

nomic depression. Raguet concluded that the depression had been caused by bank credit expansion in the boom, followed by a subsequent contraction when the boom caused specie to drain out of the bank vaults. As a result, Raguet emerged from the depression a dedicated opponent of fractional-reserve banking, and a convinced partisan of free trade. He was impressed that, out of the leading citizens and legislators of 19 counties to whom the Raguet committee sent a questionnaire, 16 counties replied flatly that 'the advantages of the banking system' did not 'outweigh its evils'. From then on, Raguet favoured 100 per cent reserve banking to specie, and, while not a Jacksonian politically, staunchly supported the Jacksonian 'Independent Treasury' plan that divorced the treasury from banks or bank paper. Raguet later expanded his views in his *Of the Principles of Banking* (1830), *A Treatise on Currency and Banking* (1839, 1840), *Principles of Free Trade* (1835), and in a series of journals which he launched in the late 1830s, which included a documentary history of the current commercial crisis as well as reprints of Ricardo and other monetary theorists, and of the bullion *Report*.

Raguet explained, in his *Treatise on Money and Banking*, how expansion of bank credit brought about a boom, higher prices, a demand to export specie and a consequent call upon the banks for specie contraction and crisis. Remarkably, he also anticipated James Wilson of *The Economist* by almost a decade in demonstrating, in a pre-Austrian treatment of the business cycle, how the boom brought about overinvestment in fixed capital goods. Thus Raguet wrote:

At the winding up of the catastrophe, it is discovered that during the whole of this operation *consumption* has been increasing faster than *production* – that the community is poorer in the end than when it began – that instead of food and clothing it has railroads and canals adequate for the transportation of double the quantity of produce and merchandise than there is to be transported – and that the whole of the appearance of prosperity which was exhibited while the currency was gradually increasing in quantity was like the appearance of wealth and affluence which the spendthrift exhibits while running through his estate, and like it, destined to be followed by a period of distress and inactivity.²⁷

The difference is that the more celebrated Wilson, a leader of the so-called banking school of Britain, never realized that the overinvestment was caused by monetary and credit expansion. In short, he never caught up with Raguet and the Jacksonians in the US.

The panic of 1819 also inspired the publication of the first systematic treatise on political economy in the United States, *Thoughts on Political Economy* (1820), by the Baltimore lawyer, Daniel Raymond (1786–1849).²⁸ Raymond was born into a conservative Connecticut federalist family, and his book was a paean to protective tariffs, and to the nationalist Alexander

Hamilton, whom Raymond considered the only truly sound political economist. But even Hamilton nodded, according to Raymond, on the bank question, and Raymond, too, came out in opposition to bank credit expansion and in favour of 100 per cent specie banking. Criticizing Hamilton's, and Adam Smith's, assertion that bank notes add to the national capital by economizing on specie, Raymond cited David Hume's statement that 'in proportion as money is increased in quantity, it must be depreciated in value'. Bank credit also promotes extravagant speculation, raises prices of domestic goods in export markets, and brings about a deficit in the balance of trade. To Raymond, the issuing of any bank notes beyond specie was, quite simply, a 'stupendous fraud'. Ideally, he believed that the federal government should eliminate bank paper entirely, and supply the country with a national paper backed 100 per cent by specie.

As can be seen from the case of Raymond, it was not only the Jacksonians who came to a staunch anti-fractional-reserve bank position during the 1819–21 depression. Young frontier state representative from western Tennessee, Davy Crockett (1786–1836), future Whig leader and enemy of the Jacksonians, stated that he 'considered the whole Banking system a species of swindling on a large scale'. Protectionist and future Whig president, General William Henry Harrison (1773–1841), ran successfully for the Ohio state senate in the Autumn of 1819. When attacked at a local pre-election citizens' meeting for being a director of a local branch of the Bank of the United States, Harrison, in a lengthy reply, insisted that he was a sworn enemy of all banks, and especially of the Bank of the United States, and that he was unalterably opposed to its establishment and continuation. And, finally, at least at this time, secretary of state and future president John Quincy Adams fully shared his father's hostility to all fractional-reserve banking. To a Frenchman who had sent him a plan for federal government paper money, Adams commended the famous Bank of Amsterdam, where paper 'was always a representative and nothing more', of specie in its vaults.

6.5 Monetary and banking thought on the Continent

Monetary thought on the European continent often paralleled the richer and more developed controversy in Great Britain. In Sweden, notably enough, a 'bullionist' controversy developed a half-century before the more famous one in Great Britain. Since few Britons were versed in the Swedish language, the controversy and its significance went unremarked outside Sweden.

In the mid-eighteenth century, Sweden experienced four decades (specifically, 1739–72) of roughly democratic government, with political power in the hands of the parliament, or Riksdag, and with representatives chosen from four estates (nobility, clergy, middle class and peasants). Two political parties battling for power in this era, in the nomenclature reminiscent of

Gulliver's Travels, were the 'Hats' and the 'Caps'. The Hats, who were in power from the beginning of the grandiloquently named 'Age of Freedom' until 1765, were mercantilists who believed in using inflation for economic development. Export subsidies, direct subsidies, cheap loans, and high protective tariffs were all used to build internal improvements and to foster favoured industries, especially textile manufacturing (a favourite motto of the Hats was 'Swedish men in Swedish clothing').

The choice method of financing these lavish expenditures was inflationary credit expansion by the central Bank of Sweden. The convenient proto-Keynesian Hat theory was that an increased money supply would all go into increased development and output rather than higher prices. As for the nagging thought that deficits might ensue in the balance of payments, there was no need to worry, since imports would be held down by direct government controls, while increased national income would, in some odd way, promote increased exports.

After several years of inflationary bank credit expansion, the Swedish government went off the silver standard in 1745, and from then on was free to inflate, ad libitum. Thus, total inconvertible bank notes in circulation in 1745 were 6.9 million *daler*, doubling until 1754, when total circulation was 13.7 million *daler*. Monetary inflation accelerated after that, more than doubling in the next four years, reaching 33.1 million *daler* in 1758. Finally, the supply of bank notes reached a peak in 1762 at 44.5 million *daler*, a 545 per cent increase over 1745, or an average of 32.1 per cent per year.

In response to the monetary expansion, prices remained stable for a few years and then rose from 1749 to 1756, the general price index rising 23 per cent in the seven years. After that, as usually happens, the price rise accelerated, doubling in the next eight years, and reaching a peak in 1764. The biggest concern was the foreign exchange rate, which rose even more precipitately. Thus, after remaining only 5 or 6 per cent above par from 1752 to 1755, the rate of Hamburg *mark bancos* in terms of *dalers* rose to 247 per cent above par in 1765.

The fall in the foreign exchange value of the *daler* led the Hat government to attempt direct control of foreign exchange rates. A foreign exchange office was established in 1747 to try to push rates down, using massive French government subsidies to prop up *dalers* in the foreign exchange market. The exchange office succeeded for a few years, bringing the price of Hamburg *mark bancos* down, for example, from 24 per cent above par in 1748 to 5 or 6 per cent above par from 1752 to 1755. But an artificially falling foreign exchange rate combined with rising domestic prices amounted to an enormous subsidy of imports into Sweden. The resulting huge deficit in the balance of payments raised the increasing problem of how a country on inconvertible paper is going to finance the deficits. Finally, loans and subsi-

dies from abroad ceased, the house of cards collapsed, and foreign exchange rates spiralled upward.

It is interesting to see how the Hat theoreticians, led by one Edward Runeberg, explained the mounting crisis. Like the anti-bullionists and the later banking school theorists in Britain, they – even more starkly – reversed the causal chain. The problem, the Hats declared, originated in the deficit in the balance of payments. Where the deficit came from was far more murky; presumably it was a wilful act of greedy consumers and importers. The deficit then caused the price of foreign exchange to rise, which in turn raised the prices of domestic goods in export markets, which in turn pulled up all the prices of domestic goods. Hence the entire domestic inflation was *really* due to the mysterious deficit in the balance of payments. The policy conclusion was clear to the Hats: restrict imports by coercion.

Not once did the Hat theoreticians admit that there could be a causal chain running from increased bank note issue to prices and exchange rates. On the contrary, the Hats advocated further issues in bank money to raise domestic production, which would in turn somehow increase exports, and thereby increase foreign exchange earnings and, along with a coerced restriction of imports, cure the deficit.

In addition to massive private credits, the inflation of money and credit by the Bank of Sweden financed government deficits, many of which were used for heavy Swedish military expenses to fight in the multinational Seven Years' War (1756–63).

As the inflation began to accelerate in 1756, Cap political strength grew steadily, in reaction not only to the inflationary spiral, but also to participation in a widely unpopular war. The Caps, who found their constituency among small merchants and civil servants injured by inflation, were in favour of free trade and *laissez-faire*, and opposed to mercantilism and government controls. As the inflation proceeded, the Caps were able to show how the government-engineered inflation aided privileged manufacturers with cheap bank loans. They also demonstrated how Hat privileges and subsidies aided certain privileged commercial capitalists, especially iron exporters. Smaller industrialists, merchants, and importers opposed to special privilege, were the backbone of the Cap party.

Worried by rising Cap power, the Hats finally stopped the monetary inflation in 1762, but prices and exchange rates continued to rise as expectations of further inflation still held sway. Finally, the Caps toppled the Hats in 1765, and promptly ended the inflation by a heroic policy of monetary deflation, lowering the total supply of bank notes to 33.5 million *daler* in 1768, or a 25 per cent drop in seven years, most of it since 1765. The result was, of course, a sharp deflation in prices and foreign exchange, the *marc banco* rate falling

from 247 per cent of par in 1765 to 117 per cent of par three years later. Output and unemployment declined sharply as well.

Throughout this boom–bust cycle, the Caps firmly took what would later be called the bullionist position. The excess issue of bank notes, especially with an inconvertible currency, brought about rises in price and in foreign exchange rates. As we have indicated, the Caps were wisely not content with simply pointing out the economic flaws in the Hats' reasoning. They also attacked the special privileges enjoyed by the Hats, and showed how the Hat constituency benefited by inflation and mercantilism.

The deflationary course taken by the Caps in power may be economically justified by pointing out that drastic measures were necessary to reverse inflationary expectations. But the Caps stressed another attractive political argument: retribution. Why shouldn't the wealthy Hat merchants and industrialist profiteers from inflation pay the major price for a return to the silver standard and sound money? In this way, deflation would reward those who had suffered from inflation, and the profiteers from the previous inflation would, in a sense, pay reparations to compensate the previous victims of inflation. This was far from an absurd programme. And so the Caps set out, quite frankly, to deflate prices and exchange rates down to the pre-1745 Hat inflation and to the old silver par with the *daler*.

Economically, too, the Caps had an important argument: since bank notes received their true value from their silver reserves, the *daler* should always designate the same quantity, or weight, of specie.

Two of the leading Cap economists, however, argued against the deflation and instead suggested going back to silver at the existing rate of twice the old par. One was the Rev. Anders Chydenius (1729–1803), a Lutheran pastor from a small city on the western coast of Finland. Coming from a coastal city in a Finland colonized by Sweden (the Kingdom of Sweden and Finland), and whose trade suffered from state privileges to Stockholm and other Swedish interests, Chydenius early spoke and wrote numerous pamphlets against mercantilism and in favour of free trade. He also propounded a philosophy of natural law and natural rights of every individual. In 1766, as a representative of the Finnish clergy in the *Riksdag*, Chydenius was censured and removed from Parliament for the flagrant crime (in the 'Age of Freedom') of writing a tract, *The Succour of the Realm by a Natural Finance System*, attacking the policy of deflation to the old par after he had voted for it. Apparently changing one's mind after a vote was not permissible. In the pamphlet, Chydenius, without benefit of having read or heard of Adam Smith, worked out some 'real bills' notions of permissible banking in a convertible monetary system.

The other Cap opponent of deflation was a teacher of economics at the University of Uppsala, Pehr Niclas Christiernin. Christiernin began at Uppsala as an adjunct in law and economics in 1761, then rose to professor in the

same field, then held a chair in philosophy, and finally ended as chancellor of the university. In contrast to the poorly read Chydenius, Chistiernin was steeped in such foreign economic literature as Cantillon, Hume, Justi, Locke and Malynes. In a pamphlet published in 1761 (*Summary of Lectures on the High Price of Foreign Exchange in Sweden*), Christiernin presented a theory of flexible exchange rates as an equilibrating mechanism in inconvertible currency that anticipated the bullionists and was superior to anything written up to that time. Unfortunately, Christiernin remained untranslated into English, and therefore unread there, until 1971. Christiernin pointed out that the continuing increase in the supply of bank notes led to the fall in value of the *daler*, both in raising foreign exchange rates as well as prices of goods at home. The increase in the issue of bank notes, in turn, stemmed from the bank's more liberal lending policy, which lowered the rate of interest sharply by the mid-1750s, and also increased inflation by creating money to redeem all extant government bonds.

Christiernin, however, was far from a hard-core hard-money man. He defended bank notes as useful, increasing activity and employment, and opposed deflation because, he pointed out, prices and wages were sticky downward. It is doubtful, however, that downward stickiness could last for long in the eighteenth century. But Christiernin's main objection to deflation was that his ideal was not sound, metallic money but a pre-Friedmanite desire to stabilize the value of the *daler* and make the price level constant. In pursuit of that goal, he urged open market operations by the central bank. Furthermore, again in anticipation of the monetarists, he admittedly preferred inflation to deflation, if that was the choice.

Unfortunately, the heroic deflationary measures led to temporary Cap reverses. The Hats came back to power in 1769, but although they promptly re-inflated, they began to prepare seriously for restoration of the silver standard. When the Caps returned in 1772, however, the powerful merchant capitalists of the Hat party collaborated with the Crown and the nobility to seize power; in a *coup d'état*, overthrowing parliamentary democracy, and installing King Gustav III as absolute monarch. King Gustav returned Sweden to the silver standard in 1777 at the existing market price.

Later, British bullionist views spread to more intellectually accessible parts of the Continent. Thus, in 1816, Johann Georg Busch (1728–1800), a mathematics teacher at the Hamburg Gymnasium, economist and founder of the Academy of Commerce at Hamburg, denounced inflationary banking propelled by government. Busch noted that, as a result,

The customary abuse has been that too many paper symbols have been produced measured against the needs of the citizens. As a consequence there are too many who want to change back their paper money into the commodity which is and can

be the true symbol of value. Since the bank cannot produce this commodity [gold or silver] out of nature like the paper with letters and figures on it, and since she must then confess that she cannot fulfill her promise [to convert to specie], the deceived citizen must become reluctant to take one [the paper] for the other [specie] money.²⁹

Busch identified the financing of war as the main reason for the emergency of governmental bank credit inflation since the beginning of the eighteenth century.

Meanwhile, in Russia, the Baltic German professor of political economy, the Smithian Heinrich Friedrich Freiherr von Storch, denounced government instigation of bank credit and paper money in a lengthy monetary appendix to the 1823 edition of his *Cours d'économie politique*. Storch, like Busch, zeroed in on war as the main reason for continuing inflation:

the principal motive for introducing this calamitous invention [of paper money] in nearly all states of Europe, have been [sic] the financial disorders caused by wars, which have been sometimes just and necessary but mostly useless... How many wars could have been prevented without this unhappy expedient? How many tears and how much blood could have been saved.

The best remedy for this evil, declared Storch, would be return to a pure, 100 per cent gold or silver standard in all nations. Failing that, however, Storch was willing to settle for free private, competing banks which, he was perhaps the first to point out, would be much less inflationary than governmentally privileged banking. As Storch put it:

private banks are those presenting most advantages and least dangers... Great Britain is the only country in Europe where private banks exist; in all other states banking business is concentrated in one institution, if not founded then at least approved and privileged by government. Nevertheless, public banks are much more prone to degenerate than are private banks. As long as banking companies exist in isolation their operations seem to be insignificant: as soon as they form one sole and great institution they excite the attention of the government, their profits being more considerable; and because of this the special protection they enjoy or the privileges which they solicit have to be bought by favours which change their nature and subtly undermine their credit.³⁰

6.6 Notes

1. Charles F. Peake, 'Henry Thornton and the Development of Ricardo's Economic Thought', *History of Political Economy*, 10 (Summer 1978), pp. 193–212.
2. Horner's starting point, as we have seen, was a bit different: he had been converted from a moderate neutral to moderate bullionist by Lord King's booklet in 1804.
3. Peake, *op. cit.*, note 1, p. 193.
4. As Peake writes, 'Ricardo's total productive output was dominated by monetary questions, and a full understanding of Ricardo requires an interpretation that includes his monetary works'. *Ibid.*

5. Malthus, formerly a moderate anti-bullionist, had now become a Thorntonian, and expressed his views in two articles on the bullion controversy in 1811 in the *Edinburgh Review*. See the critique of Malthus in Frank W. Fetter, *Development of British Monetary Orthodoxy, 1797-1875* (Cambridge, Mass.: Harvard University Press, 1965), p. 48.
On Ricardo's exclusive emphasis on long-run equilibrium in his monetary analysis, see J.A. Schumpeter, *History of Economic Analysis* (New York: Oxford University Press, 1954), pp. 494-5, and Jacob Viner, *Studies in the Theory of International Trade* (New York: Harper & Bros, 1937), pp. 139-40.
6. Joseph Salerno, 'The Doctrinal Antecedents of the Monetary Approach to the Balance of Payments' (doctoral dissertation, Rutgers University, 1980), p. 447. Salerno goes on to point out that Ricardo's strict, mechanistic split between the money and the real, leading to the doctrine that money is a 'veil', led also to the seeming paradox of Ricardo, in his *Principles*, flip-flopping to a highly misleading purely real, non-monetary, 'barter' analysis of the balance of payments. The paradox is only seeming, for a severe split enables someone to leap back and forth between the purely monetary and the purely real. It was the barter analysis of Ricardo's *Principles*, Salerno notes, 'which served as the foundation for the classical theory of the balance of payments'. *Ibid.*, p. 449.
7. Peake, *op. cit.*, note 1, p. 203.
8. Jacob H. Hollander, 'The Development of the Theory of Money from Adam Smith to David Ricardo', *Quarterly Journal of Economics*, 25 (May 1911), p. 470.
9. Spencer Perceval (1762-1812), the son of the earl of Egmont, received an MA from Trinity College, Cambridge in 1781, then became an attorney and king's counsel. An MP from 1796 on, Perceval was an ardent war hawk, and a defender of Pitt's repressive crackdown on anti-war dissidents at home. Rising to solicitor-general and attorney-general, Perceval, as a leading follower of Pitt, became chancellor of the exchequer in 1807, and then added the post of prime minister in 1809. He was assassinated in 1812.
10. Huskisson, though a respected and leading Tory, was all his life a classical liberal and devoted to freedom of trade. Raised by a great-uncle who was a well-known physician to the British embassy at Paris, Huskisson lived with leading French liberals as a youth, and knew Franklin and Jefferson. After the fall of the Bastille, at which he was present, Huskisson joined the Club of 1789 (a group of eminent constitutional monarchist classical liberals). At the age of 20, Huskisson read before the club in 1790, and then printed, a much applauded discourse on the currency.
Huskisson became a close friend and private secretary to the British ambassador, Lord Gower, and returned with him to England when recalled in 1792. Three years later, he gained a key post as Secretary to the administration in 1795, and became an MP the following year. As a young Pittite, Huskisson rose as secretary to the treasury from 1804 until 1809, and in 1808 played a large share in arranging relations between the Treasury and the Bank of England.
11. Sharp, a great conversationalist known as 'Conversation Sharp', was the son of an English officer, born in Newfoundland, who rose to become a leading West Indies merchant in London as well as head of the hat manufacturing firm of Richard Sharp & Co. This wealthy businessman became a leading Whig, devoted to parliamentary and other liberal reforms. Sharp was a member of many leading London clubs, and was a friend of John Adams, Ricardo and James Mill. He long wanted to write a history of the attainment of American independence. Sharp was also a poet very interested in literature, and a friend of Byron, Coleridge and Wordsworth. He was an MP intermittently from 1806 to 1827.
12. A decade later, Huskisson, during a parliamentary debate on monetary policy, mentioned his 'misfortune' in 1810, 'to differ from some distinguished members of this House to whom I was personally attached, and in whose political views I had generally concurred'. See Frank W. Fetter, 'The Politics of the Bullion Report', *Economica*, n.s. 26 (May 1959), pp. 106-7.
13. *Ibid.*, p. 106.
14. As Frank W. Fetter put it, 'Only after the Bullion Committee had issued a Report...that differed substantially from Ricardo in its analysis of the causes of depreciation but agreed in part with Ricardo's criticisms of the Bank of England and with his view that the

Restriction should stop, regardless of the war, did Ricardo become the champion of the doctrines of the Bullion Report. Its conclusions as to policy were close enough to his so that he, as a pamphleteer and a propagandist, became their defender, thereby achieving a wide reputation'. Frank W. Fetter, 'The Bullion Report Reexamined', (1942) in T.S. Ashton and R.S. Sayers (eds.), *Papers in English Monetary History* (Oxford: The Clarendon Press, 1953), p. 67.

15. *Ibid.*, p. 67.
16. Here we should note the courage of Pascoe Grenfell (1761–1838), Whig merchant and mine promoter, who voted for the bullion *Report* even though a large stockholder in the Bank of England, as well as the timorousness of Alexander Baring, who spoke for the doctrines of the *Report*, but who voted against out of reluctance to return to the gold standard during the war. Grenfell was a Cornishman, whose father was a leading London merchant, and large dealer in tin and copper. Grenfell joined his father's firm, and then became principal managing partner of firms connected with Thomas Williams, the largest manufacturer in Cornwall and Anglesey. Grenfell was an MP from 1802 to 1826.
17. Vansittart, son of Henry Vansittart, a governor of Bengal, received a BA from Christ Church, Oxford, in 1781 and an MA four years later. Vansittart became an attorney and frequent pamphleteer, dedicated to the pro-war and the pro-restriction policies of William Pitt. An MP from 1796 on, Vansittart became a co-secretary to the treasury, the secretary for Ireland, and again secretary to the treasury in various Tory governments. In 1809, Vansittart had led the debate for extending the restriction. He became chancellor of the exchequer in 1812, and remained in that post for ten years.
18. Jackson, who had received an MA from Exeter College, Oxford, in 1793, was a prominent parliamentary counsel, also parliamentary counsel to the East India Co., and counsel to the Corporation of London.
19. George Ellis, whose father was a member of the House of Assembly of St George in the West Indies, had briefly been an MP in the 1790s, but was even more a poet, historian and *littérateur*. A clever poet, who edited and published an anthology of poetry, and the author of a history of the Dutch Revolution of the mid-1780s, George Ellis had been a diplomat, and then became a frequent contributor to the *Anti-Jacobin Review*. He was a close friend of George Canning and of the Scottish Tory writer Sir Walter Scott.
20. Alexander Baring, son of Sir Francis of the great banking family, had been a member of the bullion committee of 1810 who voted against the *Report*. Trained from early life to work in his father's banking house, he married the daughter of the wealthy federalist associate of Robert Morris of Philadelphia, US Senator William Bingham. Baring became head of his family bank in 1810, and was an MP for 30 years from 1806 on.
21. Salim Rashid, 'Edward Copleston. Robert Peel, and Cash Payments', *History of Political Economy*, 15 (Summer 1983), pp. 249–59.
22. Frank W. Fetter, *Development of British Monetary Orthodoxy 1797–1875* (Cambridge, Mass.: Harvard University Press, 1965), pp. 69–70.
23. Cobbett (1762–1835) was one of the few political writers to come from a lower-class background. Son of a peasant family in Surrey, Cobbett became a copying clerk to a lawyer in London, enlisted in the ranks of the army, becoming an NCO in Nova Scotia in 1791, and married a soldier's daughter. Wandering to France and thence to the United States, Cobbett became an English teacher to French refugees and a translator in Philadelphia, where he made his mark in the mid-1790s as a virulently pro-English Tory and federalist and opponent of Jacobinism. He became a newspaper writer, editor, and publisher in Philadelphia in the late 1790s.

Returning to England in 1800, Cobbett began his highly influential *Cobbett's Weekly Political Register* in 1802, continuing its publication until his death. He also published the parliamentary debates and a multi-volume parliamentary history of England. In 1804, Cobbett shifted sharply and permanently to an all-out radical position, praising parliamentary reform, denouncing paper money, and repeatedly being charged with sedition.

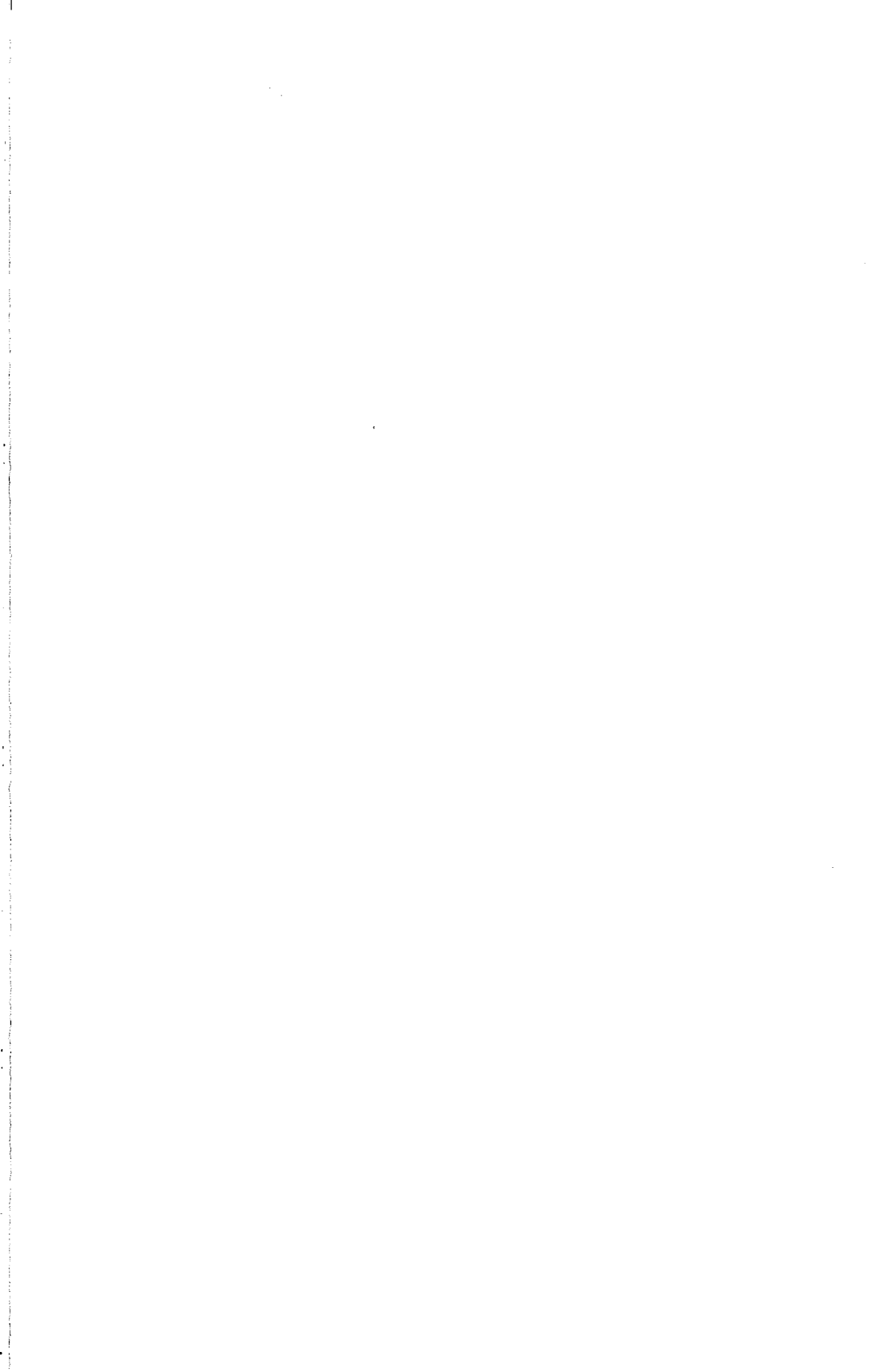
24. Cited in Mark Skousen, *The 100% Gold Standard: Economics of a Pure Money Commodity* (Washington, DC: University Press of America, 1977), p. 45.
25. The corollary goals of the Jacksonian movement were all consistent with the aim of

achieving a free market, *laissez-faire* economy and polity: free trade (accomplished in the 1840s), repayment of the entire national debt (achieved in the 1830s), no federal and precious little state 'internal improvements' (public works), and generally, an ultra-minimal budget or governmental power, certainly on the federal and even on the state and local levels.

26. The plan was two terms of Benton as president, to follow two terms of Van Buren, Jackson's selected heir. But Van Buren never gained his second term, the great split amongst the Jacksonians, symbolically including a split between Van Buren and Jackson himself, coming in 1844 over the crucial question of whether or not the Republic of Texas should be admitted to the Union as a slave state.
27. Condé Raguet, *Treatise on Money and Banking* (1839), p. 137, quoted in Vera Smith, *The Rationale of Central Banking* (1936, Indianapolis, Ind.: Liberty Press, 1990), p. 84.
28. The second, more widely known, edition of this book was published as *The Elements of Political Economy* (2 vols, 1823, 1836, 1840).
29. Quoted in Peter Bernholz, 'Inflation and Monetary Constitutions in Historical Perspective', *Kyklos*, 36, no. 3 (1983), pp. 407–8.
30. *Ibid.*, pp. 408–9.

7 Monetary and banking thought, III: the struggle over the currency school

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7.1 The trauma of 1825

In 1823, the British economy finally recovered from the post-Napoleonic War and post-1819 agricultural depression. In fact, an expansionary boom got under way, so much so as to quieten the vociferous agricultural advocates of higher prices and the opponents of the return to gold. Unsurprisingly, Bank of England credit expansion led the way in this new inflationary boom, its total credit rising from £17.5 million in August 1823 to £25.1 million two years later, a huge increase of 43 per cent or 21.7 per cent un compounded per annum. Much of the monetary and credit boom came through investment in highly speculative Latin American mining stocks. The great hard-money radical William Cobbett kept up a drumfire of attack on this inflation but, significantly, he was also joined, if more privately, by such moderate hard-money men as William Huskisson, who worried that 'this universal Jobbery in Foreign Stock will turn out the most tremendous Bubble ever known'.

By late 1824, the exchanges turned unfavourable, and gold began to flow abroad; by the following year, Britons began to demand gold from the banks in increasing numbers. Huskisson repeatedly warned the Cabinet in the Spring of 1825 that 'the Bank, in its greedy folly, was playing over again the game of 1817'. In late June, a bank in Bristol refused outright to give gold to a noteholder who spurned payments in Bank of England notes, and this ominous incident was widely publicized by Cobbett. Bank of England cash reserves were at their lowest in five years at the end of February, at £8.86 million; and from that low point they fell alarmingly to no more than £3.0 million at the end of October. Bank runs and a bank panic ensued and at the height of that panic, in mid-December, a noteholder of the recalcitrant Bristol bank distributed a leaflet warning the citizens of the city: 'As there is no knowing what may happen, get Gold, for if Restriction come it will be too late'. During the panic, the late Henry Thornton's important bank, Pole, Thornton & Co. went under, despite last-minute borrowing from the Bank of England and despite the fact that Sir Peter Pole, head of the bank, was connected by marriage with the governor of the Bank of England, Cornelius Buller.

After a week of hysteria in mid-December, the Bank of England, pursuing a highly risky policy of massive loans to the banks and rediscounting of bills, managed to stem the run, even though its cash reserves had been reduced to £1.0 million by the end of the year.

The country was saved by a hair's breadth from another suspension of specie payments by the Bank of England. The bank pleaded with the government to order such a suspension, but the Tory government, largely due to the ardent pressure of Huskisson and Canning, resisted the bank's demands. The prime minister, Robert Banks Jenkinson, the earl of Liverpool, much to the disgust of his fellow High Tories of the duke of Wellington faction, agreed with Huskisson that, in the words of one prominent Wellington man, 'if the

[Bank] stopped payment, it would be a good opportunity of taking their Charter from them,...for letting the Bank break'.

The boom and crisis of 1825 dealt a traumatic lesson to thoughtful analysts of the monetary and economic scene. For these dramatic events demonstrated that the gold standard, important as it was as a check on monetary and banking inflation, *was not enough*; bank failures, and boom and bust cycles, could and would still occur. Something further, then, was needed to fulfil the promise of the bullionists; something more than the gold standard was needed to counter the ills of boom-and-bust and of fractional-reserve banking.

The most concrete and immediate response to the panic of 1825 was a decision of the government to outlaw small denomination (under £5) bank notes, a measure that even the pro-bank credit Adam Smith had favoured. In that way, at least for these popular and widely used small denominations, the public would be using only specie as money. On 22 March 1826, Parliament forbade banks in England and Wales to issue new small notes, or to reissue any old ones after April 1829. After June 1826, the Bank of England continued to obey this edict for a little over a century. In another banking reform, Parliament ended the system that had prevailed since the turn of the eighteenth century: the Bank of England had a monopoly of all commercial banking except for partnerships of less than six persons. This monopoly was now shaken. Corporate and large partnership banks were now permitted in England, by an act of 26 May 1826. Unfortunately, this liberalization was greatly weakened by the act's preserving the bank's monopoly of corporate and large-scale banking inside a 65-mile radius of London. In short, corporate or joint-stock banking was permitted only to the 'country' banks.

Political pressure by Scottish Tories gained an exemption from these reforms for Scotland. In the first place, Scotland already had joint-stock banking and, more importantly, Scotland had long been a swamp of small-bank note inflationism. Even after resumption of the gold standard in 1821, Scotland did not have a gold standard in practice. Frank Fetter discloses the solution as follows:

Even after the resumption of payments in 1821 little coin had circulated; and to a large degree there was a tradition, almost with the force of law, that banks should not be required to redeem their notes in coin. Redemption in London drafts was the usual form of paying noteholders. There was a core of truth in the remark of an anonymous pamphleteer (1826): Any southern fool who had the temerity to ask for a hundred sovereigns [gold coins], might, if his nerves supported him through the cross examination at the bank counter, think himself in luck to be hunted to the border.¹

To work, a gold standard must, of course, be truly in effect – in practice as well as in the official statutes.

The Scottish Tories, led by the eminent novelist Sir Walter Scott, successfully blocked application of the anti-small-note reform to Scotland. The mouthpiece for Scottish High Toryism, *Blackwood's Edinburgh Magazine*, after hailing Scott's campaign, published two articles on 'The Country Banks and the Bank of England', in 1827-28, in which it wove together two major strains of ultra-inflationism: going off the gold standard, and praising the country banks. *Blackwood's* also attacked the Bank of England as overly restrictionist, thus helping to launch the legend that the bank was too restrictive instead of being itself the main engine of inflation. In contrast, the *Westminster Review*, mouthpiece for the philosophical radicals, scoffed at the Scots for threatening 'a civil war in defence of the privilege of being plundered' by the bank credit system.

It was also in this period in 1827, that Henry Burgess founded the powerful committee of country bankers, and edited for over 20 years the committee's influential periodical, *Circular to Bankers*. For that entire period, Burgess kept up a drumfire of inflationist vilification of the gold standard, of 'those ignorant, vain, and obstinate, projectors - Huskisson, Peel, and Ricardo', and of the Bank of England for being too restrictive of bank credit. He also denounced the 'Political Economists' as being 'the curse of the country' because of their generally hard-money views. For its part, *Blackwood's Edinburgh Magazine* pursued a similar unwavering line for nearly three decades, denouncing the return to gold in 1819 as having given 'the Jews, stock-brokers, and attorneys of the country, an enormous advantage, at the expense of classes connected with land...'

On the other hand, William Cobbett continued his hard-hitting anti-bank paper stance, proclaiming in 1828 that 'Ever since that hellish compound Paper-money was understood by me, I have wished for the destruction of the accursed thing: I have applauded every measure that tended to produce its destruction, and censured every measure having a tendency to preserve it'. Blasting the inflationist and privileged Scottish country banks as 'the Scottish monopolists', Cobbett also denounced the Scotsman John Ramsay McCulloch for defending bank paper - 'this Scotch stupidity, conceit, pertinacity and impudence'. Cobbett escalated the attack by asserting that 'these ravenous Rooks of Scotland have been a pestilence to England for more than two hundred years'. It might be commented, of course, that one simple way for England to cast off that 'pestilence' was for England to give Scotland back its independence, a solution that Cobbett and the other nationalist English radicals somehow failed to consider.

Despite the continuing inflationism of the High Tories and of the Birmingham Attwoods, and despite the imminent clash of economic opinion over banking reform, the bulk of economists stood foursquare, from the mid-1820s on, in defence of the gold standard. That much had been agreed upon,

and accomplished. Their differences on banking did not prevent unity on this fundamental monetary question. John Ramsay McCulloch, James Mill and Nassau W. Senior, stood solidly in favour of gold. Even the alleged radical, and for a time, pre-Keynesian Malthus expressed complete support for return to the gold standard in 1823 and thereafter. Archbishop Whately, Mountifort Longfield, Thomas Perronet Thompson, even the arch inductivist and historicist Richard Jones of Cambridge, were all staunch supporters of gold. Even the often confused and irenic John Stuart Mill was hard-hitting in defence of gold. The younger Mill, upon reading the testimony, in 1821, of Thomas Attwood in favour of a combined silver and inconvertible fiat paper standard, denounced the idea of depreciating the standard as a 'gigantic plan of confiscation'. Mill thundered 'that men who are not knaves in their private dealings should understand what the word "depreciation" means, and yet support it, speaks but ill for the existing state of morality on such subjects'.²

7.2 The emergence of the currency principle

The prohibition of small notes, however, scarcely tackled the main problem. The first to go beyond this minor aspect of banking and go straight to the heart of the matter was a brilliant and influential thinker who has remained as little known to historians as he was obscure in his own day. It is with justice that Lionel Robbins has wittily referred to James Pennington (1777–1862) as the 'Mycroft Holmes' of the later monetary controversy of the classical period.³

James Pennington was born into a prominent Quaker family in the town of Kendal, in Westmorland; his father, William, was a bookseller, printer and architect, who eventually became mayor of Kendal. Graduating from a first-rate Quaker school at Kendal, Pennington moved to London. Little is known of his personal life thereafter, except that he lived in Clapham, and that he and his large family of seven children were parishioners, and James a trustee, of the famous Clapham Anglican parish church, obviously abandoning the Quakerism of his youth. Apart from that, we know that he was a merchant, 'gentleman' and accountant, and briefly became a member of the board of control for India in 1832. From then on, retired from commerce, he would be consulted repeatedly in technical financial matters by the government.

In the wake of the great banking crisis of December 1825, London was agog with discussions of money and banking, the august Political Economy Club dealing with this topic in its meetings of 9 January and 6 February, 1826. At the latter occasion, Pennington was present as a guest and, stimulated by the discussion, he sat down to write a memorandum on the subject to the powerful president of the board of trade, the liberal Tory William Huskisson. Huskisson did not request the memo, but he was known to be receptive to intelligent memoranda on crucial topics, and this method of

promoting his views may have been suggested to Pennington by his long-time friend, and one of the original founders of the Political Economy Club, the merchant and economist Thomas Tooke. In this first memo to Huskisson on 13 February 'On the Private Banking Establishments of the Metropolis', Pennington outlined with crystal clarity how private banks, by expanding loans, create demand deposits which function as part of the money supply. Walter Boyd and others had pointed this out, but Pennington's exposition was unmatched in its lucidity and, when published as an appendix to Tooke's *Letter to Grenville* (1829), greatly influenced the banking controversies of the era. Unfortunately, the *Letter* did not sufficiently influence Pennington's own camp, the currency school, who stubbornly and tragically failed to realize that bank demand deposits formed part of the supply of money, equivalent to bank notes.

Without any encouragement from Huskisson, Pennington followed up his first memorandum with another, a year later (16 May 1827) on 'Observations on the Coinage'. After explaining the technical procedures of the gold standard, Pennington detailed the dangers to gold of the existence of a paper currency, and then added a tantalizing hint: 'It is possible to regulate an extensive paper circulation...to render its contraction and expansion...subject to the same Law as that which determines the expansion and contraction of a currency wholly and exclusively metallic'. Here was the first indication in Great Britain of the 'Currency Principle': that more than simple gold redeemability was needed to transform bank money into a mere surrogate of gold.

William Huskisson finally sat up and took notice, writing to Pennington that:

I perceive that towards the end of your Paper on Coinage, you state an opinion that means may be found of preventing those alternations of excitement and depression which have been attended with such alarming consequences to this Country. This, for a long time, has appeared to me to be one of the most important matters which can engage the attention...[T]he too great facility of expansion at one time, and the too rapid contraction of paper credit...at another, is unquestionably an evil of the greatest magnitude.

In short, bank credit and paper money were perceived by Huskisson as responsible for the business cycle; what, then, could be done about it? He urged Pennington to elaborate on his tantalizing suggestion.

The upshot was an ironic one: while James Pennington's third memorandum, in reply, 'On the management of the Bank of England', 23 June, was the first fateful elaboration of the justly famous currency principle, it was scarcely action-oriented enough to suit the minister. At any rate, monetary matters faded temporarily, and Huskisson himself resigned his post the following year, to die three years later. But Pennington's memorandum, never-