

CHAPTER XVII.

OF INTERNATIONAL TRADE.

§ 1. THE causes which occasion a commodity to be brought from a distance, instead of being produced, as convenience would seem to dictate, as near as possible to the market where it is to be sold for consumption, are usually conceived in a rather superficial manner. Some things it is physically impossible to produce, except in particular circumstances of heat, soil, water, or atmosphere. But there are many things which, though they could be produced at home without difficulty, and in any quantity, are yet imported from a distance. The explanation which would be popularly given of this would be, that it is cheaper to import than to produce them: and this is the true reason. But this reason itself requires that a reason be given for it. Of two things produced in the same place, if one is cheaper than the other, the reason is that it can be produced with less labour and capital, or, in a word, at less cost. Is this also the reason as between things produced in different places? Are things never imported but from places where they can be produced with less labour (or less of the other element of cost, time) than in the place to which they are brought? Does the law, that permanent value is proportioned to cost of production, hold good between commodities produced in distant places, as it does between those produced in adjacent places?

We shall find that it does not. A thing may sometimes be sold cheapest, by being produced in some other place than that at which it can be produced with the smallest amount of labour and abstinence. England might import corn from Poland, and pay for it in cloth, even though she had a decided advantage over Poland in the production of both the one and

the other. England might send cottons to Portugal in exchange for wine, although Portugal might be able to produce cottons with a less amount of labour and capital than England could.

This could not happen between adjacent places. If the north bank of the Thames possessed an advantage over the south bank in the production of shoes, no shoes would be produced on the south side; the shoemakers would remove themselves and their capitals to the north bank, or would have established themselves there originally; for, being competitors in the same market with those on the north side, they could not compensate themselves for their disadvantage at the expense of the consumer; the amount of it would fall entirely on their profits; and they would not long content themselves with a smaller profit, when, by simply crossing a river, they could increase it. But between distant places, and especially between different countries, profits may continue different; because persons do not usually remove themselves or their capitals to a distant place, without a very strong motive. If capital moved to remote parts of the world, as readily, and for as small an inducement, as it moves to another quarter of the same town; if people would transport their manufactories to America or China whenever they could save a small percentage in their expenses by it; profits would be alike all over the world, and all things would be produced in the places where the same labour and capital would produce them in greatest quantity and of best quality. A tendency may, even now, be observed towards such a state of things; capital is becoming more and more cosmopolitan; there is so much greater similarity of manners and institutions than formerly, and so much less alienation of feeling, among the more civilized countries, that both population and capital will now move from one of those countries to another on much less temptation than heretofore. But there are still extraordinary differences, both of wages and of profits, between different parts of the world. It needs but a small

motive to transplant capital, or even persons, from Warwickshire to Yorkshire; but a much greater to make them remove to India, the colonies, or Ireland. To France, Germany, or Switzerland, capital moves perhaps almost as readily as to the colonies; the differences of language and government being scarcely so great a hindrance as climate and distance. To countries still barbarous, or, like Russia or Turkey, only beginning to be civilized, capital will not migrate, unless under the inducement of a very great extra profit.

Between all distant places therefore in some degree, but especially between different countries (whether under the same supreme government or not,) there may exist great inequalities in the return to labour and capital, without causing them to move from one place to the other in such quantity as to level those inequalities. The capital belonging to a country will, to a great extent, remain in the country, even if there be no mode of employing it in which it would not be more productive elsewhere. Yet even a country thus circumstanced might, and probably would, carry on trade with other countries. It would export articles of some sort, even to places which could make them with less labour than itself; because those countries, supposing them to have an advantage over it in all productions, would have a greater advantage in some things than in others, and would find it their interest to import the articles in which their advantage was smallest, that they might employ more of their labour and capital on those in which it was greatest.

§ 2. As I have said elsewhere* after Ricardo (the first who made any great step towards clearing up this subject) "it is not a difference in the *absolute* cost of production, which determines the interchange, but a difference in the *comparative* cost. It may be to our advantage to procure iron

* Essays on some Unsettled Questions of Political Economy, Essay I.

from Sweden in exchange for cottons, even although the mines of England as well as her manufactories should be more productive than those of Sweden; for if we have an advantage of one-half in cottons, and only an advantage of a quarter in iron, and could sell our cottons to Sweden at the price which Sweden must pay for them if she produced them herself, we should obtain our iron with an advantage of one-half, as well as our cottons. We may often, by trading with foreigners, obtain their commodities at a smaller expense of labour and capital than they cost to the foreigners themselves. The bargain is still advantageous to the foreigner, because the commodity which he receives in exchange, though it has cost us less, would have cost him more."

To illustrate the cases in which interchange of commodities will not, and those in which it will, take place between two countries, Mr. Mill, in his Elements of Political Economy*, makes the supposition, that Poland has an advantage over England in the production of both cloth and of corn. He first supposes the advantage to be of equal amount in both commodities; the cloth and the corn, each of which required 100 days labour in Poland, requiring each 150 days labour in England. "It would follow, that the cloth of 150 days labour in England, if sent to Poland, would be equal to the cloth of 100 days labour in Poland; if exchanged for corn, therefore, it would exchange for the corn of only 100 days labour. But the corn of 100 days labour in Poland, was supposed to be the same quantity with that of 150 days labour in England. With 150 days labour in cloth, therefore, England would only get as much corn in Poland as she could raise with 150 days labour at home; and she would, in importing it, have the cost of carriage besides. In these circumstances no exchange would take place." In this case the comparative costs of the two articles in England and in Poland were supposed to be the same, though the absolute

* Third ed. p. 120.

costs were different; on which supposition we see that there would be no labour saved to either country by confining its industry to one of the two productions, and importing the other.

It is otherwise when the comparative, and not merely the absolute costs of the two articles are different in the two countries. "If," continues the same author, "while the cloth produced with 100 days labour in Poland was produced with 150 days labour in England, the corn which was produced in Poland with 100 days labour could not be produced in England with less than 200 days labour; an adequate motive to exchange would immediately arise. With a quantity of cloth which England produced with 150 days labour, she would be able to purchase as much corn in Poland as was there produced with 100 days labour; but the quantity which was there produced with 100 days labour, would be as great as the quantity produced in England with 200 days labour." By importing corn, therefore, from Poland, and paying for it with cloth, England would obtain for 150 days labour what would otherwise cost her 200; being a saving of 50 days labour on each repetition of the transaction: and not merely a saving to England, but a saving absolutely; for it is not obtained at the expense of Poland, who, with corn that costs her 100 days labour, has purchased cloth which, if produced at home, would have cost her the same. Poland, therefore, on this supposition, loses nothing; but also she derives no advantage from the trade, the imported cloth costing her as much as if it were made at home. To enable Poland to gain anything by the interchange, something must be abated from the gain of England: the corn produced in Poland by 100 days labour must be able to purchase from England more cloth than Poland could produce by that amount of labour; more therefore than England could produce by 150 days labour, England thus obtaining the corn which would have cost her 200 days at a cost exceeding 150, though short of 200. Eng-

land therefore no longer gains the whole of the labour which is saved to the two jointly by trading with one another.

§ 3. From this exposition we perceive in what consists the benefit of international exchange, or in other words, foreign commerce. Setting aside its enabling countries to obtain commodities which they could not themselves produce at all; its advantage consists in a more efficient employment of the productive forces of the world. If two countries which trade together attempted, as far as was physically possible, to produce for themselves what they now import from one another, the labour and capital of the two countries would not be so productive, the two together would not obtain from their industry so great a quantity of commodities, as when each employs itself in producing, both for itself and for the other, the things in which its labour is relatively most efficient. The addition thus made to the produce of the two combined, constitutes the advantage of the trade. It is possible that one of the two countries may be altogether inferior to the other in productive capacities, and that its labour and capital could be employed to greatest advantage by being removed bodily to the other. The labour and capital which have been sunk in rendering Holland habitable, would have produced a much greater return if transported to America or Ireland. The produce of the whole world would be greater than it is, if everything were produced where there is the greatest absolute facility for its production. But nations do not, at least in modern times, emigrate *en masse*; and while the labour and capital of a country remain in the country, they are most beneficially employed in producing for foreign markets as well as for its own, the things in which it lies under the least disadvantage, if there be none in which it possesses an advantage.

§ 4. Before proceeding further, let us contrast this view of the benefits of international commerce with other theories

which have prevailed, and which to a certain extent still prevail, on the same subject.

According to the doctrine now stated, the only direct advantage of foreign commerce consists in the imports. A country obtains things which it either could not have produced at all, or which it must have produced at a greater expense of capital and labour than the cost of the things which it exports to pay for them. It thus obtains a more ample supply of the commodities it wants, for the same labour and capital; or the same supply, for less labour and capital, leaving the surplus disposable to produce other things. The vulgar theory disregards this benefit, and deems the advantage of commerce to reside in the exports: as if not what a country obtains, but what it parts with, by its foreign trade, was supposed to constitute the gain to it. An extended market for its produce—an abundant consumption for its goods—a vent for its surplus—are the phrases by which it has been customary to designate the uses and recommendations of commerce with foreign countries. This notion is intelligible, when we consider that the authors and leaders of opinion on mercantile questions have always hitherto been the selling class. It is in truth a surviving relic of the Mercantile Theory, according to which, money being the only wealth, selling, or in other words, exchanging goods for money, was (to countries without mines of their own) the only way of growing rich—and importation of goods, that is to say, parting with money, was so much subtracted from the benefit.

The notion that money alone is wealth, has been long defunct, but it has left many of its progeny behind it; and even its destroyer, Adam Smith, retained some opinions which it is impossible to trace to any other origin. Adam Smith's theory of the benefit of foreign trade, was that it afforded an outlet for the surplus produce of a country, and enabled a portion of the capital of the country to replace itself with a profit. These expressions suggest ideas inconsistent with a clear conception of the phenomena. The expression, surplus

produce, seems to imply that a country is under some kind of necessity of producing the corn or cloth which it exports; so that the portion which it does not itself consume, if not wanted and consumed elsewhere, would either be produced in sheer waste, or if it were not produced, the corresponding portion of capital would remain idle, and the mass of productions in the country would be diminished by so much. Either of these suppositions would be entirely erroneous. The country produces an exportable article, in excess of its own wants, from no inherent necessity, but as the cheapest mode of supplying itself with other things. If prevented from exporting this surplus, it would cease to produce it, and would no longer import anything, being unable to give an equivalent; but the labour and capital which had been employed in producing with a view to exportation, would find immediate employment in producing those desirable objects which were previously brought from abroad: or, if some of them could not be produced, in producing substitutes for them. These articles would of course be produced at a greater cost than that of the things with which they had previously been purchased from foreign countries. But the value and price of the articles would rise in proportion; and the capital would just as much be replaced, with the ordinary profit, from the returns, as it was when employed in producing for the foreign market. The only losers (after the temporary inconvenience of the change) would be the consumers of the heretofore imported articles; who would be obliged either to do without them, consuming in lieu of them something which they did not like so well, or to pay a higher price for them than before.

There is much misconception in the common notion of what commerce does for a country. When commerce is spoken of as a source of national wealth, the imagination fixes itself upon the large fortunes acquired by merchants, rather than upon the saving of price to consumers. But the gains of merchants, when they enjoy no exclusive privilege,

are no greater than the profits obtained by the employment of capital in the country itself. If it be said that the capital now employed in foreign trade could not find employment in supplying the home market, I might reply, that this is the fallacy of general over-production, discussed in a former chapter: but the thing is in this particular case too evident, to require an appeal to any general theory. We not only see that the capital of the merchant would find employment, but we see what employment. There would be employment created, equal to that which would be taken away. Exportation ceasing, importation to an equal value would cease also, and all that part of the income of the country which had been expended in imported commodities, would be ready to expend itself on the same things produced at home, or on others instead of them. Commerce is virtually a mode of cheapening production; and in all such cases the consumer is the person ultimately benefited: the dealer, in the end, is sure to get his profit, whether the buyer obtains much or little for his money. This is said without prejudice to the effect (already touched upon, and to be hereafter fully discussed,) which the cheapening of commodities may have in raising profits; in the case when the commodity cheapened, being one of those consumed by labourers, enters into the cost of labour, by which the rate of profits is determined.

§ 5. Such, then, is the direct economical advantage of foreign trade. But there are, besides, indirect effects, which must be counted as benefits of a high order. One is, the tendency of every extension of the market to improve the processes of production. A country which produces for a larger market than its own, can introduce a more extended division of labour, can make greater use of machinery, and is more likely to make inventions and improvements in the processes of production. Whatever causes a greater quantity of anything to be produced in the same place, tends to the

general increase of the productive powers of the world*. There is another consideration, principally applicable to an early stage of industrial advancement. A people may be in a quiescent, indolent, uncultivated state, with few wants and wishes, all their tastes being either fully satisfied or entirely undeveloped, and they may fail to put forth the whole of their productive energies for want of any sufficient object of desire. The opening of a foreign trade, by making them acquainted with new objects, or tempting them by the easier acquisition of things which they had not previously thought attainable, sometimes works a complete industrial revolution in a country whose resources were previously undeveloped for want of energy and ambition in the people: inducing those who were satisfied with scanty comforts and little work, to work harder for the gratification of their new tastes, and even to save, and accumulate capital, for the still more complete satisfaction of those tastes at a future time.

But the economical advantages of commerce are surpassed in importance by those of its effects which are intellectual and moral. It is hardly possible to overrate the value, for the improvement of human beings, of things which bring them into contact with persons dissimilar to themselves, and with modes of thought and action unlike those with which they are familiar. Commerce is now, what war once was, the principal source of this contact. Commercial adventurers from more advanced countries have generally been the first civilizers of barbarians. And commerce is the purpose of the far greater part of the communication which takes place between civilized nations. Such communication has always been, and is peculiarly in the present age, one of the primary sources of progress. To a being like man, who, as hitherto educated, can scarcely cultivate even a good quality without running it into a fault, it is indispensable to be perpetually comparing his own notions and customs with the

* Vide supra, vol. i. pp. 158 et seqq.

experience and example of persons in different circumstances from himself: and there is no nation which does not need to borrow from others, not merely particular arts or practices, but essential points of character in which its own type is inferior. Finally, commerce first taught nations to see with good will the wealth and prosperity of one another. Before, the patriot wished all countries weak, poor, and ill-governed, but his own: he now sees in their wealth and progress a direct source of wealth and progress to his own country. It was in vain to inculcate feelings of brotherhood among mankind by moral influences alone, unless a sense of community of interest could also be established; and that sense we owe to commerce. It is commerce which is rapidly rendering war obsolete, by strengthening and multiplying the personal interests which are in natural opposition to it. And since war is now almost the only event, not highly improbable, which could throw back for any length of time the progress of human improvement, it may be said without exaggeration that the great extent and rapid increase of international trade, in being the principal guarantee of the peace of the world, is the great permanent security for the uninterrupted progress of the ideas, the institutions, and the character of the human race.

CHAPTER XVIII.

OF INTERNATIONAL VALUES.

§ 1. The values of commodities produced at the same place, or in places sufficiently adjacent for capital to move freely between them—let us say, for simplicity, of commodities produced in the same country—depend (temporary fluctuations apart) upon their cost of production. But the value of a commodity brought from a distant place, especially from a foreign country, does not depend on its cost of production in the place from whence it comes. On what, then, does it depend? The value of a thing in any place, depends on the cost of its acquisition in that place; which, in the case of an imported article, means the cost of production of the thing which is exported to pay for it.

Since all trade is in reality barter, money being a mere instrument for exchanging things against one another, we will, for simplicity, begin by supposing the international trade to be in form, what it always is in reality, an actual trucking of one commodity against another. As far as we have hitherto proceeded, we have found all the laws of interchange to be essentially the same, whether money is used or not; money never governing, but always obeying, those general laws.

If, then, England imports wine from Spain, giving for every pipe of wine a bale of cloth, the exchange-value of a pipe of wine in England will not depend upon what the production of the wine may have cost in Portugal, but upon what the production of the cloth has cost in England. Though the wine may have cost in Portugal the equivalent of only ten days labour, yet, if the cloth costs in England twenty days labour, the wine, when brought to England, will exchange for the produce of twenty days English labour,

plus the cost of carriage, including the usual profit on the importer's capital during the time it is locked up and withheld from other employment.

The value, then, in any country, of a foreign commodity, depends on the quantity of home produce which must be given to the foreign country in exchange for it. In other words, the values of foreign commodities depend on the terms of international exchange. What, then, do these depend upon? What is it, which, in the case supposed, causes a pipe of wine from Spain to be exchanged with England for exactly that quantity of cloth? We have seen that it is not their cost of production. If the cloth and the wine were both made in Spain, they would exchange at their cost of production in Spain; if they were both made in England, they would exchange at their cost of production in England: but all the cloth being made in England, and all the wine in Spain, they are in circumstances to which we have already determined that the law of cost of production is not applicable. We must accordingly, as we have done before in a similar embarrassment, fall back upon an antecedent law, that of supply and demand: and in this we shall again find the solution of our difficulty.

I have entered into this question very fully in a separate Essay, already once referred to; and a repetition of part of the exposition then given, will answer our purpose better than an alteration made merely for alteration's sake. I must give notice that we are now in the region of the most complicated questions which political economy affords; that the subject is one which cannot possibly be made elementary; and that a more continuous effort of attention than has yet been required, will be necessary to follow the series of deductions. The thread, however, which we are about to take in hand, is in itself very simple and manageable; the only difficulty is in following it through the windings and entanglements of complex international transactions.

§ 2. "When the trade is established between the two countries, the two commodities will exchange for each other at the same rate of interchange in both countries—bating the cost of carriage, of which, for the present, it will be more convenient to omit the consideration.—Supposing, therefore, for the sake of argument, that the carriage of the commodities from one country to the other could be effected without labour and without cost, no sooner would the trade be opened than the value of the two commodities, estimated in each other, would come to a level in both countries.

"Suppose that 10 yards of broadcloth cost in England as much labour as 15 yards of linen, and in Germany as much as 20." In common with most of my predecessors, I find it advisable, in these intricate investigations, to give distinctness and fixity to the conception by numerical examples. These examples must sometimes, as in the present case, be purely supposititious. I should have greatly preferred real ones; but all that is essential is, that the numbers should be such as admit of being easily followed through the subsequent combinations into which they enter.

This supposition then being made, it would be the interest of England to import linen from Germany, and of Germany to import cloth from England. "When each country produced both commodities for itself, 10 yards of cloth exchanged for 15 yards of linen in England, and for 20 in Germany. They will now exchange for the same number of yards of linen in both. For what number? If for 15 yards, England will be just as she was, and Germany will gain all. If for 20 yards, Germany will be as before, and England will derive the whole of the benefit. If for any number intermediate between 15 and 20, the advantage will be shared between the two countries. If, for example, 10 yards of cloth exchange for 18 of linen, England will gain an advantage of 3 yards on every 15, Germany will save 2 out of every 20. The problem is, what are the causes which determine the propor-

tion in which the cloth of England and the linen of Germany will exchange for each other?

“As exchange value, in this case as in every other, is proverbially fluctuating, it does not matter what we suppose it to be when we begin: we shall soon see whether there be any fixed point about which it oscillates, which it has a tendency always to approach to, and to remain at. Let us suppose, then, that by the effect of what Adam Smith calls the higgling of the market, 10 yards of cloth, in both countries, exchange for 17 yards of linen.

“The demand for a commodity, that is, the quantity of it which can find a purchaser, varies, as we have before remarked, according to the price. In Germany the price of 10 yards of cloth is now 17 yards of linen; or whatever quantity of money is equivalent in Germany to 17 yards of linen. Now, that being the price, there is some particular number of yards of cloth, which will be in demand, or will find purchasers, at that price. There is some given quantity of cloth, more than which could not be disposed of at that price; less than which, at that price, would not fully satisfy the demand. Let us suppose this quantity to be 1,000 times 10 yards.

“Let us now turn our attention to England. There, the price of 17 yards of linen is 10 yards of cloth, or whatever quantity of money is equivalent in England to 10 yards of cloth. There is some particular number of yards of linen which, at that price, will exactly satisfy the demand, and no more. Let us suppose that this number is 1000 times 17 yards.

“As 17 yards of linen are to 10 yards of cloth, so are 1000 times 17 yards to 1,000 times 10 yards. At the existing exchange value, the linen which England requires will exactly pay for the quantity of cloth which, on the same terms of interchange, Germany requires. The demand on each side is precisely sufficient to carry off the supply on the other. The conditions required by the principle of demand and supply are fulfilled, and the two commodities will con-

tinue to be interchanged, as we supposed them to be, in the ratio of 17 yards of linen for 10 yards of cloth.

“But our supposition might have been different. Suppose that, at the assumed rate of interchange, England had been disposed to consume no greater quantity of linen than 800 times 17 yards: it is evident that, at the rate supposed, this would not have sufficed to pay for the 1,000 times 10 yards of cloth which we have supposed Germany to require at the assumed value. Germany would be able to procure no more than 800 times 10 yards, at that price. To procure the remaining 200, which she would have no means of doing but by bidding higher for them, she would offer more than 17 yards of linen in exchange for 10 yards of cloth: let us suppose her to offer 18. At that price, perhaps, England would be inclined to purchase a greater quantity of linen. She would consume, possibly, at that price, 900 times 18 yards. On the other hand, cloth having risen in price, the demand of Germany for it would probably have diminished. If, instead of 1,000 times 10 yards, she is now contented with 900 times 10 yards, these will exactly pay for the 900 times 18 yards of linen which England is willing to take at the altered price: the demand on each side will again exactly suffice to take off the corresponding supply; and 10 yards for 18 will be the rate at which, in both countries, cloth will exchange for linen.

“The converse of all this would have happened, if instead of 800 times 17 yards, we had supposed that England, at the rate of 10 for 17, would have taken 1200 times 17 yards of linen. In this case, it is England whose demand is not fully supplied; it is England who, by bidding for more linen, will alter the rate of interchange to her own disadvantage; and 10 yards of cloth will fall, in both countries, below the value of 17 yards of linen. By this fall of cloth, or what is the same thing, this rise of linen, the demand of Germany for cloth will increase, and the demand of England for linen will diminish, till the rate of interchange has so adjusted itself that

the cloth and the linen will exactly pay for one another; and when once this point is attained, values will remain without further alteration.

"It may be considered, therefore, as established, that when two countries trade together in two commodities, the exchange value of these commodities relatively to each other will adjust itself to the inclinations and circumstances of the consumers on both sides, in such manner that the quantities required by each country, of the articles which it imports from its neighbour, shall be exactly sufficient to pay for one another. As the inclinations and circumstances of consumers cannot be reduced to any rule, so neither can the proportions in which the two commodities will be interchanged. We know that the limits within which the variation is confined, are the ratio between their costs of production in the one country, and the ratio between their costs of production in the other. Ten yards of cloth cannot exchange for more than 20 yards of linen, nor for less than 15. But they may exchange for any intermediate number. The ratios, therefore, in which the advantage of the trade may be divided between the two nations, are various. The circumstances on which the proportionate share of each country more remotely depends, admit only of a very general indication.

"It is even possible to conceive an extreme case, in which the whole of the advantage resulting from the interchange would be reaped by one party, the other country gaining nothing at all. There is no absurdity in the hypothesis that, of some given commodity, a certain quantity is all that is wanted at any price; and that, when that quantity is obtained, no fall in the exchange value would induce other consumers to come forward, or those who are already supplied, to take more. Let us suppose that this is the case in Germany with cloth. Before her trade with England commenced, when 10 yards of cloth cost her as much labour as 20 yards of linen, she nevertheless consumed as much cloth as she wanted under any circumstances, and, if she could

obtain it at the rate of 10 yards of cloth for 15 of linen, she would not consume more. Let this fixed quantity be 1000 times 10 yards. At the rate, however, of 10 for 20, England would want more linen than would be equivalent to this quantity of cloth. She would, consequently, offer a higher value for linen; or, what is the same thing, she would offer her cloth at a cheaper rate. But, as by no lowering of the value could she prevail on Germany to take a greater quantity of cloth, there would be no limit to the rise of linen or fall of cloth, until the demand of England for linen was reduced by the rise of its value, to the quantity which 1000 times 10 yards of cloth would purchase. It might be, that to produce this diminution of the demand, a less fall would not suffice than that which would make 10 yards of cloth exchange for 15 of linen. Germany would then gain the whole of the advantage, and England would be exactly as she was before the trade commenced. It would be for the interest, however, of Germany herself to keep her linen a little below the value at which it could be produced in England, in order to keep herself from being supplanted by the home producer. England, therefore, would always benefit in some degree by the existence of the trade, though it might be in a very trifling one."

In this statement, I conceive, is contained the principle of International Values; which it only remains to follow into its applications. I have, as is indispensable in such abstract and hypothetical cases, supposed the circumstances to be much less complex than they really are: in the first place, by suppressing the cost of carriage; next, by supposing that there are only two countries trading together; and lastly, that they trade only in two commodities. To complete the exposition, it is necessary to restore the various circumstances thus temporarily left out to simplify the argument. Those who are accustomed to any kind of scientific investigation will probably see, without formal proof, that the introduction of these circumstances cannot alter the theory

of the subject. Trade among any number of countries, and in any number of commodities, must take place on the same essential principles as trade between two countries and in two commodities. Introducing a greater number of agents precisely similar, cannot change the law of their action, no more than putting additional weights into the two scales of a balance alters the law of gravitation. It alters nothing but the numerical results. For more complete satisfaction, however, we will enter into the complex cases with the same particularity with which we have stated the simpler one.

§ 3. First, let us introduce the element of cost of carriage. The chief difference will then be, that the cloth and the linen will no longer exchange for each other at precisely the same rate in both countries. Linen, having to be carried to England, will be dearer there by its cost of carriage; and cloth will be dearer in Germany by the cost of carrying it from England. Linen, estimated in cloth, will be dearer in England than in Germany, by the cost of carriage of both articles; and so will cloth in Germany, estimated in linen. Suppose that the cost of carriage of each is equivalent to one yard of linen; and suppose that, if they could have been carried without cost, the terms of interchange would have been 10 yards of cloth for 17 of linen. It seems at first that each country will pay its own cost of carriage; that is, the carriage of the article it imports; that in Germany 10 yards of cloth will exchange for 18 of linen, namely the original 17, and 1 to cover the cost of carriage of the cloth; while in England, 10 yards of cloth will only purchase 16 of linen, 1 yard being deducted for the cost of carriage of the linen. This, however, cannot be affirmed with certainty; it will only be true, if the linen which the English consumers would take at the price of 10 for 16, exactly pays for the cloth which the German consumers would take at 10 for 18. The values must be those, whatever they are, which will establish this equilibrium. No absolute rule, therefore, can be laid down

for the division of the cost, no more than for the division of the advantage: and it does not follow that in whatever ratio the one is divided, the other will be divided in the same. It is impossible to say, if the cost of carriage could be annihilated, whether the producing or the importing country would be most benefitted. All would depend on the play of international demand.

Cost of carriage has one effect more. But for it, every commodity would be either regularly imported or regularly exported. A country would make nothing for itself which it did not also make for other countries. But in consequence of cost of carriage there are many things, especially bulky articles, which every or almost every country produces within itself. After exporting the things in which it can employ itself most advantageously, and importing those in which it is under the greatest disadvantage, there are many lying between, of which the relative cost of production in that and in other countries differs so little, that the cost of carriage would absorb more than the whole saving in cost of production which would be obtained by importing one and exporting another. This is the case with numerous commodities of common consumption; including the coarser qualities of many articles of food and manufacture, of which the finer kinds are the subject of extensive international traffic.

§ 4. Let us now introduce a greater number of commodities than the two we have hitherto supposed. Let cloth and linen, however, be still the articles of which the comparative cost of production in England and in Germany differs the most; so that if they were confined to two commodities, these would be the two which it would be most their interest to exchange. We will now again omit cost of carriage, which, having been shown not to affect the essentials of the question, does but embarrass unnecessarily the statement of it. Let us suppose, then, that the demand of

England for linen is either so much greater than that of Germany for cloth, or so much more extensible by cheapness, that if England had no commodity but cloth which Germany would take, the demand of England would force up the terms of interchange to 10 yards of cloth for only 16 of linen, so that England would gain only the difference between 15 and 16, Germany the difference between 16 and 20. But let us now suppose that England has also another commodity, say iron, which is in demand in Germany, and that the quantity of iron which is of equal value in England with 10 yards of cloth, (let us call this quantity a hundred weight) will, if produced in Germany, cost as much labour as 18 yards of linen, so that if offered by England for 17, it will undersell the German producer. In these circumstances, linen will not be forced up to the rate of 16 yards for 10 of cloth, but will stop at 17; for although, at that rate of interchange, Germany will not take enough cloth to pay for all the linen required by England, she will take iron for the remainder, and it is the same thing to England whether she gives a hundred weight of iron or 10 yards of cloth, both being made at the same cost. If we now superadd coals or cottons on the side of England, and wine, or corn, or timber, on the side of Germany, it will make no difference in the principle. The exports of each country must exactly pay for the imports; meaning now the aggregate exports and imports, not those of particular commodities taken singly. The produce of fifty days English labour, whether in cloth, coals, iron, or any other exports, will exchange for the produce of forty, or fifty, or sixty days German labour, in linen, wine, corn, or timber, according to the international demand. There is some proportion at which the demand of the two countries for each other's products will exactly correspond; so that the things supplied by England to Germany will be completely paid for, and no more, by those supplied by Germany to England. This accordingly will be the ratio in which the produce of English and the produce of German labour will exchange for one another.

If, therefore, it be asked what country draws to itself the greatest share of the advantage of any trade it carries on, the answer is, the country for whose productions there is in other countries the greatest demand, and a demand the most susceptible of increase from additional cheapness. In so far as the productions of any country possess this property, the country obtains all foreign commodities at less cost. It gets its imports cheaper, the greater the intensity of the demand in foreign countries for its exports. It also gets its imports cheaper, the less the extent and intensity of its own demand for them. The market is cheapest to those whose demand is small. A country which desires few foreign productions, and only a limited quantity of them, while its own commodities are in great request in foreign countries, will obtain its limited imports at extremely small cost; that is, in exchange for the produce of a very small quantity of its labour and capital.

Lastly, having introduced more than the original two commodities into the hypothesis, let us also introduce more than the original two countries. After the demand of England for the linen of Germany has raised the rate of interchange to 10 yards of cloth for 16 of linen, suppose a trade opened between England and some other country which also exports linen. And let us suppose that if England had no trade but with this third country, the play of international demand would enable her to obtain from it, for 10 yards of cloth or its equivalent, 17 yards of linen. She evidently would not go on buying linen from Germany at the former rate: Germany would be undersold, and must consent to give 17 yards, like the other country. In this case, the circumstances of production and of demand in the third country are supposed to be in themselves more advantageous to England than the circumstances of Germany; but this supposition is not necessary: we might suppose, that if the trade with Germany did not exist, England would be obliged to give to the other country the same advantageous terms which she gives to Germany; 10 yards of cloth for 16, or even less

than 16, of linen. Even so, the opening of the third country makes a great difference in favour of England. There is now a double market for English exports, while the demand of England for linen is only what it was before. This necessarily obtains for England more advantageous terms of interchange. The two countries, requiring much more of her produce than was required by either alone, must, in order to obtain it, force an increased demand for their exports, by offering them at a lower value.

It deserves notice, that this effect in favour of England from the opening of another market for her exports, will equally be produced even though the country from which the demand comes should have nothing to sell which England is willing to take. Suppose that the third country, though she requires cloth or iron from England, produces no linen, nor any other article which is in demand there. She, however, produces exportable articles, or she would have no means of paying for imports: her exports, though not suitable to the English consumer, can find a market somewhere. As we are only supposing three countries, we must assume her to find this market in Germany, and to pay for what she imports from England by orders on her German customers. Germany, therefore, besides having to pay for her own imports, now owes a debt to England on account of the third country, and the means for both purposes must be derived from her exportable produce. She must therefore tender that produce to England on terms sufficiently favourable to force a demand equivalent to this double debt. Everything will take place precisely as if the third country had bought German produce with her own goods, and offered that produce to England in exchange for her's. There is an increased demand for English goods, for which German goods have to furnish the payment; and this can only be done by forcing an increased demand for them in England, that is, by lowering their value. Thus an increase of demand for a country's exports, in any foreign country, enables her to obtain more cheaply

even those imports which she procures from other quarters. And conversely, an increase of her own demand for any foreign commodity, compels her, *ceteris paribus*, to pay dearer for all foreign commodities.

§ 5. The law which we have now illustrated, may be appropriately named, the Equation of International Demand. It may be concisely stated as follows. The produce of a country exchanges for the produce of other countries, at such values as are required in order that the whole of her exports may exactly pay for the whole of her imports. This law of International Values is but an extension of the more general law of Value, which we called the Equation of Supply and Demand*. We have seen that the value of a commodity always so adjusts itself as to bring the demand to the exact level of the supply. But all trade, either between nations or individuals, is an interchange of commodities, in which the things that they respectively have to sell, constitute also their means of purchase: the supply brought by the one constitutes his demand for what is brought by the other. So that supply and demand are but another expression for reciprocal demand: and to say that value will adjust itself so as to equalize demand with supply, is in fact to say that it will adjust itself so as to equalize the demand on one side with the demand on the other.

To trace the consequences of the law of International Values through their wide ramifications, would occupy more space than can be devoted to such a purpose in the present treatise. Several of those consequences were indicated in the Essay already quoted; and others have been pointed out in the writings of Colonel Torrens, who appears to me substantially correct in his general view of the subject, and who has supported it with great closeness and consecutiveness of reasoning, though his conclusions are occasionally pushed much

* *Supra*, vol. i. p. 529.

beyond what appear to me the proper limits of the principle on which they are grounded.

There is one special application of the law, which I think it advisable to notice, both as being in itself not unimportant, and as bearing on the question which will occupy us in the next chapter, but especially as conducing to the more full and clear understanding of the law itself.

We have seen that the value at which a country purchases a foreign commodity, does not conform to the cost of production in the country from which the commodity comes. Suppose now a change in that cost of production; an improvement, for example, in the process of manufacture. Will the benefit of the improvement be fully participated in by other countries? Will the commodity be sold as much cheaper to foreigners, as it is produced cheaper at home? This question, and the considerations which must be entered into in order to resolve it, are well adapted to try the worth of the theory.

Let us first suppose, that the improvement is of a nature to create a new branch of export; to make foreigners resort to the country for a commodity which they had previously produced at home. On this supposition, the foreign demand for the productions of the country is increased; which necessarily alters the international values to its advantage, and to the disadvantage of foreign countries, who, therefore, though they participate in the benefit of the new product, must purchase that benefit by paying for all the other productions of the country at a dearer rate than before. How much dearer, will depend on the degree necessary for re-establishing, under these new conditions, the Equation of International Demand. These consequences follow in a very obvious manner from the law of international values, and I shall not occupy space in illustrating them, but shall pass to the more frequent case, of an improvement which does not create a new article of export, but lowers the cost of production of something which the country already exported.

It being advantageous, in discussions of this complicated nature, to employ definite numerical amounts, we shall return to our original example. Ten yards of cloth, if produced in Germany, would require the same amount of labour and capital as twenty yards of linen; but, by the play of international demand, they can be obtained from England for seventeen. Suppose now, that by a mechanical improvement made in Germany, and not capable of being transferred to England, the same quantity of labour and capital which produced twenty yards of linen, is enabled to produce thirty. Linen falls one-third in value in the German market, as compared with other commodities produced in Germany. Will it also fall one-third as compared with English cloth, thus giving to England, in common with Germany, the full benefit of the improvement? Or (ought we not rather to say), since the cost to England of *obtaining* linen was not regulated by the cost to Germany of *producing* it, and since England, accordingly, did not get the entire benefit even of the twenty yards which Germany *could* have given for ten yards of cloth, but only obtained seventeen—why should she now obtain more, merely because this theoretical limit is removed ten degrees further off?

It is evident that in the outset, the improvement will lower the value of linen in Germany, in relation to all other commodities in the German market, including, among the rest, even the imported commodity, cloth. If 10 yards of cloth previously exchanged for 17 yards of linen, they will now exchange for half as much more, or $25\frac{1}{2}$ yards. But whether they will continue to do so, will wholly depend on the effect which this increased cheapness of linen produces on the international demand. The demand for linen in England could scarcely fail to be increased. But it might be increased either in proportion to the cheapness, or in a greater proportion than the cheapness, or in a less proportion.

If the demand was increased in the same proportion with

the cheapness, England would take as many times $25\frac{1}{2}$ yards of linen, as the number of times 17 yards which she took previously. She would expend in linen exactly as much of cloth, or of the equivalents of cloth, as much in short of the collective income of her people, as she did before. Germany, on her part, would probably require, at that rate of interchange, the same quantity of cloth as before, because it would in reality cost her exactly as much; $25\frac{1}{2}$ yards of linen being now of the same value in her market, as 17 yards were before. In this case, therefore, 10 yards of cloth for $25\frac{1}{2}$ of linen is the rate of interchange which under these new conditions would restore the equation of international demand; and England would obtain linen one-third cheaper than before, being the same advantage as was obtained by Germany.

It might happen, however, that this great cheapening of linen would increase the demand for it in England in a greater ratio than the increase of cheapness; and that if she before wanted 1000 times 17 yards, she would now require more than 1000 times $25\frac{1}{2}$ yards to satisfy her demand. If so, the equation of international demand cannot establish itself at that rate of interchange; to pay for the linen England must offer cloth on more advantageous terms: say, for example, 10 yards for 21 of linen; so that England will not have the full benefit of the improvement in the production of linen, while Germany, in addition to that benefit, will also pay less for cloth. But again, it is possible that England might not desire to increase her consumption of linen in even so great a proportion as that of the increased cheapness; she might not desire so great a quantity as 1000 times $25\frac{1}{2}$ yards: and in that case Germany must force a demand, by offering more than $25\frac{1}{2}$ yards of linen for 10 of cloth; linen will be cheapened in England in a still greater degree than in Germany; while Germany will obtain cloth on more unfavourable terms, and at a higher exchange value than before.

After what has already been said, it is not necessary to

particularize the manner in which these results might be modified by introducing into the hypothesis other countries and other commodities. There is a further circumstance by which they may also be modified. In the case supposed, the consumers of Germany have had a part of their incomes set at liberty by the increased cheapness of linen, which they may indeed expend in increasing their consumption of that article, but which they may, likewise, expend in other articles, and among others, in cloth or other imported commodities. This would be an additional element in the international demand, and would modify more or less the terms of interchange.

Of the three possible varieties in the influence of cheapness on demand, which is the more probable? that the demand would be increased more than the cheapness, as much as the cheapness, or less than the cheapness? This depends on the nature of the particular commodity, and on the tastes of purchasers. When the commodity is one in general request, and the fall of its price brings it within the reach of a much larger class of incomes than before, the demand is often increased in a greater ratio than the fall of price, and a larger sum of money is on the whole expended in the article. Such was the case with coffee, when its price was lowered by successive reductions of taxation; and such would probably be the case with sugar, wine, and a large class of commodities which, though not necessaries, are largely consumed, and in which many consumers indulge when the articles are cheap and economize when they are dear. But it more frequently happens that when a commodity falls in price, less money is spent in it than before: a greater quantity is consumed, but not so great a value. The consumer who saves money by the cheapness of the article, will be likely to expend part of his saving in increasing his consumption of other things: and unless the low price attracts a large class of new purchasers who were either not consumers of the article at all, or only in small quantity and occasionally, a less aggregate sum will

be expended on it. Speaking generally, therefore, the third of our three cases is the most probable: and an improvement in an exportable article is likely to be as beneficial, if not more beneficial, to foreign countries, than to the country where the article is produced.

§ 6. We now pass to another essential part of the theory of the subject. There are two senses in which a country obtains commodities cheaper by foreign trade: in the sense of Value, and in the sense of Cost. It gets them cheaper in the first sense, by their falling in value relatively to other things: the same quantity of them exchanging, in the country, for a smaller quantity than before of the other produce of the country. In England, after the trade was opened, all consumers of linen obtained 17 or some greater number of yards for the same quantity of all other things for which they before obtained only 15. The degree of cheapness, in this sense of the term, depends on the law which has now been so copiously illustrated, that of the Equation of International Demand. But in the other sense, that of Cost, a country gets a commodity cheaper, when it obtains a greater quantity of the commodity with the same expenditure of labour and capital. In this sense of the term, cheapness in a great measure depends upon a cause of a different nature: a country gets its imports cheaper, in proportion to the general productiveness of its domestic industry; to the general efficiency of its labour. The labour of one country may be, as a whole, much more efficient than that of another; all or most of the commodities capable of being produced in both, may be produced in one at less absolute cost than in the other; which, as we have seen, will not necessarily prevent the two countries from exchanging commodities. The things which the more favoured country will import from others, are of course those in which it is least superior; but by importing them it acquires, even in those commodities, the same advantage which it possesses in the articles it gives

in exchange for them. Thus the countries which obtain their own productions at least cost, also get their imports at least cost.

This truth will be made more obvious if we suppose two competing countries. England sends cloth to Germany, and gives 10 yards of it for 17 yards of linen, or for something else which in Germany is the equivalent of those 17 yards. Another country, as for example France, does the same. The one giving 10 yards of cloth for a certain quantity of German commodities, so must the other: if, therefore, in England, these 10 yards are produced by only half as much labour as that by which they are produced in France, the linen or other commodities of Germany will cost to England only half the amount of labour which they will cost to France. England would thus obtain her imports at less cost than France, in the ratio of the greater efficiency of her labour in the production of cloth: which might be taken as an approximative estimate of the efficiency of her labour generally; since France, as well as England, by selecting cloth as her article of export, would have shown that (notwithstanding her absolute inferiority) it was still the commodity in which her labour was relatively the most efficient. It follows, therefore, that every country gets its imports at less cost, in proportion to the general efficiency of its labour.

This proposition was first clearly seen and expounded by Mr. Senior*, but only as applicable to the importation of the precious metals. I think it important to point out, that the proposition holds equally true of all other imported commodities; and further, that it is only a portion of the truth. For, in the case supposed, the cost to England of the linen which she pays for with ten yards of cloth, does not depend solely upon the cost to herself of ten yards of cloth, but partly also upon how many yards of linen she obtains in exchange for them. What her imports cost to her is a func-

* Three Lectures on the Cost of Obtaining Money.

tion of two variables; the quantity of her own commodities which she gives for them, and the cost of those commodities. Of these, the last only depends on the efficiency of her labour; the first depends on the law of international values; that is, on the intensity and extensibility of the foreign demand for her commodities, compared with her demand for foreign commodities.

In the case just now supposed of a competition between England and France, the state of international values affected both competitors alike, since they were supposed to trade with the same country, and to export and import the same commodities. The difference, therefore, in what their imports cost them, depended solely on the other cause, the unequal efficiency of their labour. They gave the same quantities; the difference could only be in the cost of production. But if England traded to Germany with cloth, and France with iron, the comparative demand in Germany for those two commodities would bear a share in determining the comparative cost, in labour and capital, with which England and France would obtain German products. If iron were more in demand in Germany than cloth, France would recover, through that channel, part of her disadvantage: if less, her disadvantage would be increased. The efficiency, therefore, of a country's labour, is not the only thing which determines even the *cost* at which that country obtains imported commodities—while it has no share whatever in determining either their exchange *value*, or, as we shall presently see, their *price*.

CHAPTER XIX.

OF MONEY, CONSIDERED AS AN IMPORTED COMMODITY.

§ 1. THE degree of progress which we have now made in the theory of Foreign Trade, puts it in our power to supply what was previously deficient in our view of the theory of Money; and this, when completed, will in its turn enable us to conclude the subject of Foreign Trade.

Money, or the material of which it is composed, is, in Great Britain, and in most other countries, a foreign commodity. Its value and distribution must therefore be regulated, not by the law of value which obtains in adjacent places, but by that which is applicable to imported commodities—the law of International Values.

In the discussion into which we are now about to enter, I shall use the terms Money and the Precious Metals indiscriminately. This may be done without leading to any error; it having been shewn that the value of money, when it consists of the precious metals, or even of a paper currency convertible into them on demand, is entirely governed by the value of the metals themselves; from which it never differs, except by the expense of coinage when this is paid by the individual and not by the state.

Money is brought into a country in two different ways. It is imported (chiefly in the form of bullion) like any other merchandize, as being an advantageous article of commerce. It is also imported in its other character of a medium of exchange, to pay some debt due to the country, either for goods exported or on any other account. There are other ways in which it may be introduced casually; these are the two in which it is received in the ordinary course of business,

and which determine its value. The existence of these two distinct modes in which money flows into a country, while other commodities are habitually introduced only in the first of these modes, occasions somewhat more of complexity and obscurity than exists in the case of other commodities; and for this reason only is any special and minute exposition necessary.

§ 2. In so far as the precious metals are imported in the ordinary way of commerce, their value must depend on the same causes, and conform to the same laws, as the value of any other foreign production. It is in this mode chiefly that gold and silver diffuse themselves from the mining countries into all other parts of the commercial world. They are the staple commodities of those countries, or at least are among their great articles of regular export; and are shipped on speculation, in the same manner as other exportable commodities. The quantity, therefore, which a country (say England) will give of its own produce, for a certain quantity of bullion, will depend, if we suppose only two countries and two commodities, upon the demand in England for bullion, compared with the demand in the mining country (which we will call Brazil) for what England has to give. They must exchange in such proportions as will leave no unsatisfied demand on either side, to alter values by its competition. The bullion required by England must exactly pay for the cottons or other English commodities required by Brazil. If, however, we substitute for this simplicity the degree of complication which really exists, the equation of international demand must be established not between the bullion wanted in England and the cottons or broadcloth wanted in Brazil, but between the whole of the imports of England and the whole of her exports. The demand in foreign countries for English products, must be brought into equilibrium with the demand in England for the products of foreign countries; and all foreign commodities, bullion among the

rest, must be exchanged against English products in such proportions, as will, by the effect they produce on the demand, establish this equilibrium.

There is nothing in the peculiar nature or uses of the precious metals, which should make them an exception to the general principles of demand. So far as they are wanted for purposes of luxury or the arts, the demand increases with the cheapness, in the same irregular way as the demand for any other commodity. So far as they are required for money, the demand increases with the cheapness in a perfectly regular way, the quantity needed being always in inverse proportion to the value. This is the only real difference, in respect to demand, between money and other things; and for the present purpose it is a difference altogether immaterial.

Money, then, if imported solely as a merchandize, will, like other imported commodities, be of lowest value in the countries for whose exports there is the greatest foreign demand, and which have themselves the least demand for foreign commodities. To these two circumstances it is however necessary to add two others, which produce their effect through cost of carriage. The cost of obtaining bullion is compounded of two elements; the goods given to purchase it, and the expense of transport: of which last, the bullion countries will bear a part, (though an uncertain part), in the adjustment of international values. The expense of transport is partly that of carrying the goods to the bullion countries, and partly that of bringing back the bullion: both these items are influenced by the distance from the mines; and the former is also much affected by the bulkiness of the goods. Countries whose exportable produce consists of the finer manufactures, obtain bullion, as well as all other foreign articles, *ceteris paribus* at less expense, than countries which export nothing but bulky raw produce.

To be quite accurate, therefore, we must say—The countries whose exportable productions are most in demand abroad, and contain greatest value in smallest bulk, which are

nearest to the mines, and which have least demand for foreign productions, are those in which money will be of lowest value, or in other words, in which prices will habitually range the highest. If we are speaking not of the value of money, but of its cost, (that is, the quantity of the country's labour which must be expended to obtain it), we must add to these four conditions of cheapness a fifth condition, namely, "whose productive industry is the most efficient." This, however, does not at all affect the value of money, estimated in commodities: it affects the general abundance and facility with which all things, money and commodities together, can be obtained.

Although, therefore, Mr. Senior is right in pointing out the great efficiency of English labour as the chief cause why the precious metals are obtained at less *cost* by England than by most other countries, I cannot admit that it at all accounts for their being of less *value*; for their going less far in the purchase of commodities. This, in so far as it is a fact, and not an illusion, must be occasioned by the great demand in foreign countries for the staple commodities of England, and the generally unbulky character of those commodities, compared with the corn, wine, timber, sugar, wool, hides, tallow, hemp, flax, tobacco, raw cotton, &c., which form the exports of other commercial countries. These two causes will account for a somewhat higher range of general prices in England than elsewhere, notwithstanding the counteracting influence of her own great demand for foreign commodities. I am, however, strongly of opinion, that the high prices of commodities, and low purchasing power of money in England, are more apparent than real. Food, indeed, is somewhat dearer; and food composes so large a portion of the expenditure when the income is small and the family large, that to such families England is a dear country. Services also, of most descriptions, are dearer than on the Continent, from the less costly manner in which the poorer classes on the Continent are contented to live. But almost all sorts

of manufactured commodities are decidedly cheaper; or would be so, if buyers would be content with the same quality of material and of workmanship. What is called the dearness of living in England, is mainly an affair not of necessity but of foolish custom; it being thought imperative by all classes in England above the condition of a day-labourer, that the things they consume should either be of the same quality with those used by much richer people, or at least should be as nearly as possible undistinguishable from them in outward appearance.

§ 3. From the preceding considerations, it appears that those are greatly in error who contend (as has been done in the controversies called forth by the recent publications of Colonel Torrens) that the value of money, in countries where it is an imported commodity, must be entirely regulated by its value in the countries which produce it; and cannot be raised or lowered in any permanent manner unless some change has taken place in the cost of production at the mines. On the contrary, any circumstance which disturbs the equation of international demand with respect to a particular country, not only may, but must, affect the value of money in that country—its value at the mines remaining the same. The opening of a new branch of export trade from England; an increase in the foreign demand for English products, either by the natural course of events or by the abrogation of duties; a check to the demand in England for foreign commodities, by the laying on of import duties in England or of export duties elsewhere; these, and all other events of similar tendency, would make the imports of England (bullion and other things taken together) no longer an equivalent for her exports; and the countries which take her exports would be obliged to offer their commodities, and bullion among the rest, on cheaper terms, in order to re-establish the equation of demand: and thus England would obtain money cheaper, and would acquire a generally higher

range of prices. Incidents the reverse of these would produce effects the reverse—would reduce prices; or, in other words, raise the value of the precious metals. It must be observed, however, that money would be thus raised in value only with respect to home commodities: in relation to all imported articles it would remain as before, since their values would be affected in the same way and in the same degree with its own. A country which, from any of the causes mentioned, gets money cheaper, obtains all its other imports cheaper likewise.

It is by no means necessary that the increased demand for English commodities, which enables England to supply herself with bullion at a cheaper rate, should be a demand in the mining countries. England might export nothing whatever to those countries, and yet might be the country which obtained bullion from them on the lowest terms, provided there were a sufficient intensity of demand in other foreign countries for English goods, which would be paid for circuitously with gold and silver from the mining countries. The whole of its exports are what a country exchanges against the whole of its imports, and not its exports and imports to and from any one country; and the general foreign demand for its productions will determine what equivalent it must give for imported goods, in order to establish an equilibrium between its sales and purchases generally; without regard to the maintenance of a similar equilibrium between it and any country singly.

CHAPTER XX.

OF THE FOREIGN EXCHANGES.

§ 1. WE have thus far considered the precious metals as a commodity, imported like other commodities in the common course of trade, and have examined what are the circumstances which would in that case determine their value. But those metals are also imported in another character, that which belongs to them as a medium of exchange; not as an article of commerce, to be sold for money, but as themselves money, to pay a debt, or effect a transfer of property. It remains to consider whether the liability of gold and silver to be transported from country to country for such purposes, in any way modifies the conclusions we have already arrived at, or places those metals under a different law of value from that to which, in common with all other imported commodities, they would be subject if international trade were an affair of direct barter.

Money is sent from one country to another for various purposes, such as the payment of tributes or subsidies; remittances of revenue to or from dependencies, or of rents or other incomes to their absent owners; emigration of capital, or transmission of it for foreign investment. The most usual purpose, however, is that of payment for goods. To shew in what circumstances money actually passes from country to country for this or any of the other purposes mentioned, it is necessary briefly to state the nature of the mechanism by which international trade is carried on, when it takes place not by barter but through the medium of money.

§ 2. In practice, the exports and imports of a country not only are not exchanged directly against each other, but

often do not even pass through the same hands. Each is separately bought and paid for with money. We have seen however that, even in the same country, money does not actually pass from hand to hand each time that purchases are made with it, and still less does this happen between different countries. The habitual mode of paying and receiving payment for commodities, between country and country, is by bills of exchange.

A merchant in England, A, has exported English commodities, consigning them to his correspondent B in France. Another merchant in France, C, has exported French commodities, suppose of equivalent value, to a merchant D in England. It is evidently unnecessary that B in France should send money to A in England, and that D in England should send an equal sum of money to C in France. The one debt may be applied to the payment of the other, and the double cost of carriage be thus saved. A draws a bill on B for the amount which B owes to him: D, having an equal amount to pay in France, buys this bill from A, and sends it to C, who, at the expiration of the number of days which the bill has to run, presents it to B for payment. Thus the debt due from France to England, and the debt due from England to France, are both paid without sending an ounce of gold or silver from one country to the other.

In this statement however it is supposed, that the sum of the debts due from France to England, and the sum of those due from England to France, are equal; that each country has exactly the same number of ounces of gold or silver to pay and to receive. This implies (if we exclude for the present any other international payments than those occurring in the course of commerce,) that the exports and imports exactly pay for one another, or in other words, that the equation of international demand is established. When such is the fact, the international transactions are liquidated without the passage of any money from one country to the other. But if there is a greater sum due from England to

France, than is due from France to England, or *vice versa*, the debts cannot be simply written off against one another. After the one has been applied, as far as it will go, towards covering the other, the balance must be transmitted in the precious metals. In point of fact, the merchant who has the amount to pay, will even then pay for it by a bill. When a person has a remittance to make to a foreign country, he does not himself search for some one who has money to receive from that country, and ask him for a bill of exchange. In this, as in other branches of business, there is a class of middlemen or brokers, who bring buyers and sellers together, or stand between them, buying bills from those who have money to receive, and selling bills to those who have money to pay. When a customer comes to a broker for a bill on Paris or Amsterdam, the broker sells to him, perhaps the bill he may himself have bought that morning from a merchant, perhaps a bill on his own correspondent in the foreign city: and to enable his correspondent to pay, when due, all the bills he has granted, he remits to him all those which he has bought and has not resold. In this manner these bill-brokers, or exchange-brokers, take upon themselves the whole settlement of the pecuniary transactions between distant places, being remunerated by a small commission or percentage on the amount of each bill which they either sell or buy. Now, if the brokers find that they are asked for bills on the one part, to a greater amount than bills are offered to them on the other, they do not on this account refuse to give them; but since, in that case, they have no means of enabling the correspondents on whom their bills are drawn, to pay them when due, except by transmitting part of the amount in gold or silver, they require from those to whom they sell bills an additional price, sufficient to cover the freight and insurance of the gold and silver, with a profit sufficient to compensate them for their trouble and for the temporary occupation of a portion of their capital. This premium (as it is called,) the buyers are willing to pay, because they must otherwise

go to the expense of remitting the precious metals themselves, and it is done cheaper by those who make doing it a part of their especial business. But although only some of those who have a debt to pay would have actually to remit money, all will be obliged, by each other's competition, to pay the premium; and the brokers are for the same reason obliged to pay it to those whose bills they buy. The reverse of all this happens, if, on the comparison of exports and imports, the country, instead of having a balance to pay, has a balance to receive. The brokers find more bills offered to them, than are sufficient to cover those which they are required to grant. Bills on foreign countries consequently fall to a discount; and the competition among the brokers, which is exceedingly active, prevents them from retaining this discount as a profit for themselves, and obliges them to give the benefit of it to those who buy the bills for purposes of remittance.

Let us suppose that all countries had the same currency, as in the progress of political improvement they one day will have: and, as most familiar to the reader, let us suppose this currency to be the English. When England had the same number of pounds sterling to pay to France, which France had to pay to her, one set of merchants in England would want bills, and another set would have bills to dispose of, for the very same number of pounds sterling; and consequently a bill on France for 100% would sell for exactly 100%, or, in the phraseology of merchants, the exchange would be at par. As France also, on this supposition, would have an equal number of pounds sterling to pay and to receive, bills on England would be at par in France, whenever bills on France were at par in England.

If, however, England had a larger sum to pay to France than to receive from her, there would be persons requiring bills on France for a greater number of pounds sterling than there were bills drawn by persons to whom money was due. A bill on France for 100% would then sell for more than 100%, and

bills would be said to be at a premium. The premium, however, could not exceed the cost and risk of making the remittance in gold, together with a trifling profit; because if it did, the debtor would send the gold itself, in preference to buying the bill.

If, on the contrary, England had more money to receive from France than to pay, there would be bills offered for a greater number of pounds than were wanted for remittance, and the price of bills would fall below par: a bill for 100% might be bought for somewhat less than 100%, and bills would be said to be at a discount.

When England has more to pay than to receive, France has more to receive than to pay, and *vice versa*. When, therefore, in England, bills on France bear a premium, then, in France, bills on England are at a discount: and when bills on France are at a discount in England, bills on England are at a premium in France. If they are at par in either country, they are so, as we have already seen, in both.

Thus do matters stand between countries, or places, which have the same currency. So much of barbarism, however, still remains in the transactions of the most civilized nations, that almost all independent countries choose to assert their nationality by having, to their own inconvenience and that of their neighbours, a peculiar currency of their own. To our present purpose this makes no other difference, than that instead of speaking of *equal* sums of money, we have to speak of *equivalent* sums. By equivalent sums, when both currencies are composed of the same metal, are meant sums which contain exactly the same quantity of the metal, in weight and fineness: but when, as in the case of France and England, the metals are different, what is meant is that the quantity of gold in the one sum, and the quantity of silver in the other, are of the same value in the general market of the world: there being no material difference between one place and another in the relative value of these metals. Suppose 25 francs to be (as within a trifling fraction it is) the equiva-

lent of a pound sterling. The debts and credits of the two countries would be equal, when the one owed as many times 25 francs, as the other owed pounds. When this was the case, a bill on France for 2500 francs would be worth in England 100%, and a bill on England for 100% would be worth in France 2500 francs. The exchange is then said to be at par: and 25 francs (in reality 25 francs and a trifle more) is called the par of exchange with France. When England owed to France more than the equivalent of what France owed to her, a bill for 2500 francs would be at a premium, that is, would be worth more than 100%. When France owed to England more than the equivalent of what England owed to France, a bill for 2500 francs would be worth less than 100%, or would be at a discount.

When bills on foreign countries are at a premium, it is customary to say that the exchanges are against the country, or unfavourable to it. In order to understand these phrases, we must take notice of what "the exchange," in the language of merchants, really means. It means the power which the money of the country has of purchasing the money of other countries. Supposing 25 francs to be the exact par of exchange, then when it requires more than 100% to buy a bill for 2500 francs, 100% of English money are worth less than their real equivalent of French money: and this is called, an exchange unfavourable to England. The only persons in England, however, to whom it is really unfavourable, are those who have money to pay in France; for they come into the bill market as buyers, and have to pay a premium: but to those who have money to receive in France, the same state of things is favourable; for they come as sellers, and receive the premium. The premium, however, indicates that a balance is due by England, which must be eventually liquidated in the precious metals; and since, according to the old theory, the benefit of a trade consisted in bringing money into the country, this prejudice introduced the practice of calling the exchange favourable when it indi-

cated a balance to receive, and unfavourable when it indicated one to pay: and the phrases in turn tended to maintain the prejudice.

§ 3. It might be supposed at first sight that when the exchange is unfavourable, or in other words, when bills are at a premium, the premium must always amount to a full equivalent for the cost of transmitting money: since, as there is really a balance to pay, and as the full cost must therefore be incurred by some of those who have remittances to make, their competition will compel all to submit to an equivalent sacrifice. And such would certainly be the case, if it were always necessary that whatever is destined to be paid should be paid immediately. The expectation of great and immediate foreign payments sometimes produces a most startling effect on the exchanges*. But a small excess of imports above exports, or any other small amount of debt to be paid to foreign countries, does not usually affect the exchanges to the full extent of the cost and risk of transporting bullion. The length of credit allowed, generally permits, on the part of some of the debtors, a postponement of payment, and in the mean time the balance may turn the other way, and restore the equality of debts and credits without any actual trans-

* On the news of Bonaparte's landing from Elba, the price of bills advanced in one day as much as ten per cent. Of course this premium was not a mere equivalent for cost of carriage, since the freight of such an article as gold, even with the addition of war insurance, could never have amounted to so much. This great price was an equivalent not for the difficulty of sending gold, but for the anticipated difficulty of procuring it to send; the expectation being that there would be such immense remittances to the Continent in subsidies and for the support of armies, as would press hard on the stock of bullion in the country (which was then entirely denuded of specie), and this, too, in a shorter time than would allow of its being replenished. Accordingly the price of bullion rose likewise, with the same suddenness. It is hardly necessary to say that this took place during the Bank restriction. In a convertible state of the currency, no such thing could have occurred until the Bank stopped payment.

mission of the metals. And this is the more likely to happen, as there is a self-adjusting power in the variations of the exchange itself. Bills are at a premium because a greater money value has been imported than exported. But the premium is itself an extra profit to those who export. Besides the price they obtain for their goods, they draw for the amount and gain the premium. It is, on the other hand, a diminution of profit to those who import. Besides the price of the goods, they have to pay a premium for remittance. So that what is called an unfavourable exchange is an encouragement to export, and a discouragement to import. And if the balance due is of small amount, and is the consequence of some merely casual disturbance in the ordinary course of trade, it is soon liquidated in commodities, and the account adjusted by means of bills, without the transmission of any bullion. Not so, however, when the excess of imports above exports, which has made the exchange unfavourable, arises from a permanent cause. In that case, what disturbed the equilibrium must have been the state of prices, and it can only be restored by acting on prices. It is impossible that prices should be such as to invite to an excess of imports, and yet that the exports should be kept permanently up to the imports by the extra profit on exportation derived from the premium on bills; for if the exports *were* kept up to the imports, bills would not be at a premium, and the extra profit would not exist. It is through the prices of commodities that the correction must be administered.

Disturbances, therefore, of the equilibrium of imports and exports, and consequent disturbances of the exchange, may be considered as of two classes; the one casual or accidental, which, if not on too large a scale, correct themselves through the premium on bills, without any transmission of the precious metals; the other arising from the general state of prices, which cannot be corrected without the subtraction of actual money from the circulation of one of the countries, or an annihilation of credit equivalent to it, since the

mere transmission of bullion (as distinguished from money), not having any effect on prices, is of no avail to abate the cause from which the disturbance proceeded.

It remains to observe, that the exchanges do not depend on the balance of debts and credits with each country separately, but with all countries taken together. England may owe a balance of payments to France; but it does not follow that the exchange with France will be against England, and that bills on France will be at a premium; because a balance may be due to England from Holland or Hamburg, and she may pay her debt to France with bills on those places; which is technically called arbitration of exchange. There is some little additional expense, partly commission and partly loss of interest, in settling debts in this circuitous manner, and to the extent of that small difference the exchange with one country may vary apart from that with others; but in the main, the exchanges with all foreign countries vary together, according as the country has a balance to receive or to pay on the general result of its foreign transactions.

CHAPTER XXI.

OF THE DISTRIBUTION OF THE PRECIOUS METALS THROUGH THE COMMERCIAL WORLD.

§ 1. HAVING now examined the mechanism by which the commercial transactions between nations are actually conducted, we have next to inquire whether this mode of conducting them makes any difference in the conclusions respecting international values, which we previously arrived at on the hypothesis of barter.

The nearest analogy would lead us to presume the negative. We did not find that the intervention of money and its substitutes made any difference in the law of value as applied to adjacent places. Things which would have been equal in value if the mode of exchange had been by barter, are worth equal sums of money. The introduction of money is a mere addition of one more commodity, of which the value is regulated by the same laws as that of all other commodities. We shall not be surprised, therefore, if we find that international values also are determined by the same causes under a money and bill system, as they would be under a system of barter; and that money has little to do in the matter, except to furnish a convenient mode of comparing values.

All interchange is, in substance and effect, barter: he who sells his productions for money, and with that money buys other goods, really buys those goods with his own produce. And so of nations: their trade is a mere exchange of exports for imports; and whether money is employed or not, things are only in their permanent state when the exports and imports exactly pay for each other. When this is the case, equal sums of money are due from each country to

the other, the debts are settled by bills, and there is no balance to be paid in the precious metals. The trade is in a state like that which is called in mechanics a condition of stable equilibrium.

But the process by which things are brought back to this state when they happen to deviate from it, is, at least outwardly, not the same in a barter system and in a money system. Under the first, the country which wants more imports than its exports will pay for, must offer its exports at a cheaper rate, as the sole means of creating a demand for them sufficient to re-establish the equilibrium. When money is used, the country seems to do a thing totally different. She takes the additional imports at the same price as before, and as she exports no equivalent, the balance of payments turns against her; the exchange becomes unfavourable, and the difference has to be paid in money. This is in appearance a very distinct operation from the former. Let us see if it differs in its essence, or only in its mechanism.

Let the country which has the balance to pay be England, and the country which receives it, France. By this transmission of the precious metals, the quantity of the currency is diminished in England, and increased in France. This I am at liberty to assume. As we shall see hereafter, it would be a very erroneous assumption if made in regard to *all* payments of international balances. A balance which has only to be paid once, such as the payment made for an extra importation of corn in a season of dearth, may be paid from hoards, or from the reserves of bankers, without acting on the circulation. But we are now supposing that there is an excess of imports over exports, arising from the fact that the equation of international demand is not yet established: that there is at the ordinary prices a permanent demand in England for more French goods than the English goods required in France at the ordinary prices will pay for. When this is the case, if a change were not made in the prices,

there would be a perpetually renewed balance to be paid in money. The imports require to be permanently diminished or the exports to be increased; which can only be accomplished through prices; and hence, even if the balances are at first paid from hoards, or by the exportation of bullion, they will reach the circulation at last, for until they do, nothing can stop the drain.

When, therefore, the state of prices is such that the equation of international demand cannot establish itself, the country requiring more imports than can be paid for by her exports; it is a sign that the country has more of the precious metals or their substitutes, in circulation, than can permanently circulate, and must necessarily part with some of them before the balance can be restored. Her currency is accordingly contracted: prices fall, and among the rest, the prices of exportable articles; for which, accordingly, there arises, in foreign countries, a greater demand: while imported commodities have possibly risen in price, from the influx of money into foreign countries, and at all events have not participated in the general fall. But until the increased cheapness of English goods induces foreign countries to take a greater pecuniary value, or until the increased dearness (positive or comparative) of foreign goods makes England take a less pecuniary value, the exports of England will be no nearer to paying for her imports than before, and the stream of the precious metals which had begun to flow out of England, will still flow on. This efflux will continue, until the fall of prices in England brings within reach of the foreign market some commodity which England did not previously send thither; or until the reduced price of the things which she did send, has forced a demand abroad for a sufficient quantity to pay for the imports, aided, perhaps, by a reduction of the English demand for foreign goods, from their enhanced price, either positive or comparative.

Now this is the very process which took place on our original supposition of barter. Not only, therefore, does the

trade between nations tend to the same equilibrium between exports and imports, whether money is employed or not, but the means by which this equilibrium is established are essentially the same. The country whose exports are not sufficient to pay for her imports, offers them on cheaper terms, until she succeeds in forcing the necessary demand: in other words, the Equation of International Demand, under a money system as well as under a barter system, is the law of international trade. Every country exports and imports the very same things, and in the very same quantity, under the one system as under the other. In a barter system, the trade gravitates to the point at which the sum of the imports exactly exchanges for the sum of the exports: in a money system, it gravitates to the point at which the sum of the imports and the sum of the exports exchange for the same quantity of money. And since things which are equal to the same thing are equal to one another, the exports and imports which are equal in money price, would, if money were not used, precisely exchange for one another*.

* The subjoined extract from the separate Essay previously referred to, will give some assistance in following the course of the phenomena. It is adapted to the imaginary case used for illustration throughout that Essay, the case of a trade between England and Germany in cloth and linen.

"We may, at first, make whatever supposition we will with respect to the value of money. Let us suppose, therefore, that before the opening of the trade, the price of cloth is the same in both countries, namely, six shillings per yard. As 10 yards of cloth were supposed to exchange in England for 15 yards of linen, in Germany for 20, we must suppose that linen is sold in England at four shillings per yard, in Germany at three. Cost of carriage and importer's profit are left, as before, out of consideration.

"In this state of prices, cloth, it is evident, cannot yet be exported from England into Germany: but linen can be imported from Germany into England. It will be so; and, in the first instance, the linen will be paid for in money.

"The efflux of money from England, and its influx into Germany, will raise money prices in the latter country, and lower them in the former. Linen will rise in Germany above three shillings per yard, and cloth above six shillings. Linen in England, being imported from Germany, will

§ 2. It thus appears that the law of international values, and, consequently, the division of the advantages of trade

(since cost of carriage is not reckoned) sink to the same price as in that country, while cloth will fall below six shillings. As soon as the price of cloth is lower in England than in Germany, it will begin to be exported, and the price of cloth in Germany will fall to what it is in England. As long as the cloth exported does not suffice to pay for the linen imported, money will continue to flow from England into Germany, and prices generally will continue, to fall in England and rise in Germany. By the fall however, of cloth in England, cloth will fall in Germany also, and the demand for it will increase. By the rise of linen in Germany, linen must rise in England also, and the demand for it will diminish. As cloth fell in price and linen rose, there would be some particular price of both articles at which the cloth exported and the linen imported would exactly pay for each other. At this point prices would remain, because money would then cease to move out of England into Germany. What this point might be, would entirely depend upon the circumstances and inclinations of the purchasers on both sides. If the fall of cloth did not much increase the demand for it in Germany, and the rise of linen did not diminish very rapidly the demand for it in England, much money must pass before the equilibrium is restored; cloth would fall very much, and linen would rise, until England, perhaps, had to pay nearly as much for it as when she produced it for herself. But if, on the contrary, the fall of cloth caused a very rapid increase of the demand for it in Germany, and the rise of linen in Germany reduced very rapidly the demand in England from what it was under the influence of the first cheapness produced by the opening of the trade; the cloth would very soon suffice to pay for the linen, little money would pass between the two countries, and England would derive a large portion of the benefit of the trade. We have thus arrived at precisely the same conclusion, in supposing the employment of money, which we found to hold under the supposition of barter.

"In what shape the benefit accrues to the two nations from the trade, is clear enough. Germany, before the commencement of the trade, paid six shillings per yard for broadcloth: she now obtains it at a lower price. This, however, is not the whole of her advantage. As the money-prices of all her other commodities have risen, the money-incomes of all her producers have increased. This is no advantage to them in buying from each other, because the price of what they buy has risen in the same ratio with their means of paying for it: but it is an advantage to them in buying anything which has not risen, and, still more, anything which has fallen. They, therefore, benefit as consumers of cloth, not merely to the extent to which cloth has fallen, but also to the extent to which other prices have risen.

among the nations which carry it on, are the same, on the supposition of money, as they would be in a state of barter. In international, as in ordinary domestic interchanges, money is to commerce only what oil is to machinery, or railways to locomotion, a contrivance to diminish friction. In order still

Suppose that this is one-tenth. The same proportion of these money-incomes as before, will suffice to supply their other wants; and the remainder, being increased one-tenth in amount, will enable them to purchase one-tenth more cloth than before, even though cloth had not fallen: but it has fallen; so that they are doubly gainers. They purchase the same quantity with less money, and have more to expend upon their other wants.

"In England, on the contrary, general money-prices have fallen. Linen, however, has fallen more than the rest, having been lowered in price by importation from a country where it was cheaper; whereas the others have fallen only from the consequent efflux of money. Notwithstanding, therefore, the general fall of money-prices, the English producers will be exactly as they were in all other respects, while they will gain as purchasers of linen.

"The greater the efflux of money required to restore the equilibrium, the greater will be the gain of Germany, both by the fall of cloth and by the rise of her general prices. The less the efflux of money requisite, the greater will be the gain of England; because the price of linen will continue lower, and her general prices will not be reduced so much. It must not, however, be imagined that high money-prices are a good, and low money-prices an evil, in themselves. But the higher the general money-prices in any country, the greater will be that country's means of purchasing those commodities which, being imported from abroad, are independent of the causes which keep prices high at home."

In practice, the cloth and the linen would not, as here supposed, be at the same price in England and in Germany: each would be dearer in money-price in the country which imported than in that which produced it, by the amount of the cost of carriage, together with the ordinary profit on the importer's capital for the average length of time which elapsed before the commodity could be disposed of. But it does not follow that each country pays the cost of carriage of the commodity it imports; for the addition of this item to the price may operate as a greater check to demand on one side than on the other; and the equation of international demand, and consequent equilibrium of payments, may not be maintained. Money would then flow out of one country into the other, until, in the manner already illustrated, the equilibrium was restored: and, when this was effected, one country would be paying more than its own cost of carriage, and the other less.

further to test these conclusions, let us proceed to re-examine, on the supposition of money, a question which we have already investigated on the hypothesis of barter, namely, to what extent the benefit of an improvement in the production of an exportable article, is participated in by the countries importing it.

The improvement may either consist in the cheapening of some article which was already a staple production of the country, or in the establishment of some new branch of industry, or of some process rendering an article exportable which had not till then been exported at all. It will be convenient to begin with the case of a new export, as being somewhat the simpler of the two.

The first effect is that the article falls in price, and a demand arises for it abroad. This new exportation disturbs the balance, turns the exchanges, money flows into the country (which we shall suppose to be England), and continues to flow until prices rise. This higher range of prices will somewhat check the demand on foreign countries for the new article of export; and will diminish the demand which existed abroad for the other things which England was in the habit of exporting. The exports will thus be diminished; while at the same time the English public, having more money, will have a greater power of purchasing foreign commodities. If they make use of this increased power of purchase, there will be an increase of imports; and by this, and the check to exportation, the equilibrium of imports and exports will be restored. The result to foreign countries will be, that they have to pay dearer than before for their other imports, and obtain the new commodity cheaper than before, but not so much cheaper as England herself does. I say this, being well aware that the article would be actually at the very same price (cost of carriage excepted) in England and in other countries. The cheapness, however, of the article is not measured solely by the money-price, but by that price compared with the money-incomes of the consumers. The

price is the same to the English and to the foreign consumers; but the former pay that price from money-incomes which have been increased by the new distribution of the precious metals; while the latter have had their money-incomes probably diminished by the same cause. The trade, therefore, has not imparted to the foreign consumer the whole, but only a portion, of the benefit which the English consumer has derived from the improvement; while England has also benefited in the prices of foreign commodities. Thus, then, any industrial improvement which leads to the opening of a new branch of export trade, benefits a country not only by the cheapness of the article in which the improvement has taken place, but by a general cheapening of all imported products.

Let us now change the hypothesis, and suppose that the improvement, instead of creating a new export from England, cheapens an existing one. When we examined this case on the supposition of barter, it appeared to us that the foreign consumers might either obtain the same benefit from the improvement as England herself, or a less benefit, or even a greater benefit, according to the degree in which the consumption of the cheapened article is calculated to extend itself as the article diminishes in price. The same conclusions will be found true on the supposition of money.

Let the commodity in which there is an improvement, be cloth. The first effect of the improvement is that its price falls, and there is an increased demand for it in the foreign market. But this demand is of uncertain amount. Suppose the foreign consumers to increase their purchases in the exact ratio of the cheapness, or in other words, to lay out in cloth the same sum of money as before; the same aggregate payment as before will be due from foreign countries to England; the equilibrium of exports and imports will remain undisturbed, and foreigners will obtain the full advantage of the increased cheapness of cloth. But if the foreign demand for cloth is of such a character as to increase in a greater ratio

than the cheapness, a larger sum than formerly will be due to England for cloth, and when paid will raise English prices, the price of cloth included; this rise, however, will affect only the foreign purchaser, English incomes being raised in a corresponding proportion; and the foreign consumer will thus derive a less advantage than England from the improvement. If, on the contrary, the cheapening of cloth does not extend the foreign demand for it in a proportional degree, a less sum of debts than before will be due to England for cloth, while there will be the usual sum of debts due from England to foreign countries; the balance of trade will turn against England, money will be exported, prices (that of cloth included) will fall, and cloth will eventually be cheapened to the foreign purchaser in a still greater ratio, than the improvement has cheapened it to England. These are the very conclusions which we deduced on the hypothesis of barter.

The result of the preceding discussion cannot be better summed up than in the words of Ricardo*. "Gold and silver having been chosen for the general medium of circulation, they are, by the competition of commerce, distributed in such proportions amongst the different countries of the world, as to accommodate themselves to the natural traffic which would take place if no such metals existed, and the trade between countries were purely a trade of barter." Of this principle, so fertile in consequences, previous to which the theory of foreign trade was an unintelligible chaos, Mr. Ricardo, though he did not pursue it into its ramifications, was the real originator. No writer who preceded him appears to have had a glimpse of it: and few are those who even since his time have had an adequate conception of its scientific value.

§ 3. It is now necessary to inquire, in what manner this

* *Principles of Political Economy and Taxation*, 3rd ed. p. 143.

law of the distribution of the precious metals by means of the exchanges, affects the exchange value of money itself; and how it tallies with the law by which we found that the value of money is regulated when imported as a mere article of merchandize. For there is here a semblance of contradiction, which has, I think, contributed more than anything else to make some distinguished political economists resist the evidence of the preceding doctrines. Money, they justly think, is no exception to the general laws of value; it is a commodity like any other, and its average or natural value must depend on the cost of producing, or at least of obtaining it. That its distribution through the world, therefore, and its different value in different places, should be liable to be altered, not by causes affecting itself, but by a hundred causes unconnected with it; by everything which affects the trade in other commodities, so as to derange the equilibrium of exports and imports; appears to these thinkers a doctrine altogether inadmissible.

But the supposed anomaly exists only in semblance. The causes which bring money into or carry it out of a country through the exchanges, to restore the equilibrium of trade, and which thereby raise its value in some countries and lower it in others, are the very same causes on which the local value of money would depend, if it were never imported except as a merchandize, and never except directly from the mines. When the value of money in a country is permanently lowered by an influx of it through the balance of trade, the cause, if it is not diminished cost of production, must be one of those causes which compel a new adjustment, more favourable to the country, of the equation of international demand: namely, either an increased demand abroad for her commodities, or a diminished demand on her part for those of foreign countries. Now an increased foreign demand for the commodities of a country, or a diminished demand in the country for imported commodities, are the very causes which, on the general principles of trade, enable a country to purchase all

imports, and consequently the precious metals, at a lower value. There is therefore no contradiction, but the most perfect accordance, in the results of the two different modes in which the precious metals may be obtained. When money flows from country to country in consequence of changes in the international demand for commodities, and by so doing alters its own local value, it merely realizes, by a more rapid process, the effect which would otherwise take place more slowly, by an alteration in the relative breadth of the streams by which the precious metals flow into different regions of the earth from the mining countries. As therefore we before saw that the use of money as a medium of exchange does not in the least alter the law on which the values of other things, either in the same country or internationally, depend, so neither does it alter the law of the value of the precious metal itself: and there is in the whole doctrine of international values as now laid down, a unity and harmony which is a strong collateral presumption of truth.

§ 4. Before closing this discussion, it is fitting to point out in what manner and degree the preceding conclusions are affected by the existence of international payments not originating in commerce, and for which no equivalent in either money or commodities is expected or received; such as a tribute, or remittances of rent to absentee landlords or of interest to foreign creditors, or a government expenditure abroad, such as England incurs in the management of some of her colonial dependencies.

To begin with the case of barter. The supposed annual remittances being made in commodities, and being exports for which there is to be no return, it is no longer requisite that the imports and exports should pay for one another: on the contrary, there must be an annual excess of exports over imports, equal to the value of the remittance. If, before the country became liable to the annual payment, foreign commerce was in its natural state of equilibrium, it will now be

necessary for the purpose of effecting the remittances, that foreign countries should be induced to take a greater quantity of exports than before; which can only be done by offering those exports on cheaper terms, or in other words, by paying dearer for foreign commodities. The international values will so adjust themselves that either by greater exports, or smaller imports, or both, the requisite excess on the side of exports will be brought about; and this excess will become the permanent state. The result is, that a country which makes regular payments to foreign countries, besides losing what it pays, loses also something more, by the less advantageous terms on which it is forced to exchange its productions for foreign commodities.

The same results follow on the supposition of money. Commerce being supposed to be in a state of equilibrium when the obligatory remittances begin, the first remittance is necessarily made in money. This lowers prices in the remitting country, and raises them in the receiving. The natural effect is that more commodities are exported than before, and fewer imported, and that, on the score of commerce alone, a balance of money will be constantly due from the receiving to the paying country. When the debt thus annually due to the tributary country becomes equal to the annual tribute or other regular payment due from it, no further transmission of money takes place; the equilibrium of exports and imports will no longer exist, but that of payments will; the exchange will be at par, the two debts will be set off against one another, and the tribute or remittance will be virtually paid in goods. The result to the interests of the two countries will be as already pointed out: the paying country will give a higher price for all that it buys from the receiving country, while the latter, besides receiving the tribute, obtains the exportable produce of the tributary country at a lower price.

CHAPTER XXII.

INFLUENCE OF CURRENCY ON THE EXCHANGES AND ON FOREIGN TRADE.

§ 1. IN our inquiry into the laws of international trade, we commenced with the principles which determine international exchanges and international values on the hypothesis of barter. We next shewed that the introduction of money as a medium of exchange, makes no difference in the laws of exchanges and of values between country and country, no more than between individual and individual: since the precious metals, under the influence of those same laws, distribute themselves in such proportions among the different countries of the world, as to allow the very same exchanges to go on, and at the same values, as would be the case under a system of barter. We lastly considered how the value of money itself is affected, by those alterations in the state of trade which arise from alterations either in the demand and supply of commodities or in their cost of production. It remains to consider the alterations in the state of trade which originate not in commodities but in money.

Gold and silver may vary like other things, though they are not liable to vary so much as other things, in their cost of production. The demand for them in foreign countries may also vary. It may increase, by augmented employment of the metals for purposes of art and ornament, or because the increase of production and of transactions has created a greater amount of business to be done by the circulating medium. It may diminish, for the opposite reasons; or from the extension of the economizing expedients by which the use of metallic money is partially dispensed with. These changes act upon the trade between other countries and the

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mining countries, and upon the value of the precious metals, according to the general laws of the value of imported commodities: which have been set forth in the previous chapters with sufficient fulness.

What I propose to examine in the present chapter, is, not those circumstances affecting money, which alter the permanent conditions of its value; but the effects produced on international trade by casual or temporary variations in the value of money, which have no connexion with any causes affecting its permanent value. This is a subject of importance, on account of its bearing upon the practical problem which has excited so much discussion for fifty years past, the regulation of the currency.

§ 2. Let us suppose in any country a circulating medium purely metallic, and a sudden casual increase made to it; for example, by bringing again into circulation hoards of treasure, which had been concealed in a previous period of foreign invasion or internal disorder. The natural effect would be, a rise of prices. This would check exports, and encourage imports; the imports would exceed the exports, the exchanges would become unfavourable, and the newly-acquired stock of money would diffuse itself over all countries with which the supposed country carried on trade, and from them, progressively, through all parts of the commercial world. The money which thus overflowed would spread itself to an equal depth over all commercial countries. For it would go on flowing until the exports and imports again balanced one another: and this (as no change is supposed in the permanent circumstances of international demand) could only be, when the money had diffused itself so equally that prices had risen in the same ratio in all countries, so that the alteration of price would be for all practical purposes ineffective, and the exports and imports, though at a higher money valuation, would be exactly the same as they were originally. This diminished value of money throughout

the world, would cause a suspension, or at least a diminution, of the annual supply from the mines; since the metal would no longer command a value equivalent to its highest cost of production. The annual waste would, therefore, not be fully made up, and the usual causes of destruction would gradually reduce the aggregate quantity of the precious metals to its former amount; after which their production would recommence on its former scale. The discovery of the treasure would thus produce only temporary effects; namely, a brief disturbance of international trade until the treasure had disseminated itself through the world, and then a temporary depression in the value of the metal, below that which corresponds to the cost of producing or of obtaining it; which depression would gradually be corrected, by a temporarily diminished production in the producing countries, and importation in the importing countries.

The same effects which would thus arise from the discovery of a treasure, accompany the process by which bank notes, or any of the other substitutes for money, take the place of the precious metals. Suppose that England possessed a currency wholly metallic, of twenty millions sterling, and that suddenly twenty millions of bank notes were sent into circulation. If these were issued by bankers, they would be employed in loans, or in the purchase of securities, and would therefore create a sudden fall in the rate of interest, which would probably send a great part of the twenty millions of gold out of the country as capital, to seek a higher rate of interest elsewhere, before there had been time for any action on prices. But we will suppose that the notes are not issued by bankers, or money lenders of any kind, but by manufacturers, in the payment of wages and purchase of materials, or by the government in its ordinary expenses, so that the whole amount would be rapidly carried into the markets for commodities. The following would be the natural order of consequences. All prices would rise greatly. Exportation would almost cease; importation would be pro-

digiously stimulated. A great balance of payments would become due; the exchanges would turn against England, to the full extent of the cost of exporting money; and the surplus coin would pour itself rapidly forth, over the various countries of the world, in the order of their proximity, geographically and commercially, to England. The efflux would continue until the currencies of all countries had come to a level; by which I do not mean, until money became of the same value everywhere, but until the differences were only those which existed before, and which corresponded to permanent differences in the cost of obtaining it. When the rise of prices had extended itself in an equal degree to all countries, exports and imports would everywhere revert to what they were at first, would balance one another, and the exchanges would return to par. So large a sum of money as twenty millions, even when spread over the whole surface of the commercial world, would probably raise the general level in a perceptible degree; but for no very long period. No alteration having occurred in the general conditions under which the metals were procured, either in the world at large or in any part of it, the reduced value would no longer be remunerating, and the supply from the mines would cease partially or wholly, until the twenty millions were absorbed; after which absorption, the currencies of all countries would be, in quantity and in value, nearly at their original level. I say nearly, for in strict accuracy there would be a slight difference. A somewhat smaller annual supply of the precious metals would now be required, there being in the world twenty millions less of metallic money undergoing waste. The equilibrium of payments, consequently, between the mining countries and the rest of the world, would thenceforth require that the mining countries should either export rather more of something else, or import rather less of foreign commodities; which implies a somewhat lower range of prices than previously in the mining countries, and a somewhat higher in all others; a scantier currency in the former, and

rather fuller currencies in the latter. This effect, which would be too trifling to require notice except for the illustration of a principle, is the only permanent change which would be produced on international trade, or on the value or quantity of the currency of any country.

Effects of another kind, however, will have been produced. Twenty millions which formerly existed in the unproductive form of metallic money, have been converted into what is, or is capable of becoming, productive capital. This gain is at first made by England at the expense of other countries, who have taken her superfluity of this costly and unproductive article off her hands, giving for it an equivalent value in other commodities. By degrees the loss is made up to those countries by diminished influx from the mines, and finally the world has gained a virtual addition of twenty millions to its productive resources. Adam Smith's illustration, though so well known, deserves for its extreme aptness to be once more repeated. He compares the substitution of paper in the room of the precious metals, to the construction of a highway through the air, by which the ground now occupied by roads would become available for agriculture. As in that case a portion of the soil, so in this a part of the accumulated wealth of the country, would be relieved from a function in which it was only employed in rendering other soils and capitals productive, and would itself become applicable to production; the office it previously fulfilled being equally well discharged by a medium which costs nothing.

The value saved to the community by thus dispensing with metallic money, is a clear gain to those who provide the substitute. They have the use of twenty millions of circulating medium which have cost them only the expense of an engraver's plate. If they employ this accession to their fortunes as productive capital, the produce of the country is increased and the community benefited, as much as by any other capital of equal amount. Whether it is so employed or not, depends, in some degree, upon the mode of issuing it.

If issued by the government, and employed in paying off debt, it would probably become productive capital. The government, however, may prefer employing this extraordinary resource in its ordinary expenses; may squander it uselessly, or make it a mere temporary substitute for taxation to an equivalent amount; in which last case the amount is saved by the taxpayers at large, who either add it to their capital or spend it as income. When paper currency is supplied, as in our own country, by bankers and banking companies, the amount is almost wholly turned into productive capital: for the issuers, being at all times liable to be called upon to refund the value, are under the strongest inducements not to squander it, and the only cases in which it is not forthcoming are cases of fraud or mismanagement. A banker's profession being that of a money lender, his issue of notes is a simple extension of his ordinary occupation. He lends the amount to farmers, manufacturers, or dealers, who employ it in their several businesses. So employed, it yields, like any other capital, wages of labour and profits of stock. The profit is shared between the banker, who receives interest, and a succession of borrowers, mostly for short periods, who after paying the interest, gain a profit in addition, or a convenience equivalent to profit. The capital itself in the long run becomes entirely wages, and when replaced by the sale of the produce, becomes wages again; thus affording a perpetual fund of the value of twenty millions for the maintenance of productive labour, and increasing the annual produce of the country by all that can be produced through the means of a capital of that value. To this gain must be added a further saving to the country, of the annual supply of the precious metals necessary for repairing the wear and tear, and other waste, of a metallic currency.

The substitution, therefore, of paper for the precious metals, should always be carried as far as is consistent with safety; no greater amount of metallic currency being retained, than is necessary to maintain, both in fact and in public belief,

the convertibility of the paper. A country with the extensive commercial relations of England, is liable to be suddenly called upon for large foreign payments, sometimes in loans, or other investments of capital abroad, sometimes as the price of some unusual importation of goods, the most frequent case being that of large importations of food, consequent on a bad harvest. To meet such demands it is necessary that there should be, either in circulation or in the coffers of the banks, coin or bullion to a very considerable amount, and that this, when drawn out by any emergency, should be allowed to return after the emergency is past. But since gold wanted for exportation is almost invariably drawn from the reserves of the banks, and is never likely to be taken directly from the circulation while the banks remain solvent, the only advantage which can be obtained from retaining partially a metallic currency for daily purposes, is that the banks may occasionally replenish their reserves from it.

§ 3. When metallic money had been entirely superseded and expelled from circulation, by the substitution of an equal amount of bank notes, any attempt to keep a still further quantity of paper in circulation must, if the notes are convertible, be a complete failure. The new issue would again set in motion the same train of consequences by which the gold coin had already been expelled. The metals would, as before, be required for exportation, and would be for that purpose demanded from the banks, to the full extent of the superfluous notes; which thus could not possibly be retained in circulation. If, indeed, the notes were inconvertible, there would be no such obstacle to the increase of their quantity. An inconvertible paper acts in the same way as a convertible, while there remains any coin for it to supersede: the difference begins to manifest itself when all the coin is driven from circulation (except what may be retained for the convenience of small change), and the issues still go on increas-

ing. When the paper begins to exceed in quantity the metallic currency which it superseded, prices of course rise: things which were worth 5*l.* in metallic money, become worth 6*l.* in inconvertible paper, or more, as the case may be. But this rise of price will not, as in the cases before examined, stimulate import, and discourage export. The imports and exports are determined by the metallic prices of things, not by the paper prices: and it is only when the paper is exchangeable at pleasure for the metals, that paper prices and metallic prices must correspond.

Let us suppose that England is the country which has the depreciated paper. Suppose that some English production could be bought, while the currency was still metallic, for 5*l.*, and sold in France for 5*l.* 10*s.*, the difference covering the expense and risk, and affording a profit to the merchant. On account of the depreciation, this commodity will now cost in England 6*l.*, and cannot be sold in France for more than 5*l.* 10*s.*, and yet it will be exported as before. Why? Because the 5*l.* 10*s.* which the exporter can get for it in France, is not depreciated paper, but gold or silver; and since in England bullion has risen, in the same proportion with other things—if the merchant brings the gold or silver to England, he can sell his 5*l.* 10*s.* for 6*l.* 12*s.*, and obtain as before 10 per cent for profit and expenses.

It thus appears, that a depreciation of the currency does not affect the foreign trade of the country: this is carried on precisely as if the currency maintained its value. But though the trade is not affected, the exchanges are. When the imports and exports are in equilibrium, the exchange, in a metallic currency, would be at par; a bill on France for the equivalent of five sovereigns, would be worth five sovereigns. But five sovereigns, or the quantity of gold contained in them, having come to be worth in England 6*l.*, it follows that a bill on France for 5*l.* will be worth 6*l.* When, therefore, the *real* exchange is at par, there will be a *nominal* exchange against the country, of as much per cent as the amount of the

depreciation. If the currency is depreciated 10, 15, or 20 per cent, then in whatever way the real exchange, arising from the variations of international debts and credits, may vary, the *quoted* exchange will always differ 10, 15, or 20 per cent from it. However high this nominal premium may be, it has no tendency to send gold out of the country, for the purpose of drawing a bill against it, and profiting by the premium; because the gold so sent must be procured, not from the banks and at par, as in the case of a convertible currency, but in the market, at an advance of price equal to the premium. In such cases, instead of saying that the exchange is unfavourable, it would be a more correct representation to say that the par has altered, since there is now required a larger quantity of English currency to be equivalent to the same quantity of foreign. The exchanges, however, continued to be computed according to the metallic par. The quoted exchanges, therefore, when there is a depreciated currency, are compounded of two elements or factors; the real exchange, which follows the variations of international payments, and the nominal exchange, which varies with the depreciation of the currency, but which, while there is any depreciation at all, must always be unfavourable. Since the amount of depreciation is exactly measured by the degree in which the market price of bullion exceeds the mint valuation, we have a sure criterion to determine what portion of the quoted exchange, being referable to depreciation, may be struck off as nominal; the result so corrected expressing the real exchange.

The same disturbance of the exchanges and of international trade, which is produced by an increased issue of convertible bank notes, is in like manner produced by those extensions of credit, which, as was so fully shown in a preceding chapter, have the same effect on prices as an increase of the currency. Whenever circumstances have given such an impulse to the spirit of speculation as to occasion a great increase of purchases on credit, money prices rise, just as

much as they would have risen if each person who so buys on credit had bought with money. All the effects, therefore, must be similar. As a consequence of high prices, exportation is checked and importation stimulated; though in fact the increase of importation seldom waits for the rise of prices which is the consequence of speculation, inasmuch as some of the great articles of import are usually among the things in which speculative overtrading first shows itself. There is, therefore, in such periods, usually a great excess of imports over exports; and when the time comes at which these must be paid for, the exchanges become unfavourable, and gold flows out of the country. In what precise manner this efflux of gold takes effect on prices, depends on circumstances of which we shall presently speak more fully; but that its effect is to make them recoil downwards, is certain and evident. The recoil, once begun, generally becomes a total rout, and the unusual extension of credit is rapidly exchanged for an unusual contraction of it. Accordingly, when credit has been imprudently stretched, and the speculative spirit carried to excess, the turn of the exchanges, and consequent pressure on the banks to obtain gold for exportation, are generally the proximate cause of the catastrophe. But these phenomena, though a conspicuous accompaniment, are no essential part, of the collapse of credit called a commercial crisis; which, as we formerly showed*, might happen to as great an extent, and is quite as likely to happen, in a country, if any such there were, altogether destitute of foreign trade.

Supra, pp. 54—6.

CHAPTER XXIII.

OF THE RATE OF INTEREST.

§ 1. THE present seems the most proper place for discussing the circumstances which determine the rate of interest. The interest of loans, being really a question of exchange-value, falls naturally into the present division of our subject: and the two topics of Currency and Loans, though in themselves distinct, are so intimately blended in the phenomena of what is called the money market, that it is impossible to understand the one without the other, and in many minds the two subjects are mixed up in the most inextricable confusion.

In the preceding Book* we defined the relation in which interest stands to profit. We found that the gross profit of capital might be distinguished into three parts, which are respectively the remuneration for risk, for trouble, and for the capital itself, and may be termed insurance, wages of superintendence, and interest. After making compensation for risk, that is, after covering the average losses to which capital is exposed, either by the general circumstances of society or by the hazards of the particular employment, there remains a surplus, which partly goes to repay the owner of the capital for his abstinence, and partly the employer of it for his time and trouble. How much goes to the one and how much to the other, is shown by the amount of the remuneration which, when the two functions are separated, the owner of capital can obtain from the employer for its use. This is evidently a question of demand and supply. Nor have demand and supply any different meaning or effect in this case from what they have in all others. The rate of

* Supra, vol. i. pp. 477—80.

interest will be such as to equalize the demand for loans with the supply of them. It will be such, that exactly as much as some people are desirous to borrow at that rate, others shall be willing to lend. If there is more offered than demanded, interest will fall; if more is demanded than offered, it will rise; and in both cases, to the point at which the equation of supply and demand is re-established.

Both the demand and supply of loans fluctuate more incessantly than any other demand or supply whatsoever. The fluctuations in other things depend on a limited number of influencing circumstances; but the desire to borrow, and the willingness to lend, are more or less influenced by every circumstance which affects the state or prospects of industry or commerce, either generally or in any of their branches. The rate of interest, therefore, on good security, which alone we have here to consider (for interest in which considerations of risk bear a part, may swell to any amount) is seldom, in the great centres of money transactions, precisely the same for two days together; as is shewn by the never-ceasing variations in the quoted prices of the funds and other negotiable securities. Nevertheless, there must be, as in other cases of value, some rate which (in the language of Adam Smith and Ricardo) may be called the natural rate; some rate about which the market rate oscillates, and to which it always tends to return. This rate partly depends on the amount of accumulation going on in the hands of persons who cannot themselves attend to the employment of their savings, and partly on the comparative taste existing in the community for the active pursuits of industry, or for the leisure, ease, and independence of an annuitant.

§ 2. To exclude casual fluctuations, we will suppose commerce to be in a quiescent condition, no employment being unusually prosperous, and none particularly distressed. In these circumstances, the more thriving producers and traders have their capital fully employed, and many are able

to transact business to a considerably greater extent than they have capital for. These are naturally borrowers; and the amount which they desire to borrow, and can give security for, constitutes the demand for loans on account of productive employment. To these must be added the loans required by Government, and by landowners or other unproductive consumers who have good security to give. This constitutes the mass of loans for which there is an habitual demand.

Now it is conceivable that there might exist, in the hands of persons disinclined or disqualified for engaging personally in business, a mass of capital equal to, and even exceeding, this demand. In that case there would be an habitual excess of competition on the part of lenders, and the rate of interest would bear a low proportion to the rate of profit. Interest would be forced down to the point which would either tempt borrowers to take a greater amount of loans than they had a reasonable expectation of being able to employ in their business, or would so discourage a portion of the lenders, as to make them either forbear to accumulate, or endeavour to increase their income by engaging in business on their own account, and incurring the risks, if not the labours, of industrial employment.

On the other hand, the capital owned by persons who prefer lending it at interest, or whose avocations prevent them from personally superintending its employment, may be short of the habitual demand for loans. It may be in great part absorbed by the investments afforded by the public debt and by mortgages, and the remainder may not be sufficient to supply the wants of commerce. If so, the rate of interest will be raised so high as in some way to re-establish the equilibrium. When there is only a small difference between interest and profit, many borrowers may no longer be willing to increase their responsibilities and involve their credit for so small a remuneration: or some who would otherwise have engaged in business, may prefer leisure, and

become lenders instead of borrowers: or others, under the inducement of high interest and easy investment for their capital, may retire from business earlier, and with smaller fortunes, than they otherwise would have done. Or, lastly, there is another process by which, in England and other commercial countries, a large portion of the requisite supply of loans is obtained. Instead of its being afforded by persons not in business, the affording it may itself become a business. A portion of the capital employed in trade may be supplied by a class of professional money lenders. These money lenders, however, must have more than a mere interest; they must have the ordinary rate of profit on their capital, risk and all other circumstances being allowed for. But it can never answer to any one who borrows for the purposes of his business, to pay a full profit for capital from which he will only derive a full profit: and money-lending, as an employment, for the regular supply of trade, cannot therefore be carried on except by persons who in addition to their own capital, can lend their credit, or in other words, the capital of other people: that is, bankers, and persons (such as bill-brokers) who are virtually bankers, since they receive money in deposit. A bank which lends its notes, lends capital which it borrows from the community, and for which it pays no interest. A bank of deposit lends capital which it collects from the community in small parcels; sometimes without paying any interest, as is the case with the London private bankers; and if, like the Scotch, the joint stock, and most of the country banks, it does pay interest, it still pays much less than it receives; for the depositors, who in any other way could mostly obtain for such small balances no interest worth taking any trouble for, are glad to receive even a little. Having this subsidiary resource, bankers are enabled to obtain, by lending at interest, the ordinary rate of profit on their own capital. In any other manner, money-lending could not be carried on as a regular mode of business, except upon terms on which none would consent to borrow but

persons either counting on extraordinary profits, or in urgent need; unproductive consumers who have exceeded their means, or merchants in fear of bankruptcy. The disposable capital deposited in banks, or represented by bank notes, together with the funds belonging to those who, either from necessity or preference, live upon the interest of their property, constitute the general loan fund of the country: and the amount of this aggregate fund, when set against the habitual demands of producers and dealers, and those of the government and of unproductive consumers, determine the permanent or average rate of interest; which must always be such as to adjust these two amounts to one another*. But, while the whole of this mass of lent capital takes effect upon the *permanent* rate of interest, the *fluctuations* depend almost entirely upon the portion which is in the hands of bankers; for it is that portion almost exclusively, which, being lent for short times only, is continually in the market seeking an investment. The capital of those who live on the interest of their own fortunes, has generally sought and found some fixed investment, such as the public funds, mortgages, or the bonds of public companies, which investment, except under peculiar temptations or necessities, is not changed.

§ 3. Fluctuations in the rate of interest arise from varia-

* I do not include in the general loan fund of the country the capitals, large as they sometimes are, which are habitually employed in speculatively buying and selling the public funds and other securities. It is true, that all who buy securities add, for the time, to the general amount of money on loan, and lower *pro tanto* the rate of interest. But as the persons I speak of buy only to sell again at a higher price, they are alternately in the position of lenders and of borrowers: their operations raise the rate of interest at one time, exactly as much as they lower it at another. Like all persons who buy and sell on speculation, their function is to equalize, not to raise or lower, the value of the commodity. When they speculate prudently, they temper the fluctuations of price; when imprudently, they often aggravate them.

tions either in the demand for loans, or in the supply. The supply is liable to variation, though less so than the demand. The willingness to lend is greater than usual at the commencement of a period of speculation, and much less than usual during the revulsion which follows. In speculative times, money-dealers as well as other people are inclined to extend their business by stretching their credit; they lend more than usual (just as other classes of dealers and producers employ more than usual), of capital which does not belong to them. Accordingly, these are the times when the rate of interest is low; though for this too (as we shall immediately see), there are other causes. During the revulsion, on the contrary, interest always rises inordinately, because, while there is a most pressing need on the part of many persons to borrow, there is a general disinclination to lend. This disinclination, when at its extreme point, is called a panic. It occurs when a succession of unexpected failures has created in the mercantile, and sometimes also in the non-mercantile public, a general distrust in each other's solvency; disposing every one not only to refuse fresh credit, except on very onerous terms, but to call in, if possible, all credit which he has already given. Deposits are withdrawn from banks; notes are returned on the issuers in exchange for specie; bankers raise their rate of discount, and withhold their customary advances; merchants refuse to renew mercantile bills. At such times the most calamitous consequences were formerly experienced from the attempt of the law to prevent more than a certain limited rate of interest from being given or taken. Persons who could not borrow at five per cent, had to pay, not six or seven, but ten or fifteen per cent, to compensate the lender for risking the penalties of the law: or had to sell securities or goods for ready money at a still greater sacrifice. These evils have been less felt, since mercantile bills have been exempted by statute from the operation of the usury laws.

Except at such periods, the amount of capital disposable

on loan is subject to little other variation than that which arises from the gradual process of accumulation; which process however, in the great commercial countries, is sufficiently rapid to account for the almost periodical recurrence of these fits of speculation; since, when a few years have elapsed without a crisis, and no new and tempting channel for investment has been opened in the meantime, there is always found to have occurred in those few years so large an increase of capital seeking investment, as to have lowered considerably the rate of interest, whether indicated by the prices of securities or by the rate of discount on bills; and this diminution of interest tempts the possessors to incur hazards in hopes of a more considerable return.

The demand for loans varies much more largely than the supply, and embraces longer cycles of years in its aberrations. A time of war, for example, is a period of unusual drafts on the loan markets. The Government, at such times, generally incurs new loans, and as these usually succeed each other rapidly as long as the war lasts, the general rate of interest is kept higher in war than in peace, without reference to the rate of profit, and productive industry is stinted of its usual supplies. During a part of the last war, the government could not borrow under six per cent, and of course all other borrowers had to pay at least as much. Nor does the influence of these loans altogether cease when the government ceases to contract others; for those already contracted continue to afford an investment for a greatly increased amount of the disposable capital of the country, which, if the national debt were paid off, would be added to the mass of capital seeking investment, and (independently of temporary disturbance) could not but, to some extent, permanently lower the rate of interest.

The same effect on interest which is produced by government loans for war expenditure, is produced by the sudden opening of any new and generally attractive mode of permanent investment. The only instance of the kind in recent

history on a scale comparable to that of the war loans, is the absorption of capital in the construction of railways. This capital must have been principally drawn from the deposits in banks, or from savings which would have gone into deposit, and which were destined to be ultimately employed in buying securities from persons who would have employed the purchase money in discounts or other loans at interest: in either case, it was a draft on the general loan fund. It is, in fact, evident, that unless savings were made expressly to be employed in railway adventure, the amount thus employed must have been derived either from the actual capital of persons in business, or from capital which would have been lent to persons in business. In the first case, the subtraction, by crippling their means, obliges them to be larger borrowers, in the second, it leaves less for them to borrow; in either case it equally tends to raise the rate of interest.

§ 4. From the preceding considerations it would be seen, even it were not otherwise evident, how great an error it is to imagine that the rate of interest bears any necessary relation to the quantity or value of the money in circulation. An increase of the currency has in itself no effect, and is incapable of having any effect, on the rate of interest. A paper currency issued by government in the payment of its ordinary expenses, in however great excess it may be issued, affects the rate of interest in no manner whatever. It diminishes indeed the power of money to purchase commodities, but not the power of money to purchase money. If a hundred pounds will buy a perpetual annuity of four pounds a year, a depreciation which makes the hundred pounds worth only half as much as before, has precisely the same effect on the four pounds, and therefore cannot alter the relation between the two. Unless, indeed, it is known and reckoned upon that the depreciation will only be temporary; for people certainly might be willing to lend the depreciated currency on cheaper terms if they expected to be repaid in money of full value.

It is perfectly true that in England, and most other commercial countries, an addition to the currency almost always *seems* to have the effect of lowering the rate of interest; because it is almost always accompanied by something which really has that tendency. The currency in common use, being a currency provided by bankers, is all issued in the way of loans, except such part as happens to be employed in the purchase of gold or silver. The same operation, therefore, which adds to the currency, also adds to the loans, or to the capital seeking investment on loan; properly, indeed, the currency is only increased in order that the loans may be increased. Now, though as currency these issues have not an effect on interest, as loans they have. Inasmuch therefore as an expansion or contraction of paper currency, when that currency consists of bank notes, is always also an expansion or contraction of credit; the distinction is seldom properly drawn between the effects which belong to it in the former and in the latter character. The confusion is thickened by the unfortunate misapplication of language, which designates the rate of interest by a phrase ("the value of money") which properly expresses the purchasing power of the circulating medium. Not only, therefore, are bank notes supposed to produce effects as currency, which they only produce as loans, but attention is habitually diverted from effects similar in kind and much greater in degree, when produced by an action on loans which does not happen to be accompanied by any action on the currency.

For example, in considering the effect produced by the proceedings of banks in encouraging the excesses of speculation, an immense effect is usually attributed to their issues of notes, but until of late hardly any attention was paid to the management of their deposits, although nothing is more certain than that their imprudent extensions of credit take place more frequently by means of their deposits than of their issues. "There is no doubt," says Mr. Tooke*, "that

* *Inquiry into the Currency Principle*, ch. xiv.

banks, whether private or joint stock, may, if imprudently conducted, minister to an undue extension of credit for the purpose of speculations, whether in commodities, or in over-trading in exports or imports, or in building or mining operations, and that they have so ministered not unfrequently, and in some cases to an extent ruinous to themselves, and without ultimate benefit to the parties to whose views their resources were made subservient." But, "supposing all the deposits received by a banker to be in coin, is he not, just as much as the issuing banker, exposed to the importunity of customers, whom it may be impolitic to refuse, for loans or discounts, or to be tempted by a high interest? and may he not be induced to encroach so much upon his deposits, as to leave him, under not improbable circumstances, unable to meet the demands of his depositors? In what respect, indeed, would the case of a banker in a perfectly metallic circulation, differ from that of a London banker at the present day? He is not a creator of money, he cannot avail himself of his privilege as an issuer in aid of his other business, and yet there have been lamentable instances of London bankers issuing money in excess."

In the discussions, too, which have been for so many years carried on respecting the operations of the Bank of England, and the effects produced by those operations on the state of credit, although for nearly half a century there never has been a commercial crisis which the Bank has not been strenuously accused either of producing or of aggravating, it has been almost universally assumed that the influence of its acts was felt only through the amount of its notes in circulation, and that if it could be prevented from exercising any discretion as to that one feature in its position, it would no longer have any power liable to abuse. This at least is an error which, after the experience of the year 1847, we may hope has been committed for the last time. During that year the hands of the Bank were absolutely tied, in its character of a bank of issue; but through its operations as a bank of deposit

it exercised as great an influence, or apparent influence, on the rate of interest and the state of credit, as at any former period; it was exposed to as vehement accusations of abusing that influence; and a crisis occurred, such as few that preceded it had equalled, and none perhaps surpassed, in intensity.

§ 5. Before quitting the general subject of this chapter, I will make the obvious remark, that the rate of interest determines the value and price of all those saleable articles which are desired and bought, not for themselves, but for the income which they are capable of yielding. The public funds, shares in joint stock companies, and all descriptions of securities, are at a high price in proportion as the rate of interest is low. They are sold at the price which will give the market rate of interest on the purchase money, with allowance for all differences in the risk incurred, or in any circumstance of convenience. Exchequer bills, for example, usually sell at a higher price than consols, proportionally to the interest which they yield; because, although the security is the same, yet the former being annually paid off at par, the purchaser (unless obliged to sell in a moment of general emergency) is in no danger of losing anything by the resale, except the premium he may have paid.

The price of land, mines, and all other fixed sources of income, depends in like manner on the rate of interest. Land usually sells at a higher price, in proportion to the income afforded by it, than the public funds, not only because it is thought, even in this country, to be somewhat more secure, but because ideas of power and dignity are associated with its possession. But these differences are constant, or nearly so; and in the variations of price, land follows, *ceteris paribus*, the permanent (though of course not the daily) variations of the rate of interest. When interest is low, land will naturally be dear; when interest is high, land will be cheap. The last war presented a striking exception to this

rule, since the price of land as well as the rate of interest was then remarkably high. For this, however, there was a special cause. The continuance of a very high average price of corn for many years, had raised the rent of land even more than in proportion to the rise of interest and fall of the selling price of fixed incomes. Had it not been for this accident, chiefly dependent on the seasons, land must have sustained as great a depreciation in value as the public funds: which it probably would do, were a war to break out hereafter; to the signal disappointment of those landlords and farmers who, generalizing from the casual circumstances of a remarkable period, so long persuaded themselves that a state of war was peculiarly advantageous, and a state of peace disadvantageous, to what they chose to call the interests of agriculture.

CHAPTER XXIV.

OF THE REGULATION OF A CONVERTIBLE PAPER CURRENCY.

§ 1. THE frequent recurrence during the last half century of the painful series of phenomena called a commercial crisis, has directed much of the attention both of economists and of practical politicians to the contriving of expedients for averting, or at the least, mitigating its evils. And the habit which grew up during the era of the Bank restriction, of ascribing all alternations of high and low price to the issues of banks, has caused inquirers in general to fix their hopes of success in moderating those vicissitudes, upon schemes for the regulation of bank notes. A scheme of this nature, after having obtained the sanction of high authorities, so far established itself in the public mind, as to be, with general approbation, converted into a law, at the last renewal of the Charter of the Bank of England: and the regulation is still in force, though with a great abatement of its popularity, and with its *prestige* impaired by a temporary suspension, on the responsibility of the executive, little more than three years after its enactment. It is proper that the merits of this plan for the regulation of a convertible bank note currency should be here considered. Before touching upon the practical provisions of Sir Robert Peel's Act of 1844, I shall briefly state the nature and examine the grounds of the theory on which it is founded.

It is believed by many that banks of issue universally, or the Bank of England in particular, have a power of throwing their notes into circulation, and thereby raising prices, arbitrarily; that this power is only limited by the degree of moderation with which they think fit to exercise it;

that when they increase their issues beyond the usual amount, the rise of prices, thus produced, generates a spirit of speculation in commodities, which carries prices still higher, and ultimately causes a reaction and recoil, amounting in extreme cases to a commercial crisis; and that every such crisis which has occurred in this country within mercantile memory, has been either originally produced by this cause, or greatly aggravated by it. To this extreme length the currency theory has not been carried by the eminent political economists who have given to a more moderate form of the same theory the sanction of their names. But I have not overstated the extravagance of the popular version; which is a remarkable instance to what lengths a favourite theory will hurry, not the closet-students whose competency in such questions is often treated with so much contempt, but men of the world and of business, who pique themselves on the practical knowledge which they have at least had ample opportunities of acquiring. Not only has this fixed idea of the currency as the prime agent in the fluctuations of price, made them shut their eyes to the multitude of circumstances which, by influencing the expectation of supply, are the true causes of almost all speculations and of almost all fluctuations of price; but in order to bring about the chronological agreement required by their theory between the variations of bank issues and those of prices, they have played such fantastic tricks with facts and dates, as would be thought incredible, if an eminent practical authority had not taken the trouble of meeting them, on the ground of mere history, with an elaborate and systematic exposure. I refer, as all conversant with the subject must be aware, to Mr. Tooke's *History of Prices*. The result of Mr. Tooke's investigations was thus stated by himself, in his examination before the Commons Committee on the Bank Charter question in 1832; and the evidences of it stand recorded in his book: "In point of fact, and historically, as far as my researches have gone, in every signal instance of a rise or fall of prices, the rise or fall has preceded, and

therefore could not be the effect of, an enlargement or contraction of the bank circulation."

The extravagance of the currency theorists, in attributing almost every rise or fall of prices to an enlargement or contraction of the issues of bank notes, has raised up, by reaction, a theory the extreme opposite of the former, of which, in scientific discussion, the most prominent representatives are Mr. Tooke and Mr. Fullarton. This counter-theory denies to bank notes, so long as their convertibility is maintained, any power whatever of raising prices, and to banks any power of increasing their circulation, except as a consequence of, and in proportion to, an increase of the business to be done. This last statement is supported by the unanimous assurances of all the country bankers who have been examined before successive Parliamentary Committees on the subject. They all bear testimony that (in the words of Mr. Fullarton*) "the amount of their issues is exclusively regulated by the extent of local dealings and expenditure in their respective districts, fluctuating with the fluctuations of production and price, and that they neither can increase their issues beyond the limits which the range of such dealings and expenditure prescribes, without the certainty of having their notes immediately returned to them, nor diminish them, but at an almost equal certainty of the vacancy being filled up from some other source." From these premises it is argued by Mr. Tooke and Mr. Fullarton, that bank issues, since they cannot be increased in amount unless there be an increased demand, cannot possibly raise prices; cannot encourage speculation, nor occasion a commercial crisis; and that the attempt to guard against that evil by an artificial management of the issue of notes, is of no effect for the intended purpose, and liable to produce other consequences extremely calamitous.

* *Regulation of Currencies*, p. 85.

§ 2. As much of this doctrine as rests upon testimony, and not upon inference, appears to me incontrovertible. I give complete credence to the assertion of the country bankers, very clearly and correctly condensed into a small compass in the sentence just quoted from Mr. Fullarton. I am convinced that they cannot possibly increase their issue of notes in any other circumstances than those which are there stated. I believe, also, that the theory, grounded by Mr. Fullarton upon this fact, contains a large portion of truth, and is far nearer to being the expression of the whole truth than any form whatever of the currency theory.

There are two states of the markets: one which may be termed the quiescent state, the other the expectant, or speculative state. The first is that in which there is nothing tending to engender in any considerable portion of the mercantile public a desire to extend their operations. The producers produce and the dealers purchase only their usual stocks, having no expectation of a more than usually rapid vent for them. Each person transacts his ordinary amount of business and no more, or increases it only in correspondence with the increase of his capital or connexions, or with the gradual growth of the demand for his commodity, occasioned by the public prosperity. Not meditating any unusual extension of their own operations, producers and dealers do not need more than the usual accommodation from bankers and other money lenders; and as it is only by extending their loans that bankers increase their issues, none but a momentary augmentation of issues is in these circumstances possible. If at a certain time of the year a portion of the public have larger payments to make than at other times, or if an individual, under some peculiar exigency, requires an extra advance, they may apply for more bank notes, and obtain them; but the notes will no more remain in circulation, than the extra quantity of Bank of England notes which are issued once in every three months in payment of the dividends. The person to whom, after being borrowed, the

notes are paid away, has no extra payments to make, and no peculiar exigency, and he keeps them by him unused, or sends them into deposit, or repays with them a previous advance made to him by some banker: in any case he does not buy commodities with them, since by the supposition there is nothing to induce him to lay in a larger stock of commodities than before. In this case, therefore, there can be no addition, at the discretion of bankers, to the general circulating medium: any increase of their issues either comes back to them, or remains idle in the hands of the public, and no rise takes place in prices.

But there is another state of the markets, strikingly contrasted with the preceding, and to this state it is not so obvious that the theory of Mr. Tooke and Mr. Fullarton is applicable: namely, when an impression prevails, whether well founded or groundless, that the supply of one or more great articles of commerce is likely to fall short of the ordinary consumption. In such circumstances all persons connected with those commodities desire to extend their operations. The producers or importers desire to produce or import a larger quantity, speculators desire to lay in a stock in order to profit by the expected rise of price, and holders of the commodity desire additional advances to enable them to continue holding. All these classes are disposed to make a more than ordinary use of their credit, and to this desire it is not denied that bankers very often unduly administer. Effects of the same kind may be produced by anything which, exciting more than usual hopes of profit, gives increased briskness to business: for example, a sudden foreign demand for commodities on a large scale, or the expectation of it; such as occurred on the opening of Spanish America to English trade, and has occurred on various occasions in the trade with the United States. Such occurrences produce a tendency to a rise of price in exportable articles, and generate speculations, sometimes of a reasonable, and (as long as a large proportion of men in business prefer

excitement to safety) frequently of an irrational or immoderate character. In such cases there is a desire in the mercantile classes, or in some portion of them, to employ their credit, in a more than usual degree, as a power of purchasing. This is a state of business which, when pushed to an extreme length, brings on the revulsion called a commercial crisis; and it is a known fact that such periods of speculation hardly ever pass off without having been attended, during some part of their progress, by a considerable increase of bank notes.

To this, however, it is replied by Mr. Tooke and Mr. Fullarton, that the increase of the circulation always follows instead of preceding the rise of prices, and is not its cause, but its effect. That in the first place, the speculative purchases by which prices are raised, are not effected by bank notes but by cheques, or still more commonly on a simple book credit: and secondly, even if they were made with bank notes, borrowed for that express purpose from bankers, the notes after being used for that purpose would, if not wanted for current transactions, be returned into deposit by the persons receiving them. In this I fully concur, and I regard it as proved, both scientifically and historically, that during the ascending period of speculation, and as long as it is confined to transactions between dealers, the issues of bank notes are seldom materially increased, nor contribute anything to the speculative rise of prices. It seems to me, however, that this can no longer be affirmed when speculation has proceeded so far as to reach the producers. Speculative orders given by merchants to manufacturers induce them to extend their operations, and to become applicants to bankers for increased advances, which, if made in notes, are not paid away to persons who return them into deposit, but are partially expended in paying wages, and pass into the various channels of retail trade, where they become directly effective in producing a further rise of prices. I cannot but think that this employment of bank notes must have been power-

fully operative on prices at the time when notes of one and two pounds value were permitted by law. Admitting, however, that the prohibition of notes below five pounds has now rendered this part of their operation comparatively insignificant by greatly limiting their applicability to the payment of wages, there is another form of their instrumentality which comes into play in the later stages of speculation, and which forms the principal argument of the more moderate supporters of the currency theory. Although advances by bankers are seldom demanded for the purpose of buying on speculation, they are largely demanded by unsuccessful speculators for the purpose of holding on; and the competition of these speculators for a share of the loanable capital, makes even those who have not speculated, more dependent than before on bankers for the advances they require. Between the ascending period of speculation and the revulsion, there is an interval, extending to weeks and sometimes months, of struggling against a fall. The tide having shown signs of turning, the speculative holders are unwilling to sell in a falling market, and in the mean time they require funds to enable them to fulfil even their ordinary engagements. It is this stage that is ordinarily marked by a considerable increase in the amount of the bank note circulation. That such an increase does usually take place, is denied by no one. And I think it must be admitted that this increase tends to prolong the duration of the speculations; that it enables the speculative prices to be kept up for some time after they would otherwise have collapsed; and therefore prolongs and increases the drain of the precious metals for exportation, which is a leading feature of this stage in the progress of a commercial crisis: the continuance of which drain at last endangering the power of the banks to fulfil their engagement of paying their notes on demand, they are compelled to contract their credit more suddenly and severely than would have been necessary if they had been prevented from propping up speculation by increased advances, after the time when the recoil had become inevitable.

§ 3. To prevent this retardation of the recoil, and ultimate aggravation of its severity, is the object of the scheme for regulating the currency, of which Mr. Loyd, Mr. Norman, and Colonel Torrens, were the first promulgators, and which has, in a slightly modified form, been enacted into law.

According to the scheme in its original purity, the issue of promissory notes for circulation was to be confined to one body. In the form adopted by Parliament, all existing issuers are permitted to retain this privilege, but none are to be hereafter admitted to it, even in the place of those who may discontinue their issues: and, for all except the Bank of England, a maximum of issues is prescribed, on a scale intentionally low. To the Bank of England no maximum is fixed for the aggregate amount of its notes, but only for the portion which are issued on securities, or in other words, on loan. These are never to exceed a certain limit, fixed for the present at fourteen millions*. All issues beyond that amount must be in exchange for bullion; of which the Bank is bound to purchase, at a trifle below the mint valuation, any quantity which is offered to it, giving its notes in exchange. In regard, therefore, to any issue of notes beyond the limit of fourteen millions, the Bank is purely passive, having no function but the compulsory one of giving its notes for gold at *3l. 17s. 9d.*, and gold for its notes at *3l. 17s. 10½d.*, whenever and by whomsoever it is called upon to do so.

The object for which this mechanism is intended is, that the bank note currency may vary in its amount at the exact times, and in the exact degree, in which a purely metallic currency would vary. The precious metals being by universal experience the commodity approaching nearest to that invariability in all the circumstances influencing value, which fits

* A conditional increase of this maximum is permitted, but only when by arrangement with any country bank the issues of that bank are discontinued, and Bank of England notes substituted: and even then the increase is capriciously limited to two-thirds of the amount of the country notes to be thereby superseded.

a commodity for being adopted as a medium of exchange, it is an essential requisite of any substitute for those metals, that it should conform exactly in its value to a metallic currency, and for that purpose it is very plausibly considered necessary that it should conform in its quantity likewise.

How far this purpose is really fulfilled by the means adopted, we shall presently examine. First, however, let us consider whether the measure effects the practical object chiefly relied on in its defence by the more sober of its advocates, that of arresting speculative extensions of credit at an earlier period, with a less drain of gold, and consequently by a milder and more gradual process. I think it must be admitted that to a certain degree it is successful in this object.

I am aware of what may be urged, and reasonably urged, in opposition to this opinion. It will be said, that when the time arrives at which the banks are pressed for increased advances to enable speculators to fulfil their engagements, a limitation of the issue of notes will not prevent the banks, if otherwise willing, from making these advances; that they have still their deposits as a source from which loans may be made beyond the point which is consistent with prudence as bankers; and that, even if they refuse to do so, the only effect would be, that the deposits themselves would be drawn out to supply the wants of the depositors; which would be just as much an addition to the bank notes and coin in the hands of the public, as if the notes themselves were increased. This is true, and is a sufficient answer to those who think that the advances of banks to prop up failing speculations are objectionable chiefly as an increase of the currency. But the mode in which they are really objectionable, is as an extension of credit. If, instead of lending their notes, the banks allow the demand of their customers for disposable capital to act on the deposits, there is the same increase of currency, (for a short time at least,) but there is not an increase of loans. The rate of interest, therefore, is not prevented from rising at the first moment when the difficulties consequent

on excess of speculation begin to be felt. Speculative holders are obliged to submit earlier to that loss by resale, which could not have been prevented from coming on them at last: the recoil of prices and collapse of general credit take place sooner.

To appreciate the effect which this acceleration of the crisis has in mitigating its intensity, let us advert more particularly to the nature and effects of that leading feature in the period just preceding the collapse, the drain of gold. A rise of prices produced by a speculative extension of credit, even when bank notes have not been the instrument, is not the less effectual (if it lasts long enough) in turning the exchanges: and when the exchanges have turned from this cause, they can only be turned back, and the drain of gold stopped, either by a fall of prices or by a rise of the rate of interest. A fall of prices will stop it by removing the cause which produced it, and by rendering goods a more advantageous remittance than gold, even for paying debts already due. A rise of the rate of interest, and fall, consequently, of the prices of securities, will accomplish the purpose still more rapidly, by inducing foreigners, instead of taking away the gold which is due to them, to leave it for investment within the country, and even send gold into the country to take advantage of the increased rate of interest. Of this last mode of stopping a drain of gold, the year 1847 afforded signal examples. But until one of these two things takes place—until either prices fall, or the rate of interest rises—nothing can possibly arrest, or even moderate, the efflux of gold. Now, neither will prices fall nor interest rise, so long as the unduly expanded credit is upheld by the continued advances of bankers. It is well known that when a drain of gold has set in, even if bank notes have not increased in quantity, it is upon them that the contraction first falls, the gold wanted for exportation being always obtained from the Bank of England in exchange for its notes. But under the system which preceded 1844, the Bank of England, being

subjected, in common with other banks, to the importunities for fresh advances which are characteristic of such a time, could, and often did, immediately re-issue the notes which had been returned to it in exchange for bullion. It is a great error, certainly, to suppose that the mischief of this re-issue chiefly consisted in preventing a contraction of the currency. It was, however, quite as mischievous as it has ever been supposed to be. As long as it lasted, the efflux of gold could not cease, since neither would prices fall nor interest rise while these advances continued. Prices, having risen without any increase of bank notes, could well have fallen without a diminution of them; but having risen in consequence of an extension of credit, they could not fall without a contraction of it. As long, therefore, as the Bank of England and the other banks persevered in this course, so long gold continued to flow out, until so little was left that the Bank of England, being in danger of suspension of payments, was compelled at last to contract its discounts and other loans so greatly and suddenly as to produce a much more extreme variation in the rate of interest, inflict much greater loss and distress on individuals, and destroy a much greater amount of the ordinary credit of the country, than any real necessity required.

I acknowledge, (and the experience of 1847 has proved even to those who overlooked it before) that the mischief now described may be wrought, and in large measure, by the Bank of England, through its deposits alone. It may continue or even increase its discounts and advances, when it ought to contract them; with the ultimate effect of making the contraction much more severe and sudden than necessary. I cannot but think, however, that banks which commit this error with their deposits, would commit it still more if they were at liberty to make increased loans with their issues as well as their deposits. I am compelled to think that the being restricted from increasing their issues, is a real impediment to their making those advances which arrest the tide at

its turn, and make it rush like a torrent afterwards. If the restrictions of the Act of 1844 were no obstacle to the advances of banks in the interval preceding the crisis, why were they found an insuperable obstacle during the crisis? an obstacle which nothing less would overcome than a suspension of the law, through the assumption by Government of a temporary dictatorship? Evidently they are an obstacle*; and when the Act is blamed for interposing obstacles at a time when not obstacles but facilities are needed, it must in justice receive credit for interposing them when they are an acknowledged benefit. In this particular, therefore, I think it cannot be denied, that the new system is a real improvement upon the old.

§ 4. But although I am compelled to differ thus far, from the opinion of Mr. Tooke and of Mr. Fullarton, I concur with them in thinking that these advantages, whatever value may be put on them, are purchased by still greater disadvantages.

In the first place, a large extension of credit by bankers, though most hurtful when, credit being already in an inflated state, it can only serve to retard and aggravate the collapse, is most salutary when the collapse has come, and when credit instead of being in excess is in distressing deficiency, and increased advances by bankers instead of being an addition to the ordinary amount of floating credit, serve to replace a

* It would not be to the purpose to say, by way of objection, that the obstacle may be evaded by granting the increased advance in book credits, to be drawn against by cheques, without the aid of bank notes. This is indeed possible, as Mr. Fullarton has remarked, and as I have myself said in a former chapter. But this substitute for bank-note currency certainly has not yet been organized; and the law having clearly manifested its intention that, in the case supposed, increased credits should not be granted, it is yet a problem whether the law would not reach what might be regarded as an evasion of its prohibitions, or whether deference to the law would not produce (as it has hitherto done) on the part of banking establishments, conformity to its spirit and purpose, as well as to its mere letter.

mass of other credit which has been suddenly destroyed. Antecedently to 1844, if the Bank of England occasionally aggravated the severity of a commercial revulsion by rendering the collapse of credit more tardy and thence more violent than necessary, it in return rendered invaluable services during the revulsion itself, by coming forward with advances to support solvent firms, at a time when all other paper and almost all mercantile credit had become comparatively valueless. This service was eminently conspicuous in the crisis of 1825-6, the severest probably ever experienced; during which the Bank increased what is called its circulation by many millions, in advances to those mercantile firms of whose ultimate solvency it felt no doubt; advances which if it had been obliged to withhold, the severity of the crisis would have been even greater than it was. If the Bank, it is justly remarked by Mr. Fullarton*, complies with such applications, "it must comply with them by an issue of notes, for notes constitute the only instrumentality through which the Bank is in the practice of lending its credit. But those notes are not intended to circulate, nor do they circulate. There is no more demand for circulation than there was before. On the contrary, the rapid decline of prices which the case in supposition presumes, would necessarily contract the demand for circulation. The notes would either be returned to the Bank of England, as fast as they were issued, in the shape of deposits, or would be locked up in the drawers of the private London bankers, or distributed by them to their correspondents in the country, or intercepted by other capitalists, who, during the fervour of the previous excitement, had contracted liabilities which they might be imperfectly prepared on the sudden to encounter. In such emergencies, every man connected with business, who has been trading on other means than his own, is placed on the defensive, and his whole object is to make himself as strong as possible, an object which can-

* P. 106.

not be more effectually answered than by keeping by him as large a reserve as possible in paper which the law has made a legal tender. The notes themselves never find their way into the produce markets; and if they at all contribute to retard" (or, as I should rather say, to moderate) "the fall of prices, it is not by promoting in the slightest degree the effective demand for commodities, not by enabling consumers to buy more largely for consumption, and so giving briskness to commerce, but by a process precisely the reverse, by enabling the holders of commodities to hold on, by obstructing traffic and repressing consumption."

The opportune relief thus afforded to credit, during the excessive contraction which succeeds to an undue expansion, is consistent with the principle of the new system; for an extraordinary contraction of credit, and fall of prices, inevitably draw gold into the country, and the principle of the system is that the bank-note currency shall be permitted, and even compelled, to enlarge itself, in all cases in which a metallic currency would do the same. But, what the principle of the law would encourage, its provisions, in this instance preclude, by not suffering the increased issues to take place until the gold has actually arrived; which is never until the worst part of the crisis is past, and almost all the losses and failures attendant on it are consummated. The machinery of the system withholds, until for many purposes it comes too late, the very medicine which the theory of the system prescribes as the sovereign remedy.

This function of banks in filling up the gap made in mercantile credit by the consequences of undue speculation and its revulsion, is so entirely indispensable, that if the Act of 1844 continues unrepealed, there can be no difficulty in foreseeing that its provisions must be suspended as they were in 1847, in every period of great commercial difficulty, as soon as the crisis has really and completely set in. Were this all, there would be no absolute inconsistency in maintaining the restriction as a means of preventing a crisis, and

relaxing it for the purpose of relieving one. But there is another objection, of a still more radical and comprehensive character, to the new system.

Professing, in theory, to require that a paper currency shall vary in its amount in exact conformity to the variations of a metallic currency, it provides in fact, that in every case of an efflux of gold, a corresponding diminution shall take place in the quantity of bank notes; in other words, that every exportation of the precious metals shall be virtually drawn from the circulation; it being assumed that this would be the case if the currency were wholly metallic. This theory, and these practical arrangements, are adapted to the case in which the drain of gold originates in a rise of prices produced by an undue expansion of currency or credit; but they are adapted to no case beside.

When the efflux of gold is the last stage of a series of effects arising from an increase of the currency, or from an expansion of credit tantamount in its effect on prices to an increase of currency, it is in that case a fair assumption that in a purely metallic system the gold exported would be drawn from the currency itself; because such a drain, being in its nature unlimited, will necessarily continue as long as currency and credit are undiminished. But an exportation of the precious metals often arises from no causes affecting currency or credit, but simply from an unusual extension of foreign payments, arising either from the state of the markets for commodities, or from some circumstance not commercial. In this class of causes, four, of powerful operation, are included, of each of which the last fifty years of English history afford repeated instances. The first is that of an extraordinary foreign expenditure by government, either political or military; as in the last war, and particularly the latter years of it. The second is the case of a large exportation of capital for foreign investment; such as the loans and mining operations which partly contributed to the crisis of 1825, and the American speculations which were the principal cause of the

crisis of 1839. The third is a failure of crops in the countries which supply us with the raw material of important manufactures; such as the cotton failure in America, which compelled England in 1847 to incur unusual liabilities for the purchase of that commodity at an advanced price. The fourth is a bad harvest, and a great consequent importation of food: of which the years 1846 and 1847 present an example surpassing all antecedent experience.

In none of these cases, if the currency were metallic, would the gold or silver exported for the purposes in question be necessarily, or even probably, drawn from the circulation. It would be drawn from the hoards, which under a metallic currency always exist to a very large amount; in uncivilized countries, in the hands of all who can afford it; in civilized countries, chiefly in the form of banker's reserves. Mr. Tooke, in his "Inquiry into the Currency Principle," bears testimony to this fact; but it is to Mr. Fullarton that the public are indebted for the clearest and most satisfactory elucidation of it. As I am not aware that this part of the theory of currency has been set forth by any other writer with anything like the same degree of completeness, I shall quote somewhat largely from this able production.

"No person who has ever resided in an Asiatic country, where hoarding is carried on to a far larger extent in proportion to the existing stock of wealth, and where the practice has become much more deeply engrafted in the habits of the people, by traditional apprehensions of insecurity and the difficulty of finding safe and remunerative investments, than in any European community—no person who has had personal experience of this state of society, can be at a loss to recollect innumerable instances of large metallic treasures extracted in times of pecuniary difficulty from the coffers of individuals by the temptation of a high rate of interest, and brought in aid of the public necessities, nor, on the other hand, of the facility with which those treasures have been absorbed again, when the inducements which had drawn

them into light were no longer in operation. In countries more advanced in civilization and wealth than the Asiatic principalities, and where no man is in fear of attracting the cupidity of power by an external display of riches, but where the interchange of commodities is still almost universally conducted through the medium of a metallic circulation, as is the case with most of the commercial countries on the Continent of Europe, the motives for amassing the precious metals may be less powerful than in the majority of Asiatic principalities; but the ability to accumulate being more widely extended, the absolute quantity amassed will be found probably to bear a considerably larger proportion to the population*. In those states which lie exposed to hostile invasion, or whose social condition is unsettled and menacing, the motive indeed must still be very strong; and in a nation carrying on an extensive commerce, both foreign and internal, without any considerable aid from any of the banking substitutes for money, the reserves of gold and silver indispensably required to secure the regularity of payments, must of themselves engross a share of the circulating coin which it would not be easy to estimate.

"In this country, where the banking system has been carried to an extent and perfection unknown in any other part of Europe, and may be said to have entirely superseded the use of coin, except for retail dealings and the purposes of foreign commerce, the incentives to private hoarding exist no longer, and the hoards have all been transferred to the banks, or rather, I should say, to the Bank of England. But in France, where the bank-note circulation is still comparatively limited, the quantity of gold and silver coin in existence I

* It is known, from unquestionable facts, that the hoards of money at all times existing in the hands of the French peasantry, often from a remote date, surpass any amount which could have been imagined possible; and even in so poor a country as Ireland, it has of late been ascertained, that the small farmers sometimes possess hoards quite disproportioned to their visible means of subsistence.

find now currently estimated, on what are described as the latest authorities, at the enormous sum of 120 millions sterling; nor is the estimate at all at variance with the reasonable probabilities of the case. Of this vast treasure there is every reason to presume that a very large proportion, probably by much the greater part, is absorbed in the hoards. If you present for payment a bill for a thousand francs to a French banker, he brings you the silver in a sealed bag from his strong room. And not the banker only, but every merchant and trader, according to his means, is under the necessity of keeping by him a stock of cash sufficient not only for his ordinary disbursements, but to meet any unexpected demands. That the quantity of specie accumulated in these innumerable depôts, not in France only, but all over the Continent, where banking institutions are still either entirely wanting or very imperfectly organized, is not merely immense in itself, but admits of being largely drawn upon, and transferred even in vast masses from one country to another, with very little, if any, effect on prices, or other material derangements, we have had some remarkable proofs:" among others, "the signal success which attended the simultaneous efforts of some of the principal European powers (Russia, Austria, Prussia, Sweden, and Denmark) to replenish their treasuries, and to replace with coin a considerable portion of the depreciated paper which the necessities of the war had forced upon them, and this at the very time when the available stock of the previous metals over the world had been reduced by the exertions of England to recover her metallic currency. . . . There can be no doubt that these combined operations were on a scale of very extraordinary magnitude, that they were accomplished without any sensible injury to commerce or public prosperity, or any other effect than some temporary derangement of the exchanges, and that the private hoards of treasure accumulated throughout Europe during the war must have been the principal source from which all this gold and silver was collected. And no person,

I think, can fairly contemplate the vast superflux of metallic wealth thus proved to be at all times in existence, and, though in a dormant and inert state, always ready to spring into activity on the first indication of a sufficiently intense demand, without feeling themselves compelled to admit the possibility of the mines being even shut up for years together, and the production of the metals altogether suspended, while there might be scarcely a perceptible alteration in the exchangeable value of the metal *”

Applying this to the currency doctrine and its advocates, “one might imagine,” says Mr. Fullarton †, “that they supposed the gold which is drained off for exportation from a country using a currency exclusively metallic, to be collected by driblets at the fairs and markets, or from the tills of the grocers and mercers. They never even allude to the existence of such a thing as a great hoard of the metals, though upon the action of the hoards depends the whole economy of international payments between specie-circulating communities, while any operation of the money collected in hoards upon prices must, even according to the currency hypothesis, be wholly impossible. We know from experience what enormous payments in gold and silver specie-circulating countries are capable, at times, of making, without the least disturbance of their internal prosperity; and whence it is supposed that these payments come, but from their hoards? Let us think how the money market of a country transacting all its exchanges through the medium of the precious metals only, would be likely to be affected by the necessity of making a foreign payment of several millions. Of course the necessity could only be satisfied by a transmission of capital; and would not the competition for the possession of capital for transmission which the occasion would call forth, necessarily raise the market rate of interest? If the payment was to be

* Fullarton on the *Regulation of Currencies*, pp. 71—4.

† *Ib.*, pp. 139—42.

made by the government, would not the government, in all probability, have to open a new loan on terms more than usually favourable to the lender?” If made by merchants, would it not be drawn either from the deposits in banks, or from the reserves which merchants keep by them in default of banks, or would it not oblige them to obtain the necessary amount of specie by going into the money market as borrowers? “And would not all this inevitably act upon the hoards, and draw forth into activity a portion of the gold and silver which the money-dealers had been accumulating, and some of them with the express view of watching such opportunities for turning their treasures to advantage?”

“I would desire, indeed, no more convincing evidence of the competency of the machinery of the hoards in specie-paying countries to perform every necessary office of international adjustment, without any sensible aid from the general circulation, than the facility with which France, when but just recovering from the shock of a destructive foreign invasion, completed within the space of twenty-seven months the payment of her forced contribution of nearly twenty millions to the allied powers, and a considerable proportion of that sum in specie, without any perceptible contraction or derangement of her domestic currency, or even any alarming fluctuation of her exchanges.

“Or, to come to the present time [1844], the balance of payments with nearly all Europe has for about four years past been in favour of this country, and gold has been pouring in till the influx amounts to the unheard-of sum of about fourteen millions sterling. Yet in all this time, has any one heard a complaint of any serious suffering inflicted on the people of the Continent? Have prices there been greatly depressed beyond their range in this country? Have wages fallen, or have merchants been extensively ruined by the universal depreciation of their stock? There has occurred nothing of the kind. The tenor of commercial and monetary affairs has been everywhere even and tranquil; and in France

more particularly, an improving revenue and extended commerce bear testimony to the continued progress of internal prosperity. It may be doubted, indeed, if this great efflux of gold has withdrawn from that portion of the metallic wealth of the nation which really circulates, a single napoleon. And it has been equally obvious, from the undisturbed state of credit, that not only has the supply of specie indispensable for the conduct of business in the retail market been all the while uninterrupted, but that the hoards have continued to furnish every facility requisite for the regularity of mercantile payments. It is of the very essence of the metallic system, that the hoards, in all cases of probable occurrence, should be equal to both objects; that they should, in the first place, supply the bullion demanded for exportation, and in the next place, should keep up the home circulation to its legitimate complement. Every man trading under that system, who, in the course of his business, may have frequent occasion to remit large sums in specie to foreign countries, must either keep by him a sufficient treasure of his own, or must have the means of borrowing enough from his neighbours, not only to make up when wanted the amount of his remittances, but to enable him moreover to carry on his ordinary transactions at home without interruption."

In a country in which credit is carried to so great an extent as in England, one great reserve, in a single establishment, the Bank of England, supplies the place, as far as the precious metals are concerned, of the multitudinous reserves of other countries. The theoretical principle therefore of the currency doctrine would require, that all those drains of the metal, which, if the currency were purely metallic, would be taken from the hoards, should be allowed to operate freely upon the reserve in the coffers of the Bank of England, without any attempt to stop it either by a diminution of the currency or by a contraction of credit. Nor to this would there be any well-grounded objection, unless the drain were

so great as to threaten the exhaustion of the reserve, and a consequent stoppage of payments; a danger against which it is easy to take adequate precautions, because in the cases which we are considering, the drain is for foreign payments of definite amount, and stops of itself as soon as these are effected. And in all systems it is admitted that the habitual reserve of the Bank should exceed the utmost amount to which experience warrants the belief that such a drain may extend; which extreme limit Mr. Fullarton affirms to be seven millions, but Mr. Tooke recommends an average reserve of ten.

The machinery, however, of the new system insists upon bringing about by force, what its principle not only does not require, but positively condemns. Every drain for exportation, whatever may be its cause, and whether under a metallic currency it would affect the circulation or not, is now compulsorily drawn from that source alone. The bank-note circulation, and the discounts or other advances of the Bank, must be diminished by an amount equal to that of the metal exported, though it be to the full extent of seven or ten millions. And this, be it remembered, when there has been no speculative rise of prices which it is indispensable to correct, no unusual extension of credit requiring contraction; but the demand for gold is solely occasioned by foreign payments on account of government, or large corn importations consequent on a bad harvest. "There is at least one object, therefore," says Mr. Fullarton*, "which would be effectually accomplished by acting on this system. It would be perfectly calculated, I think, to ensure, that no derangement of the exchange, or none at least subsisting in coincidence with anything like pressure on the money market, should ever be permitted to pass off, without one of those crises hitherto fortunately of rare occurrence, but of which the results, when they have occurred, have been so extensive and deplorable."

* P. 137.

Are not the events of 1847 a fulfilment of this prediction? The crisis of that year was preceded by no inflation of credit, no speculative rise of prices. The only speculations (the corn market excepted) were those in railway shares, which had no tendency to derange the imports and exports of commodities, or to send any gold out of the country, except the small amount paid in instalments by shareholders in this country to foreign railways. The drain of gold, great as it was, originated solely in the bad harvest of 1846 and the potato failure of that and the following year, and in the increased price of raw cotton in America. There was nothing in these circumstances which could require either a fall of general prices or a contraction of credit. An unusual demand for credit existed at the time, in consequence of the pressure of railway calls, and this necessitated a rise of the rate of interest. If the bullion in the Bank of England was sufficient to bear the drain without exhaustion, where was the necessity for adding to the distress and difficulty of the time, by requiring all who wanted gold for exportation, either to draw it from the deposits, that is, to subtract it from the already insufficient loanable capital of the country, or to become themselves competitors for a portion of that inadequate fund, thus still further raising the rate of interest? The only necessity was created by the Act of 1844, which would not suffer the Bank to meet this extra demand of credit by lending its notes, not even the notes returned to it in exchange for gold. The crisis of 1847 was of that sort which the provisions of the Act had not the smallest tendency to avert; and when the crisis came, the mercantile difficulties were probably doubled by its existence.

I am aware it will be said that by allowing drains of this character to operate freely upon the Bank reserve until they cease of themselves, a contraction of the currency and of credit would not be prevented, but only postponed; since if a limitation of issues were not resorted to for the purpose of

checking the drain in its commencement, the same or a still greater limitation must take place afterwards, in order, by acting on prices, to bring back so large a quantity of gold, for the indispensable purpose of replenishing the Bank reserve. But in this argument several things are overlooked. In the first place the gold might be brought back, not by a fall of prices, but by the much more rapid and convenient medium of a rise of the rate of interest, involving no fall of any prices except the prices of securities. Either English securities would be bought on account of foreigners, or foreign securities held in England would be sent abroad for sale, both which operations took place largely during the mercantile difficulties of 1847, and not only checked the efflux of gold, but turned the tide and brought the metal back. It was not, therefore, brought back by a contraction of the currency, though in this case it certainly was so by a contraction of loans. But is even this always indispensable? For in the second place, it is not necessary that the gold should return with the same suddenness with which it went out. A great portion would probably return in the ordinary way of commerce, in payment for exported commodities. The extra gains made by dealers and producers in foreign countries through the extra payments they receive from this country, are very likely to be partly expended in increased purchases of English commodities, either for consumption or on speculation, although the effect may not manifest itself with sufficient rapidity to enable the transmission of gold to be dispensed with in the first instance. These extra purchases would turn the balance of payments in favour of the country, and gradually restore a portion of the exported gold; and the remainder would probably be brought back, not by a rise of the rate of interest in England, but by the fall of it in foreign countries, occasioned by the addition of some millions of gold to the loanable capital of those countries. If it were necessary to accelerate the process by an artificial action on the rate of interest in England, a very moderate rise would

be sufficient, instead of the very great one which is the consequence of allowing the whole demand for gold for exportation to act suddenly and at once on the existing resources of the loan market.

Thus stand, according to the best judgment I am able to form, the advantages and disadvantages of the currency system established by the Act of 1844: of which, as it seems to me, the disadvantages greatly preponderate. I am, however, far from thinking that on a subject at once so intricate and so new, a subject which has only begun to be understood through the controversies of the last few years, experience and discussion have nothing further to disclose. I give the foregoing opinions as the results to which I have been guided by the lights that have hitherto fallen on the subject; conscious that additional lights are almost sure to be struck out when the knowledge of principles and of facts necessary for the elucidation of the question becomes united in a greater number of individuals.

§ 5. There remain two questions respecting a bank-note currency, which have also been a subject of considerable discussion of late years: whether the privilege of providing it should be confined to a single establishment, such as the Bank of England, or a plurality of issuers should be allowed; and in the latter case, whether any peculiar precautions are requisite or advisable, to protect the holders of notes against losses occasioned by the insolvency of the issuers.

The course of the preceding speculations has led us to attach so much less of peculiar importance to bank notes, as compared with other forms of credit, than accords with the notions generally current, that questions respecting the regulation of so very small a part of the general mass of credit, cannot appear to us of such momentous import as they are sometimes considered. Bank notes, however, have so far a real peculiarity, that they are the

only form of credit sufficiently convenient for all the purposes of circulation, to be able entirely to supersede the use of metallic money for internal purposes. Although the extension of the use of cheques has a tendency more and more to diminish the number of bank notes, as it would that of the sovereigns or other coins which would take their place if they were abolished; there is sure, for a long time to come, to be a considerable supply of them, wherever the necessary degree of commercial confidence exists, and their free use is permitted. The exclusive privilege, therefore, of issuing them, if reserved to the government or to some one body, is a source of great pecuniary gain. That this gain should be obtained for the nation at large is both practicable and desirable: and if the management of a bank-note currency ought to be so completely mechanical, so entirely a thing of fixed rule, as it is made by the Act of 1844, there seems no reason why this mechanism should be worked for the profit of any private issuer, rather than for the public treasury. If, however, a plan be preferred which leaves the variations in the amount of issues in any degree whatever to the discretion of the issuers, it is not desirable that to the ever growing attributions of the government, so delicate a function should be super-added; and that the attention of the heads of the state should be diverted from larger objects, by their being besieged with the applications, and made a mark for all the attacks, which are never spared to those deemed to be responsible for any acts, however minute, connected with the regulation of the currency. It would be better that treasury notes, exchangeable for gold on demand, should be issued to a fixed amount, not exceeding the minimum of a bank note currency, the remainder of the notes which may be required being left to be supplied either by one or by a number of private banking establishments. Or an establishment like the Bank of England might supply the whole country, on condition of lending fifteen or twenty millions of its notes to the government without interest: which would give the same pecuniary

advantage to the state as if it issued that number of its own notes.

The reason ordinarily alleged in condemnation of the system of plurality of issuers which existed in England before the Act of 1844, and under certain limitations still subsists, is, that the competition of these different issuers induces them to increase the amount of their notes to an injurious extent. But we have seen that the power which bankers have of augmenting their issues, and the degree of mischief which they can produce by it, are quite trifling compared with the current over-estimate. As remarked by Mr. Fullarton*, the extraordinary increase of banking competition occasioned by the establishment of the joint-stock banks, a competition often of the most reckless kind, has proved utterly powerless to enlarge the aggregate mass of the bank-note circulation; that aggregate circulation having, on the contrary, actually decreased. In any case it appears desirable to maintain one great establishment like the Bank of England, distinguished from other banks of issue in this, that it alone is required to pay in gold, the others being at liberty to pay their notes with notes of the central establishment. The object of this is that there may be one body, responsible for maintaining a reserve of the precious metals sufficient to meet any drain that can reasonably be expected to take place. By disseminating this responsibility among a number of banks it is prevented from operating efficaciously upon any; or if it be still enforced against one, the reserves of the metals retained by all the others are capital kept idle in pure waste, which may be dispensed with by allowing them at their option to pay in Bank of England notes.

§ 6. The question remains whether, in case of a plurality of issuers, any peculiar precautions are needed to protect the holders of notes from the consequences of failure of

* Pp. 89—92.

payment. Before 1826, the insolvency of banks of issue was a frequent and very serious evil, often spreading distress through a whole neighbourhood, and at one blow depriving provident industry of the results of long and painful saving. This was one of the chief reasons which induced Parliament, in that year, to prohibit the issue of bank notes of a denomination below five pounds, that the labouring classes at least might be as little as possible exposed to participate in this suffering. As an additional safeguard, it has been suggested to give the holders of notes a priority over other creditors, or to require bankers to deposit stock or other public securities as a pledge for the whole amount of their issues. The insecurity, however, of the former bank-note currency of England was altogether the work of the law, which, in order to give a qualified monopoly of banking business to the Bank of England, had actually made the formation of safe banking establishments a punishable offence, by prohibiting the existence of any banks, in town or country, whether of issue or deposit, with a number of partners exceeding six. This truly characteristic specimen of the old system of monopoly and restriction, was done away with in 1826, both as to issues and deposits, everywhere but in a district of sixty five miles radius round London, and in 1833 in that district also, as far as relates to deposits. The numerous joint-stock banks since established, have, by furnishing a more trustworthy currency, made it almost impossible for any private banker to maintain his circulation, unless his capital and character inspire the most complete confidence. And although there has been in some instances very gross mismanagement by joint-stock banks (less, however, in the department of issues than in that of deposits) the failure of these banks is extremely rare, and the cases still rarer in which loss has ultimately been sustained by any one except the shareholders. The banking system of England is now almost as secure to the public, as that of Scotland (where banking was always free) has been for two centuries past; and the legislature might without any

bad consequences, at least of this kind, revoke its interdict (which was never extended to Scotland) against one and two pound notes. I cannot therefore think it at all necessary, or that it would be anything but vexatious meddling, to enforce any kind of special security in favour of the holders of notes. The true protection to creditors of all kinds is a good law of insolvency (a part of the law at present shamefully deficient), and, in the case of joint-stock companies at least, complete publicity of their accounts: the publicity now very properly given to their issues, being a very small portion of what the state has a right to require in return for their being allowed to constitute themselves, and be recognized by the law, as a collective body.

CHAPTER XXV.

OF THE COMPETITION OF DIFFERENT COUNTRIES IN
THE SAME MARKET.

§ 1. IN the phraseology of the Mercantile System, the language and doctrines of which are still the basis of what may be called the political economy of the selling classes, as distinguished from the buyers or consumers, there is no word of more frequent recurrence or more perilous import than the word *underselling*. To undersell other countries—not to be undersold by other countries—were spoken of, and are still very often spoken of, almost as if they were the sole purposes for which production and commodities exist. The feelings of rival tradesmen, prevailing among nations, overruled for centuries all sense of the general community of advantage which commercial countries derive from the prosperity of one another: and that commercial spirit, which is now one of the strongest obstacles to wars, was during a certain period of European history their principal cause.

Even in the more enlightened view now attainable of the nature and consequences of international commerce, some, though a comparatively small, space must still be made for the fact of commercial rivalry. Nations may, like individual dealers, be competitors, with opposite interests, in the markets of some commodities, while in others they are in the more fortunate relation of reciprocal customers. The benefit of commerce does not consist, as it was once thought to do, in the commodities sold; but, since the commodities sold are the means of obtaining those which are bought, a nation would be cut off from the real advantage of commerce, the imports, if it could not induce other nations to take

any of its commodities in exchange; and in proportion as the competition of other countries compels it to offer its commodities on cheaper terms, on pain of not selling them at all, the imports which it obtains by its foreign trade are procured at greater cost.

These points have been adequately, though incidentally, illustrated in some of the preceding chapters. But the great space which the topic has filled, and continues to fill, in economical speculations, and in the practical anxieties both of politicians and of dealers and manufacturers, makes it desirable, before quitting the subject of international exchange, to subjoin a few observations on the things which do, and on those which do not, enable countries to undersell one another.

One country can only undersell another in a given market, to the extent of entirely expelling her from it, on two conditions. In the first place, she must have a greater advantage than the second country in the production of the article exported by both; meaning by a greater advantage (as has been already so fully explained) not absolutely, but in comparison with other commodities: and in the second place, such must be her relation with the customer country in respect to the demand for each other's products, and such the consequent state of international values, as to give away to the customer country more than the whole advantage possessed by the rival country; otherwise the rival will still be able to hold her ground in the market.

Let us revert to the imaginary hypothesis which we have found so convenient, that of a trade between England and Germany in cloth and linen; England being capable of producing 10 yards of cloth at the same cost with 15 yards of linen, Germany at the same cost with 20, and the two commodities being exchanged between the two countries (cost of carriage apart) at some intermediate rate, say 10 for 17. Germany could not be permanently undersold in the English market, and expelled from it, unless by a country which offered not

merely more than 17, but more than 20 yards of linen for 10 of cloth. Short of that, the competition would only oblige Germany to pay dearer for cloth, but would not disable her from exporting linen. The country, therefore, which could undersell Germany, must, in the first place, be able to produce linen at less cost, compared with cloth, than Germany herself; and in the next place, must have such a demand for cloth, or other English commodities, as would compel her, even when she became sole occupant of the market, to give a greater advantage to England than Germany could give by resigning the whole of hers; to give, for example, 21 yards for 10. For if not—if, for example, the equation of international demand, after Germany was excluded, gave a ratio of 18 for 10, Germany could again enter into the competition; Germany would be now the underselling nation; and there would be a point, perhaps 19 for 10, at which both countries would be able to maintain their ground, and to sell in England enough linen to pay for the cloth, or other English commodities, for which, on these newly adjusted terms of interchange, they had a demand. In like manner England, as an exporter of cloth, could only be driven from the German market by some rival whose superior advantages in the production of cloth enabled her, and the intensity of whose demand for German produce compelled her, to offer 10 yards of cloth, not merely for less than 17 yards of linen, but for less than 15. In that case, England could no longer carry on the trade without loss; but in any case short of this, she would merely be obliged to give to Germany more cloth for less linen than she had previously given.

It thus appears that the alarm of being permanently undersold may be taken much too easily; may be taken when the thing really to be anticipated is not the loss of the trade, but the minor inconvenience of carrying it on at a diminished advantage; an inconvenience chiefly falling on the consumers of foreign commodities, and not on the producers or sellers of the exported article. It is no sufficient

ground of apprehension to the English producers, to find that some other country can sell cloth in foreign markets at some particular time, a trifle cheaper than they can themselves afford to do in the existing state of prices in England. Suppose them to be temporarily undersold, and their exports diminished: the imports will exceed the exports, there will be a new distribution of the precious metals, prices will fall, and as all the money expenses of the English producers will be diminished, they will be able (if the case falls short of that stated in the preceding paragraph) again to compete with their rivals. The loss which England will incur, will not fall upon the exporters, but upon those who consume imported commodities; who, with money incomes reduced in amount, will have to pay the same or even an increased price for all things produced in foreign countries.

§ 2. Such, I conceive, is the true theory, or rationale, of underselling. It will be observed that it takes no account of some things which we hear spoken of, oftener perhaps than any others, in the character of causes exposing a country to be undersold.

According to the preceding doctrine, a country cannot be undersold in any commodity, unless the rival country has a stronger inducement than itself for devoting its labour and capital to the production of the commodity; arising from the fact that by doing so it occasions a greater saving of labour and capital, to be shared between itself and its customers—a greater increase of the aggregate produce of the world. The underselling, therefore, though a loss to the undersold country, is an advantage to the world at large; the substituted commerce being one which economizes more of the labour and capital of mankind, and adds more to their collective wealth, than the commerce superseded by it. The advantage, of course, consists in being able to produce the commodity of better quality, or with less labour (compared with other things,) or perhaps not with less labour, but in less time; with

a less prolonged detention of the capital employed. This may arise from greater natural advantages (such as soil, climate, richness of mines); superior capability, either natural or acquired, in the labourers; better division of labour, and better tools, or machinery. But there is no place left in this theory for the case of lower wages. This, however, in the theories commonly current, is a favourite cause of underselling. We continually hear of the disadvantage under which the British producer labours, both in foreign markets and even in his own, through the lower wages paid by his foreign rivals. These lower wages, we are told, enable, or are always on the point of enabling them to sell at lower prices, and to dislodge the English manufacturer from all markets in which he is not artificially protected.

Before examining this opinion on grounds of principle, it is worth while to bestow a moment's consideration upon it as a question of fact. Is it true, that the wages of manufacturing labour are lower in foreign countries than in England, in any sense in which low wages are an advantage to the capitalist? The artisan of Ghent or Lyons may earn less wages in a day, but does he not do less work? Degrees of efficiency considered, does his labour cost less to his employer? Though wages may be lower on the Continent, is not the Cost of Labour, which is the real element in the competition, very nearly the same? That it is so, seems the opinion of competent judges, and is confirmed by the very little difference in the rate of profit between England and the Continental countries. But if so, the opinion is absurd that English producers can be undersold by their Continental rivals from this cause. It is only in America that the supposition is *prima facie* admissible. In America wages are much higher than in England, if we mean by wages the daily earnings of a labourer: but the productive power of American labour is so great—its efficiency, combined with the favourable circumstances in which it is exerted, makes it worth so much to the purchaser, that the Cost of Labour is

lower in America than in England; as is proved by the fact that the general rate of profits and of interest is very much higher.

§ 3. But is it true that low wages, even in the sense of low Cost of Labour, enable a country to sell cheaper in the foreign market? I of course mean, low wages which are common to the whole productive industry of the country.

If wages, in any of the departments of industry which supply exports, are kept, artificially, or by some accidental cause, below the general rate of wages in the country, this is a real advantage in the foreign market. It lessens the comparative cost of production of those articles, in relation to others; and has the same effect as if their production required so much less labour. Take, for instance, the case of the United States in respect to certain commodities. In that country, tobacco and cotton, two great articles of export, are produced by slave labour, while food, and manufactures generally, are produced by free labourers, who either work on their own account or are paid by wages. In spite of the inferior efficiency of slave labour, there can be no reasonable doubt that in a country where the wages of free labour are so high, the work executed by slaves is a better bargain to the capitalist. To whatever extent it is so, this smaller cost of labour, being not general, but limited to those employments, is just as much a cause of cheapness in the products, both in the home and in the foreign market, as if they had been made by a less quantity of labour. If the slaves in the Southern States were emancipated, and their wages rose to the general level of the earnings of free labour in America, she might be obliged to erase some of the slave-grown articles from the catalogue of her exports, and would certainly be unable to sell any of them in the foreign market at the present price. Their cheapness is partly an artificial cheapness, which may be compared to that produced by a bounty on production or on exportation: or, considering the means

by which it is obtained, an apter comparison would be with the cheapness of stolen goods.

An advantage of a similar economical, though of a very different moral character, is that possessed by domestic manufactures; fabrics produced in the leisure hours of families partially occupied in other pursuits, who, not depending for subsistence on the produce of the manufacture, can afford to sell it at any price, however low, for which they think it worth while to take the trouble of producing. In an account of the Canton of Zurich, to which I have had occasion to refer on another subject, it is observed,* "The workman of Zurich is to-day a manufacturer, to-morrow again an agriculturist, and changes his occupation with the seasons, in a continual round. Manufacturing industry and tillage advance hand in hand, in inseparable alliance, and in this union of the two occupations the secret may be found, why the simple and unlearned Swiss manufacturer can always go on competing, and increasing in prosperity, in the face of those extensive establishments fitted out with great economic, and (what is still more important) intellectual, resources. Even in those parts of the Canton where manufactures have extended themselves the most widely, only one-seventh of all the families belong to manufactures alone; four-sevenths combine that employment with agriculture. The advantage of this domestic or family manufacture consists chiefly in the fact, that it is compatible with all other avocations, or rather that it may in part be regarded as only a supplementary employment. In winter, in the dwellings of the operatives, the whole family employ themselves in it; but as soon as spring appears, those on whom the early field labours devolve, abandon the in-door work; many a shuttle stands still: by degrees, as the field-work increases, one member of the family follows another, till at last, at the harvest, and during the so-called 'great works,' all hands seize the implements of husbandry: but in unfavour-

* *Historisch-geographisch-statistisches Gemälde der Schweiz.* Erstes Heft. 1834. p. 105.

able weather, and in all otherwise vacant hours, the work in the cottage is resumed, and when the ungenial season again recurs, the people return in the same gradual order to their home occupation, until they have all resumed it."

In the case of these domestic manufactures, the comparative cost of production, on which the interchange between countries depends, is much lower than in proportion to the quantity of labour employed. The workpeople, looking to the earnings of their loom for a part only, if for any part, of their actual maintenance, can afford to work for a less remuneration than the lowest rate of wages which can exist in the employments by which the labourer has to support the whole expense of a family. Working, as they do, not for an employer but for themselves, they may be said to carry on the manufacture at no cost at all, except the small expense of a loom and of the material: and the limit of possible cheapness is not the necessity of living by their trade, but that of earning enough by the work, to make that social employment of their leisure hours not disagreeable.

§ 4. These two cases, of slave labour and of domestic manufactures, exemplify the conditions under which low wages enable a country to sell its commodities cheaper in foreign markets, and consequently to undersell its rivals, or to avoid being undersold by them. But no such advantage is conferred by low wages when common to all branches of industry. General low wages never caused any country to undersell its rivals, nor did general high wages ever hinder it from doing so.

To demonstrate this, we must return to an elementary principle which was discussed in a former chapter*. General low wages do not cause low prices, nor high wages high prices, within the country itself. General prices are not raised by a rise of wages, any more than they would be raised by an increase of the quantity of labour required in all production.

* Supra, book iii. ch. iv.

Expenses which affect all commodities equally, have no influence on prices. If the maker of broadcloth or cutlery, and nobody else, had to pay higher wages, the price of his commodity would rise, just as it would if he had to employ more labour; because otherwise he would gain less profit than other producers, and nobody would engage in the employment. But if everybody has to pay higher wages, or everybody to employ more labour, the loss must be submitted to; as it affects everybody alike, no one can hope to get rid of it by a change of employment, each therefore resigns himself to a diminution of profits, and prices remain as they were. In like manner, general low wages, or a general increase in the productiveness of labour, does not make prices low, but profits high. If wages fall, (meaning here by wages the cost of labour) why, on that account, should the producer lower his price? He will be forced, it may be said, by the competition of other capitalists who will crowd into his employment. But other capitalists are also paying lower wages, and by entering into competition with him they would gain nothing but what they are gaining already. The rate then at which labour is paid, as well as the quantity of it which is employed, affects neither the value nor the price of the commodity produced, except in so far as it is peculiar to that commodity, and not common to commodities generally.

Since low wages are not a cause of low prices in the country itself, so neither do they cause it to offer its commodities in foreign markets at a lower price. It is quite true that if the cost of labour is lower in America than in England, America could sell her cottons to Cuba at a lower price than England, and still gain as high a profit as the English manufacturer. But it is not with the profit of the English manufacturer that the American cotton spinner will make his comparison; it is with the profits of other American capitalists. These enjoy, in common with himself, the benefit of a low cost of labour, and have accordingly a high rate of profit. This high profit the cotton spinner must also have: he will

not content himself with the English profit. It is true he may go on for a time at that lower rate, rather than change his employment; and a trade may be carried on, sometimes for a long period, at a much lower profit than that for which it would have been originally engaged in. Countries which have a low cost of labour, and high profits, do not for that reason undersell others, but they do oppose a more obstinate resistance to being undersold, because the producers can often submit to a diminution of profit without being unable to live, and even to thrive, by their business. But that is all which their advantage does for them; and in this resistance they will not long persevere, when a change of times which may give them equal profits with the rest of their countrymen has become manifestly hopeless.

§ 5. There is a class of trading and exporting communities, on which a few words of explanation seem to be required. These are hardly to be looked upon as countries, carrying on an exchange of commodities with other countries, but more properly as outlying agricultural or manufacturing establishments belonging to a larger community. Our West India colonies, for example, cannot be regarded as countries, with a productive capital of their own. If Manchester, instead of being where it is, were on a rock in the North Sea (its present industry nevertheless continuing,) it would still be but a town of England, not a country trading with England: it would be merely, as now, the place where England finds it convenient to carry on her cotton manufacture. The West Indies, in like manner, are the place where England finds it convenient to carry on the production of sugar, coffee, and a few other tropical commodities. All the capital employed is English capital; almost all the industry is carried on for English uses; there is little production of anything except the staple commodities, and these are sent to England, not to be exchanged for things exported to the colony and consumed by its inhabitants, but to be sold in England for

the benefit of the proprietors there. The trade with the West Indies is therefore hardly to be considered as external trade, but more resembles the traffic between town and country, and is amenable to the principles of the home trade. The rate of profit in the colonies will be regulated by English profits: the expectation of profit must be about the same as in England, with the addition of compensation for the disadvantages attending the more distant and hazardous employment: and after allowance is made for those disadvantages, the value and price of West India produce in the English market must be regulated, (or rather must have been regulated formerly,) like that of any English commodity, by the cost of production. For the last ten or twelve years this principle has been in abeyance: the price was first kept up beyond the ratio of the cost of production by deficient supplies, which could not, owing to deficiency of labour, be increased; and more recently the admission of foreign competition has introduced another element, and the West Indies are undersold, not so much because wages are higher than in Cuba and Brazil, as because they are higher than in England: for were they not so, Jamaica could sell her sugars at Cuban prices, and still obtain, though not a Cuban, an English rate of profit.

It is worth while also to notice another class of small, but in this case mostly independent communities, which have supported and enriched themselves almost without any productions of their own, (except ships and marine equipments,) by a mere carrying trade, and commerce of *entrepôt*; by buying the produce of one country, to sell it at a profit in another. Such were Venice, and the Hanse Towns. The case of these communities is very simple. They made themselves and their capital the instruments, not of production, but of accomplishing exchanges between the productions of other countries. These exchanges were attended with an advantage to those countries—an increase of the aggregate returns to industry—part of which went to indemnify the

agents, for the necessary expenses of transport, and another part to remunerate the use of their capital and mercantile skill. The countries themselves had not capital disposable for the operation. When the Venetians became the agents of the general commerce of Southern Europe, they had scarcely any competitors: the thing would not have been done at all without them, and there was really no limit to their profits except the limit to what the ignorant feudal nobility would give for the unknown luxuries then first presented to their sight. At a later period competition arose, and the profit of this operation, like that of others, became amenable to natural laws. The carrying trade was taken up by Holland, a country with productions of its own and a large accumulated capital. The other nations of Europe also had now capital to spare, and were capable of conducting their foreign trade for themselves: but Holland, having, from a variety of circumstances, a lower rate of profit at home, could afford to carry for other countries at a smaller advance on the original cost of the goods, than would have been required by their own capitalists; and Holland, therefore, engrossed the greatest part of the carrying trade of all those countries which did not keep it to themselves by Navigation Laws, constructed, like those of England, for the express purpose.

CHAPTER XXVI.

OF DISTRIBUTION, AS AFFECTED BY EXCHANGE.

§ 1. WE have now completed, as far as is compatible with the purposes and limits of this treatise, the exposition of the machinery through which the produce of a country is apportioned among the different classes of its inhabitants; which is no other than the machinery of Exchange, and has for the exponents of its operation, the laws of Value and of Price. We shall now avail ourselves of the light thus acquired, to cast a retrospective glance at the subject of Distribution. The division of the produce among the three classes, Labourers, Capitalists, and Landlords, when considered without any reference to Exchange, appeared to depend on certain general laws. It is fit that we should now consider whether these same laws still operate, when the distribution takes place through the complex mechanism of exchange and money; or whether the properties of the mechanism interfere with and modify the presiding principles.

The primary division of the produce of human exertion and frugality is, as we have seen, into three shares, wages, profits, and rent; and these shares are portioned out to the persons entitled to them, in the form of money, and by a process of exchange; or rather, the capitalist, with whom in the usual arrangements of society the produce remains, pays in money, to the other two sharers, the market value of their labour and land. If we examine, on what the pecuniary value of labour, and the pecuniary value of the use of land, depend, we shall find that it is on the very same causes by which we found that wages and rent would be regulated if there were no money and no exchange of commodities.

It is evident, in the first place, that the law of Wages is not affected by the existence or non-existence of Exchange or Money. Wages depend on the ratio between population and capital; and would do so if all the capital in the world were the property of one association, or if the capitalists among whom it is shared maintained each an establishment for the production of every article consumed in the community, exchange of commodities having no existence. As the ratio between capital and population, everywhere but in new colonies, depends on the strength of the checks by which the too rapid increase of population is restrained, it may be said, popularly speaking, that wages depend on the checks to population; that when the check is not death, by starvation or disease, wages depend on the prudence of the labouring people; and that wages in any country are habitually at the lowest rate, to which in that country the labourers will suffer them to be depressed rather than put a restraint upon multiplication.

What is here meant, however, by wages, is the labourer's real scale of comfort; the quantity he obtains of the things which nature or habit has made necessary or agreeable to him: wages in the sense in which they are of importance to the receiver. In the sense in which they are of importance to the payer, they do not depend exclusively on such simple principles. Wages in the first sense, the wages on which the labourer's comfort depends, we shall call real wages, or wages in kind. Wages in the second sense, we may be permitted to call, for the present, money wages; assuming, as it is allowable to do, that money remains for the time an invariable standard, no alteration taking place in the conditions under which the circulating-medium itself is produced or obtained. If money itself undergoes no variation in cost, the money price of labour is an exact measure of the Cost of Labour, and may be made use of as a convenient symbol to express it.

The money wages of labour are a compound result of two

elements: first, real wages, or wages in kind, or in other words, the quantity which the labourer obtains of the ordinary articles of consumption; and secondly, the money prices of those articles. In all old countries—all countries in which the increase of population is in any degree checked by the difficulty of obtaining subsistence—the habitual money price of labour is that which will just enable the labourers, one with another, to purchase the commodities without which they will not consent to continue the race. Their standard of comfort being given, (and by the standard of comfort in a labouring class, is meant that, rather than forego which, they will abstain from multiplication,) money wages depend on the money price, and therefore on the cost of production, of the various articles which the labourers habitually consume: because if their wages cannot procure them a given quantity of these, their increase will slacken and their wages rise. Of these articles, food and other agricultural produce are so much the principal, as to leave little influence to anything else.

It is at this point that we are enabled to invoke the aid of the principles which have been laid down in this Third Part. The cost of production of food and agricultural produce has been analyzed in a preceding chapter. It depends on the productiveness of the least fertile land, or of the least productively employed portion of capital, which the necessities of society have as yet put in requisition for agricultural purposes. The cost of production of the food grown in these least advantageous circumstances, determines, as we have seen, the exchange value and money price of the whole. In any given state, therefore, of the labourer's habits, his money wages depend on the productiveness of the least fertile land, or least productive agricultural capital; on the point which cultivation has reached in its downward progress—in its encroachments on the barren lands, and its gradually increased strain upon the powers of the more fertile. Now, the force which urges on cultivation in this downward course,

is the increase of people; while the counter-force which checks the descent, is the improvement of agricultural science and practice, enabling the same soil to yield to the same labour more ample returns. The costliness of the most costly part of the produce of cultivation, is an exact expression of the state, at any given moment, of the race which population and agricultural skill are always running against each other.

§ 2. It is well said by Dr. Chalmers, that many of the most important lessons in political economy are to be learnt at the extreme margin of cultivation, the last point which the culture of the soil has reached in its contest with the spontaneous agencies of nature. The degree of productiveness of this extreme margin, is an index to the existing state of the distribution of the produce among the three classes, of labourers, capitalists, and landlords.

When the demand of an increasing population for more food cannot be satisfied without extending cultivation to less fertile land, or incurring additional outlay, with a less proportional return, on land already in cultivation, it is a necessary condition of this increase of agricultural produce, that the value and price of that produce must first rise. But as soon as the price has risen sufficiently to give to the additional outlay of capital the ordinary profit, the rise will not go on still further for the purpose of enabling the new land, or the new expenditure on old land, to yield rent as well as profit. The land or capital last put in requisition, and occupying what Dr. Chalmers calls the margin of cultivation, will yield, and continue to yield, no rent. But if this yields no rent, the rent afforded by all other land or agricultural capital will be exactly so much as it produces more than this. The price of food will always on the average be such, that the worst land, and the least productive instalment of the capital employed on the better lands, shall just replace the expenses with the ordinary profit. If the least favoured

land and capital just do thus much, all other land and capital will yield an extra profit, equal to the proceeds of the extra produce due to their superior productiveness; and this extra profit becomes, by competition, the prize of the landlords. Exchange, and money, therefore, make no difference in the law of rent; it is the same as we originally found it. Rent is the extra return made to agricultural capital when employed with peculiar advantages; the exact equivalent of what those advantages enable the producers to economize in the cost of production: the value and price of the produce being regulated by the cost of production to those producers who have no advantages; by the return to that portion of agricultural capital, the circumstances of which are the least favourable.

§ 3. Wages, and Rent, being thus regulated by the same principles when paid in money, as they would be if apportioned in kind, it follows that Profits are so likewise. For the surplus, after replacing wages and paying rent, constitutes Profits.

We found in the last chapter of the Second Book, that the advances of the capitalist, when analyzed to their ultimate elements, consist either in the purchase or maintenance of labour, or in the profits of former capitalists; and that therefore profits, in the last resort, depend upon the Cost of Labour, falling as that rises, and rising as it falls. Let us endeavour to trace more minutely the operation of this law.

There are two modes in which the Cost of Labour, which is correctly represented (money being supposed invariable) by the money wages of the labourer, may be increased. The labourer may obtain greater comforts; wages in kind—real wages—may rise. Or the progress of population may force down cultivation to inferior soils, and more costly processes; thus raising the cost of production, the value, and the price, of the chief articles of the labourer's consumption. On either of these suppositions, the rate of profit will fall.

If the labourer obtains more abundant commodities, only by reason of their greater cheapness; if he obtains a greater quantity, but not on the whole a greater cost; his real wages will be increased, but not his money wages, and there will be nothing to affect the rate of profit. But if he obtains a greater quantity of commodities of which the cost of production is not lowered, he obtains a greater cost; his money wages are higher. The expense of these increased money wages falls wholly on the capitalist. There are no conceivable means by which he can shake it off. It may be said—it used formerly to be said—that he will get rid of it by raising his price. But this opinion we have already, and more than once, fully refuted*.

The doctrine, indeed, that a rise of wages causes an equivalent rise of prices, is, as we formerly observed, self-contradictory: for if it did so, it would not be a rise of wages; the labourer would get no more of any commodity than he had before, let his money wages rise ever so much: a rise of real wages would be an impossibility. This being equally contrary to reason and to fact, it is evident that a rise of money wages does not raise prices; that high wages are not a cause of high prices. A rise of general wages falls on profits. There is no possible alternative.

Having disposed of the case in which the increase of money wages, and of the Cost of Labour, arises from the labourer's obtaining more ample wages in kind, let us now suppose it to arise from the increased cost of production of the things which he consumes; owing to an increase of population, unaccompanied by an equivalent increase of agricultural skill. The augmented supply required by the population would not be obtained, unless the price of food rose sufficiently to remunerate the farmer for the increased cost of production. The farmer, however, in this case sustains a twofold disadvantage. He has to carry on his cultivation

* *Supra*, vol. i. p. 543, and vol. ii. p. 226.

under less favourable conditions of productiveness than before. For this, as it is a disadvantage belonging to him only as a farmer, and not shared by other employers, he will, on the general principles of value, be compensated by a rise of the price of his commodity: indeed, until this rise has taken place, he will not bring to market the required increase of produce. But this very rise of price involves him in another necessity, for which he is not compensated. He must pay higher money wages to his labourers. This necessity, being common to him with all other capitalists, forms no ground for a rise of price. The price will rise, until it has placed him in as good a situation in respect of profits, as other employers of labour: it will rise so as to indemnify him for the increased labour which he must now employ in order to produce a given quantity of food: but the increased wages of that labour are a burthen common to all, and for which no one can be indemnified. It will be paid wholly from Profits.

Thus we see that increased wages, when common to all descriptions of productive labourers, and when really representing a greater Cost of Labour, are always and necessarily at the expense of profits. And by reversing the cases, we should find in like manner that diminished wages, when representing a really diminished Cost of Labour, are equivalent to a rise of profits. But the opposition of pecuniary interest thus indicated between the class of capitalists and that of labourers, is to a great extent only apparent. Real wages are a very different thing from the Cost of Labour, and are generally highest at the times and places where, from the easy terms on which the land yields all the produce as yet required from it, the value and price of food being low, the cost of labour to the employer, notwithstanding its ample remuneration, is comparatively cheap, and the rate of profit consequently high; as at present in the United States. We thus obtain a full confirmation of our original theorem that Profits depend on the Cost of Labour: or, to express the

meaning with still greater accuracy, the rate of profit and the cost of labour vary inversely as one another, and are joint effects of the same agencies or causes.

But does not this proposition require to be slightly modified, by making allowance for that portion (though comparatively small) of the expenses of the capitalist, which does not consist in wages paid by himself or reimbursed to previous capitalists, but in the profits of those previous capitalists? Suppose, for example, an invention in the manufacture of leather, the advantage of which should consist in rendering it unnecessary that the hides should remain for so great a length of time in the tan-pit. Shoemakers, saddlers, and other workers in leather, would save a part of that portion of the cost of their material which consists of the tanner's profits during the time his capital is locked up; and this saving, it may be said, is a source from which they might derive an increase of profit, though wages and the Cost of Labour remained exactly the same. In the case here supposed, however, the consumer alone would benefit, since the prices of shoes, harness, and all other articles into which leather enters would fall, until the profits of the producers were reduced to the general level. To obviate this objection, let us suppose that a similar saving of expenses takes place in all departments of production at once. In that case, since values and prices would not be affected, profits would probably be raised; but if we look more closely into the case we shall find, that it is because the cost of labour would be lowered. In this as in any other case of increase in the general productiveness of labour, if the labourer obtained only the same real wages, profits would be raised: but the same real wages would imply a smaller Cost of Labour; the cost of production of all things having been, by the supposition, diminished. If, on the other hand, the real wages of labour rose proportionally, and the Cost of Labour to the employer remained the same, the advances of the capitalist would bear the same ratio to his returns as before, and the rate of profit

would be unaltered. The reader who may wish for a more minute examination of this point, will find it in the volume of separate Essays to which reference has before been made*. The question is too intricate in comparison with its importance, to be further entered into in a work like the present; and I will merely say, that it seems to result from the considerations adduced in the Essay, that there is nothing in the case in question to affect the integrity of the theory which affirms an exact correspondence, in an inverse direction, between the rate of profit and the Cost of Labour.

* Essay IV. on *Profits and Interest*.