

*A small Addition to the Currency may produce
a great Effect upon Prices.*

If the currency makes six revolutions in the year, it is evident that the addition of one million must make six in the annual income. But should it make on the average twelve, which I think is at least as probable, then an addition of one million would make a difference of twelve. The very great difference in prices which occasionally does take place, without any comparatively great alteration in the amount of money in circulation, seems to warrant the inference, that the proportion of money in consumptive circulation is less, and the number of revolutions which it performs in the year greater, than might be at first supposed. But I am not aware of any correct data by which to come at certain conclusions on this subject.

CHAPTER XIX.

Paper Currency.

THE principal circulation of this country is composed of the promissory notes, payable in metallic money on demand, of public and private banks. In England, this money is issued by one public bank, the Bank of England, and by several hundred private banks. In Ireland, it is also issued by one public bank, the Bank of Ireland, and a number of private banks; and in Scotland, it is almost totally issued by public banks, or joint stock companies, constituted on the same principles, though not equal in magnitude to the public banks of Ireland and England.

For a more particular inquiry with respect to the advantage which joint stock companies possess over private banks, we must refer the reader to the Essay which he will find at the end of this treatise; and as a proper understanding of the present system of banking seems connected with, if not necessary to, the consideration of the branch of the subject at which we have arrived, we shall recommend the at-

tention of the reader to that Essay, before he proceeds further.

It may not be improper, however, as an additional argument, to remark that the charters of the Banks of England and Ireland, by preventing more than six partners from entering into any banking concern, have the effect of still further contracting the number even below that amount. The business of banks, as we have shewn, is to deal in money, and they do not require capital for that purpose, but credit; though capital is necessary, in order to give credit. The capital of private banks, however, not being known to the public, does not confer credit, and private bankers have no inducement to advance money. Private banks are in general, therefore, set up by men of property or credit, who join their respective credits to establish the concern, without any advance of capital. If we suppose, therefore, a private bank to commence with six partners, the full number allowed, it must either do well or ill, or neither well nor ill. If it is not doing well, however, it may be said to be doing ill; for in that case it leaves no adequate compensation for the risk which a private banker runs. If it is doing well, it has probably got into good business and credit. In this case, should a partner die, the credit of the bank would be such as to render one to supply his place unnecessary; and

another would not be taken in, merely for the sake of receiving one-sixth of the profits of a flourishing business. The remaining partners would divide the share amongst them; and this they would continue to do as the partners dropped off, until the number was as few as the credit of the bank (considered to be firmly established) could be supported with. If the bank was a bad concern, no new partner would join it. If it was neither good nor bad, there would be no temptation to do so. Hence with private banks, the number of partners under the present law gravitates downwards, until each bank presents the least security to the public with which it can possibly exist. Consequently, though six is allowed, there are not more than three partners to each bank on the average of the kingdom; and as at least one of these is an acting partner, there does not appear to be more than two persons of property to support the credit of each concern, even presuming every partner in a bank but the acting partner to possess the fortune requisite for such an establishment. The effect of the present law, therefore, is to give each bank as little credit, instead of as much, as possible.

Paper, as Money, of the same Value as Gold.

The notes of these banks are issued in dis-

count of commercial bills, in loans upon personal and other securities to individuals, and by the Bank of England, partly in discount of commercial bills, but principally upon bullion, and in advances to government.

This paper, in its character of money, is of the same value as gold. Gold, as a commodity, possesses intrinsic value, which bank-notes do not; it represents a value in materials, labour, and capital, which has been expended in procuring it; but as money, it is only worth the commodities in the market that it represents, whatever it may have cost; and paper money is the same. Each individual who originally acquires paper in consumptive circulation, does so by placing commodities in the market.

Paper and Metallic Money are introduced into Circulation in the first Instance upon different Principles, but the Effect upon Prices is the same.

Metallic money is introduced into circulation by a foreign demand for commodities, in consequence of their cheapness; whereas paper money is introduced by the demand of individuals for money itself. The metallic money which comes into a country, has been the re-

presentative of income in the country from whence it came; whereas paper money is made for the purpose of the demand which it supplies.

Paper money, therefore, when first issued, represents no constituent value in the market: property, or personal sureties which are indirectly the same, have been pledged for its repayment: the person who receives it, has deposited with the bank of which it is borrowed, a value of inconsumable property, equal to what he has received; but he has placed no commodity which it represents, in the market, and a demand in the market is, therefore, created beyond the supply. By this means, an elevation of prices takes place; and the paper makes way for itself, in the same manner as metallic money introduced by a foreign demand, as previously described. Precisely the reverse is the case when notes are taken out of circulation. A certain value of commodities is left in the market, without the money which represents them, and prices, consequently, fall to a parallel with the quantity of money which remains.

The Effect upon Prices produced by an Alteration in the Issues of Bank Notes, sufficiently proved by Experience.

The effect in elevating and depressing prices, produced by any alteration in the circulation of banks, is a fact now perfectly notorious, and to prove it, by a reference to particular instances, unnecessary. I shall, however, mention one, which occurred with the Bank of France. Mr Haldiman, in his evidence before the committee of the House of Commons, appointed in 1819, to consider the expediency of the Bank of England resuming cash payments, gives the following particulars:—

“ I think there would be great distress occasioned in the commercial world by the forced reduction to which I have alluded. Prices cannot be forcibly lowered without producing very great mischief in trade; we should all feel the effects of it, some directly and some indirectly. I express myself rather strongly upon this point, because I happened to be in Paris, in October last, when the bank reduced its issues upon discounts very considerably and suddenly; the distress and failures which took place, in consequence of this measure, went much beyond what any merchant could

“ have anticipated. The issues of the Bank of France upon discounts, at that period, were 130 millions of francs, which was more than double the highest amount that was ever previously known. I believe the discounts usually were from 25 to 35 and 40 millions.”

It must be observed, that a contraction of issues, by curtailing advances to trade, has a double effect; it not only reduces the demand for commodities, but it increases the supply of them. The merchants, by the liberal accommodations of the bank, had no doubt been induced to increase their merchant stocks, and extend their transactions; and when suddenly called upon to repay the money borrowed, their only mode of doing so would be, to force their stocks into the market. This, at any time, would be a great loss; but as the money was not lent out again by the bank in promoting consumption, and did not return into the market, the demand would be reduced in equal proportion. Thus, therefore, in the same degree that the commodities in the market exceeded the average supply, the money in the market would present less than the average demand.

“ This step on the part of the directors of the Bank of France, was occasioned by the following circumstances:—The metallic currency was leaving the country in every direction, owing, in all probability, in some trifling

“ degree, to the over issue of paper ; partly to
 “ some large financial operations in Russia, and
 “ partly to the enormous payments that France
 “ had engaged to make to foreign powers,
 “ which amounted nearly to 20 millions ster-
 “ ling. The Paris bankers, therefore, antici-
 “ pating a great demand for bills upon all fo-
 “ reign countries, were remitting specie to meet
 “ the drafts, which they intended to negotiate
 “ to the agents of all those foreign powers, with
 “ a small advance upon their remittance. The
 “ sudden diminution, however, of the discounts
 “ of the bank, caused the exchange to turn in
 “ favor of France, and immediately paralyzed all
 “ their operations ; the metallic currency made
 “ a retrograde movement, and was restored
 “ to Paris and to those parts where the greatest
 “ distress had been felt. I have stated these
 “ circumstances thus minutely, because I think
 “ them perfectly applicable in reasoning, though
 “ not in extent, to the case of the Bank of
 “ England.”

It appears also that the extension of issues
 was sudden as well as the contraction. Mr
 Haldiman states, that the great increase took
 place he believed in June, July, August, and
 September ; while the reduction took place in
 October. There is little doubt that the effect
 of the payments made by France to foreign
 powers, would have been to have determined

the balance of trade against the nation ; but as
 these payments were made gradually, and prin-
 cipally by loans contracted in other countries,
 we should hardly think that they were the cause.
 It is much more probable that the extent and
 suddenness of the issues made by the bank,
 had produced that effect which was so immedi-
 ately counteracted, but with such ruinous con-
 sequence to individuals, by its retracing the
 steps that had caused it.

*With a Metallic Currency, sudden Fluctuations in
 Prices could not happen.*

As the philosopher's stone has not yet been
 discovered, neither individuals nor bodies have
 the power of making gold at pleasure, and we
 are pretty well assured that it is never their
 pleasure to destroy it. The directors of the
 Bank of France might desire to circulate its
 notes, but it is quite clear that they wished to
 keep the gold in the country also. No increase
 or reduction therefore in the amount of money in
 circulation could be made with a metallic curren-
 cy, except through the medium of trade : there
 would be no acquiring it except in the regular
 channel of circulation. If a person saved money,
 he would lend it out at one rate of interest or
 other ; and if he placed it in the hands of

bankers, they would do the same. A banker does not receive deposits to let them lie idle: whether he pays interest for them or not, he lends them out on the best terms he can get. A banker who issues his own notes, may, for different reasons, be unwilling, or unable, to lend them at less than a given rate of interest; but did he deal in metallic money the case would be different. If he paid nothing for his deposits, he would consider that no reason why he should get nothing for them; and if he could not get a high rate of interest, however low it might be, he would take the highest he could get. If he paid interest for them, he could not afford to keep the money in his coffers; but the less he could get, of course, the less he would give. Thus metallic money is always kept in circulation.

Hoarding to a small extent perhaps is generally practised, but not to be worth notice; and there is perhaps upon the average an equal sum applied in that way: as one hoard accumulates, another is brought into circulation, from one cause or other.

Principles which govern the Demand for Bank Paper.

There are two principles which govern the

demand for bank paper: the value of money compared with the interest which banks charge, and the internal balance of trade.

The Value of Money compared with the Interest which Banks charge.

There can be no question that if the banks at this moment were to lower the interest of money to one per cent. there would be a very extensive demand for bank paper upon the most unexceptionable securities. On the other hand, if they were to raise the rate of interest they charge to 10 or 15 per cent. there is as little doubt that all their creditors would pay off their debts as soon as possible, and they would find but very few new customers upon such terms.

The legal rate of interest, however, in this country, is 5 per cent. above which banks are not allowed to take; while they perhaps cannot afford to charge less than four. Bank notes are subject to a stamp duty which diminishes the profit of issuing them; and it is found indeed by experience, that private banks would rather contract their issues, than take even less than five.

Now when money is worth more than 5 per cent. there is a great demand upon the banks for their notes, and when it is worth less, the demand declines; in the first case they are

enabled to extend their issues; in the last they contract of themselves.

We have seen in a former chapter, that the value of money is determined by the demand for it, and that with the demand the rate of interest rises or falls. Previous to any general extension of bank issues, therefore, it will always be found that a demand for money has arisen which has increased the value of it; on the contrary, when the value of money has fallen below 5 per cent. we shall find that a contraction of bank issues has been the consequence.

Between the rate of interest paid by government and the value of money to individuals, there is probably about one per cent. difference: at least when government securities are above 60, and the usury law does not increase the distance: when they are beneath 60, the difference may be 3 or 4 per cent. At present, individuals, however, give 5 per cent. and the funds pay four.

Since 1793, until within these five years, money has always been worth 5 per cent. and upwards to individuals; and no involuntary contraction of bank-issues has taken place: the banks have had as great a demand for their notes as they thought proper to supply, under the checks from other causes to which they were subject.

The circulation of the Bank of England is

not so liable to contraction from an alteration in the value of money. It is principally issued, not in loans to individuals, but to government upon exchequer bills. The interest of these bills, by a bargain with the bank, government may reduce, but they are not paid off in consequence of a fall in the value of money, as is the case with debts due by individuals.

Internal Balance of Trade.

Each district has its balance of trade, as well as each nation: it is as necessary between two counties as two kingdoms: it is of no importance in what its circulating medium consists, whether in metallic money, Bank of England paper, or local notes, the principle is the same. A person whose property is in Northumberland, may live and spend his income in London. But in this case, a quantity of raw or manufactured produce must, directly or indirectly, be remitted from Northumberland to him: the balance of payments must upon the average be equal. This, however, can only be preserved by an equality of prices. If the prices of a district are above the general level, the balance of payments must be against it; if below, in its favor.

When banks first began to issue notes, the