matured, it anticipated in some points the analytic developments of a century to come. No other performance of the period will bear comparison with it, though several, among them Ricardo's, met with much greater success at the time and
690 later. I have commended the taste and ability for theoretical analysis of the writers of that period. Nevertheless, their analysis was too closely bound up with the conditions and problems of their time and country to admit of exposition without reference to these conditions.

Bibliographical.

a) War Inflation, 1793-1815. In spite of the suspension of the Bank of England's obligation to redeem its notes in gold (1797), war finance did not produce any great effects upon prices and foreign-exchange rates until about 1800. To the modern student who is inured to stronger stuff, the most striking feature of the subsequent inflation is its mildness: at no time was the public's normal behavior with respect to money seriously disturbed; at no time did the impact of the government's war expenditure blot out those fluctuations that might have
691 been expected to occur in the usual course of things;/ at no time was he government driven to anything more unorthodox than abnormally heavy borrowing from the Bank, and even this borrowing never surpassed the limits beyond which 'borrowing' becomes a euphemism for printing government fiat; at no time finally was the national wage bill -- the chief conductor of inflationary effects -- so seriously expanded as to endanger the currency. It was in fact it was the very mildness of th- inflationary process that made diagnosis so difficult. In particular it made it difficult to recognize the inflationary element in the situation and to distinguish itfrom the effects upon foreign exchange of the two circumstances that a great part of the expenditure was for financing allied and English armies on the Continent, and that English exports and imports were for years together seriously interfered with.

There follows a long paragraph on misguided criticism of the Bank's handling of the matter.

692 On the surface, then, the controversy that contributed so much to monetary analysis was simply a controversy between writers who sought to prove and indite inflation and to locate responsibility for it with the Bank, and other writers who sought to deny the presence of inflation or to justifyit and to locate the responsibility for rising prices and unfavorable exchanges with circumstances other than the behavior of the Bank.... However, the practical issues and the recommendations as to 'what should be done about it' are of no great importance for us. Important is the analytic quality of the arguments and diagnoses produced. And from this standpoint the party lines lose much of their definiteness and almost all of their interest.... Before taking leave of this historic document, let us note the significant fact that the report of the Cunliffe Committee that recommended England's return to gold at prewar parity in 1918 (final report, 1919) displayed little if any, knowledge of monetary problems that was not possessed by the men who drafted the Bullion Report.

b) The Question of the Standard. ... De facto. though not legally,
693 England had been on a gold standard when restriction was decreed in 1797. Within a few years a strong political current set in that was to carry her toward the legal adoption of it (1816) and eventually toward the resumption of specie payments at the prewar par (Peel's Resumpiton Act of 1819, actual resumption 1921)...

Resumption impinged upon a depressive situation. [By 1819 [the price level had fallen by something like 30%. There was the fa[fact realized by many that the prospects of gold production were [istinctly unfavorable]. Finally, however, there was something else which these experts, like the experts of 1918, entirely failed to see: quite independently of the preceding war inflation, the English economy was then entering upon one of those periods of falling prices, interest rates, and profits, on unemployment and instability, that always follow upon industrial revolutions.

The last decades of the eighteenth century had witnessed such a revolution -- the new cotton machinery, the steam engine, and canal building are but the most conspicuous events that transformed the very bases of manufacturing and trade. Results began to pour forth from 1815 on, upsetting the pre-xisting industrial structure and exerting primarily depressive effect, until the economic process was steadied again, weakly in th e 1830's, more strongly in the 1840's by the beginning of investment in railroad construction. In a situation such as this, even a slightly restrictive monetary policy is not the matter of indifference which it would be in a situation that is located on an upward trend of prices. And a slightly restrctive effect assumption undoubtedly had.

c) Bank Reform. Pp. 694-698.

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#2. Fundamentals

698 From the first (Thornton, Evidence before the Committees of Secrecy, 1797) a comprehensive category was formed of means of payment-- also called the circulating medium and sometimes 'currency' --
699/ that included full value and/token coins, bank notes, deposits subject to check or, alternatively, the checks themselves and, under certain conditions, bills of exchange... .. the total of All We Pay With is a meaningful notion. Its chief analytic value consists in the recognition it implies of the fact that there is no essential difference between bank notes and deposits. And that the fact as not self-evident but had to be discovered is proved by the further fact that certain writers refused to recognize it. Lord Overstone and the advocates of Peel's Act of 1844 generally drew a sharp distinction between bank notes and deposits which was clearly not merely terminological and the precise significance of which is not easy to ascertain because none these writers was sufficiently explicit about logical fundamentals. Tooke was at first one of those who fought against the conceptual merger of bank notes and deposits, until 1840,
cf 520 when the third volume of his <u>History</u> appeared. By 1844 (<u>Inquiry</u>) he had changed his mind and adopted it, perhaps -- as it is too uncharitable to suspect -- because the merger offered a convenient argument against Overstone and Peel's bill.

698 In the case before us, hazy terminology was the result of hazyness of thought about what money is and money does.

699 But even most of those who used that comprehensive concept of Means of Payment did not, as do most of us, identify it with the concept of Money. The great majority of leading authors, among them Thornton, Ricardo, Senior, Fullarton, J. S. Mill and Marx, defined money as it had been defined by Galiani, Beccaria, and Smith, as a commodity that had been chosen for means of exchange, measure of value, etc. Roscher expressed dominant opiniion when he said that the false theories of money can be divided into those that hold that money is more and those that hold that money is less than the most salable commodity. This on the face of it makes them Theoretical Metallists (cf 288f).

700-705 To establish this proposition we must take account of several facts which apparently contradict it.

520 Thomas Tooke, <u>History of Prices</u>, vols 1 - 4 [1 + 2,1838; 3, 1840; 4, 1848]. Tooke 1774-1858.

William Newmarch (1820-1882) vols. 5 + 6, 1857.

MONEY AND CREDIT

In Schumpeter's History of Economic Analysis there are two main treatments of money and credit. The first is in the period, 1790-1870, and is set forth in Part III, chapter 7, pp. 717-735. The second is in the following period, 1870-1914 and later, in Part IV, chapter 8, pp. 1076-1135.

The difference between the two periods is instructive, for in the earlier period some writers were rather penetrating in their accunt of credit, but their views did not dominate the field and soon they were forgotten, but in the later period they were resurrected and, it seems, gained the acceptance of the competent.

The nature of this shift has been understood since the time of the Greeks, for intelligent inquiry begins from sensible data only to advance in understanding. The advance, sooner or later, is found to pass through a series of stages. But in historical retrospect it happens that earlier views linger on and so stand in contrast with later views and in opposition to their claims.

The simplest understanding of exchange is barter: so much of A's goods or services are exchanged for so much of B's. But barter is not an expeditious way of finding out who will give me what I need or desire in exchange for what I am ready to part with. Yet even when a medium of exchange has been introduced and accepted so that trade flourishes, the similarity of the end result offers a perhaps specious argument for the view that money is simply an elaborate type of barter. The whole intelligible pattern of trade is easily neglected, for an intelligible pattern cannot be made obvious to ocular vision; and when it is neglected what else can buying and selling be but barter.

Moreover, for centuries, there was a simple confirmation to this view. For buying (or selling) goods or services was a matter of giving (or receiving), if not some more primitive medium of exchange, then copper or silver or gold coins. But what else can this be but bartering goods or services for a concrete and quite palpable return.

Further, even when paper money (bank or government notes) became legal tender recognized by law as valid payment of debts, the transition was gradual. At the start it was termed a fiduciary issue that on demand could be exchanged for gold though the amount of gold available for that purpose was notably less than the amount that theoretically could be demanded. And later, when the offer of convertibility was replaced by the affirmation that the note was legal tender for all debts public and private, the issue turned to bank credit.

So Schumpeter after referring to 'the credit transactions of reality' could write: "It may be more useful to start from these in the first place, to look upon capitalist finance as a clearing system that cancels claims and debits and carries forward the differences -- so that 'money' payments come in as a special case without any fundamental importance. In other words: practically and analytically, a credit theory of money is possibly preferable to a monetary theory of credit" (HEA:717).

In brief, explaining money by having recourse to credit is a more effective and efficient approach than trying to explain credit by having recourse to money. Barter is simpler than money but its simplicity consists in failing to reveal how much more intelligent it is to use a monetary system. Similarly, money is simpler than contemporary credit, but its greater simplicity is due to an omission of an understanding of credit.

A basic clue to such understanding is to be had from a previous question. We asked about the possibility of an acceleration of the circuits and our answer was that an ongoing acceleration is possible when more and more money, interval by interval, is transferred from the redistributional area to the circuits. Specifically, if there is to be a long-term expansion of the surplus circuit, the transfers are to be made to surplus supply; and if the long-term expansion is to be in the basic circuit, then the transfers are to be made to the basic circuit. What is this money for? It keeps increasing the working capital, the further money that is to be spent on initial and transitional payments to generate the increased supply of, respectively, surplus or basic goods and services.

The basis of credit, then, is the need of an expanding economy for ongoing increments in its means of payment for an increasing rate of flow of goods and services.