J. S. Mill *Principles of Political Economy* (book III, chpt. xii–xiv)

CHAPTER XIII

Of an Inconvertible Paper Currency

§ 1. [*The value of an inconvertible paper, depending on its quantity, is a matter of arbitrary regulation*] After experience had shown that pieces of paper, of no intrinsic value, by merely bearing upon them the written profession of being equivalent to a certain number of francs, dollars, or pounds, could be made to circulate as such, and to produce all the benefit to the issuers which could have been produced by the coins which they purported to represent; governments began to think that it would be a happy device if they could appropriate to themselves this benefit, free from the condition to which individuals issuing such paper substitutes for money were subject, of giving, when required, for the sign, the thing signified. They determined to try whether they could not emancipate themselves from this unpleasant obligation, and make a piece of paper issued by them pass for a pound, by merely calling it a pound, and consenting to receive it in payment of the taxes. And such is the influence of almost all established governments, that they have generally succeeded in attaining this object: I believe I might say they have always succeeded for a time, and the power has only been lost to them after they had compromised it by the most flagrant abuse.

In the case supposed, the functions of money are performed by a thing which derives its power [a]for[a] performing them solely from convention; but convention is quite sufficient to confer the power; since nothing more is needful to make a person accept anything as money, and even at any arbitrary value, than the persuasion that it will be taken from him on the same terms by others. The only question is, what determines the value of such a [b]currency;[b] since it cannot be, as in the case of gold and silver (or paper exchangeable for them at pleasure), the cost of production.

We have seen, however, that even in the case of a metallic currency, the immediate agency in determining its value is its quantity. If the quantity, instead of depending on the ordinary mercantile motives of profit and loss, could be arbitrarily fixed by authority, the value would depend on the fiat of that authority, not on cost of production. The quantity of a paper

[a-a]48, 49, 52, 57, 62 of
[b-b]48, 49 currency?

currency not convertible into the metals at the option of the holder, [c]can[c] be arbitrarily fixed; especially if the issuer is the sovereign power of the state. The value, therefore, of such a currency, is entirely arbitrary.

Suppose that, in a country of which the currency is wholly metallic, a paper currency is suddenly issued, to the amount of half the metallic circulation; not by a banking establishment, or in the form of loans, but by the government, in payment of salaries and purchase of commodities. The currency being suddenly increased by one-half, all prices will rise, and among the rest, the prices of all things made of gold and silver. An ounce of manufactured gold will become more valuable than an ounce of gold coin, by more than that customary difference which compensates for the value of the workmanship; and it will be profitable to melt the coin for the purpose of being manufactured, until as much has been taken from the currency by the subtraction of gold, as had been added to it by the issue of paper. Then prices will relapse to what they were at first, and there will be nothing changed except that a paper currency has been substituted for half of the metallic currency which existed before. Suppose, now, a second emission of paper; the same series of effects will be renewed; and so on, until the whole of the metallic money has disappeared: that is, if paper be issued of as low a denomination as the lowest coin; if not, as much will remain, as convenience requires for the smaller payments. The addition made to the quantity of gold and silver disposable for ornamental purposes, will somewhat reduce, for a time, the value of the article; and as long as this is the case, even though paper has been issued to the original amount of the metallic circulation, as much coin will remain in circulation along with it, as will keep the value of the currency down to the reduced value of the metallic material; but the value having fallen below the cost of production, a stoppage or diminution of the supply from the mines will enable the surplus to be carried off by the ordinary agents of destruction, after which, the metals and the currency will recover their natural value. We are here supposing, as we have supposed throughout, that the country has mines of its own, and no commercial intercourse with other countries; for, in a country having foreign trade, the coin which is rendered superfluous by an issue of paper is carried off by a much prompter method.

Up to this point, the effects of a paper currency are substantially the same, whether it is convertible into specie or not. It is when the metals have been completely superseded and driven from circulation, that the difference between convertible and inconvertible paper begins to be operative. When the gold or silver has all gone from circulation, and an equal quantity of paper has taken its place, suppose that a still further issue is superadded. The same series of phenomena recommences: prices rise, among the rest

[c-c]48, 49, 52, 57, 62 *can*

the prices of gold and silver articles, and it becomes an object as before to procure coin in order to convert it into bullion. There is no longer any coin in circulation; but if the paper currency is convertible, coin may still be obtained from the issuers, in exchange for notes. All additional notes, therefore, which are attempted to be forced into circulation after the metals have been completely superseded, will return upon the issuers in exchange for coin; and they will not be able to maintain in circulation such a quantity of convertible paper, as to sink its value below the metal which it represents. It is not so, however, with an inconvertible currency. To the increase of that (if permitted by law) there is no check. The issuers may add to it indefinitely, lowering its value and raising prices in proportion; they may, in other words, depreciate the currency without limit.

Such a power, in whomsoever vested, is an intolerable evil. All variations in the value of the circulating medium are mischievous: they disturb existing contracts and expectations, and the liability to such changes renders every pecuniary engagement of long date entirely precarious. The person who buys for himself, or [d]gives[d] to another, an annuity of 100*l*., does not know whether it will be equivalent to 200*l*. or to 50*l*. a few years hence. Great as this evil would be if it depended only on accident, it is still greater when placed at the arbitrary disposal of [e]an individual[e] or a body of [f]individuals[f]; who may have any kind or degree of interest to be served by an artificial fluctuation in fortunes; and who have at any rate a strong interest in issuing as much as possible, each issue being in itself a source of profit. Not to add, that the issuers may have, and in the case of a government paper, always have, a direct interest in lowering the value of the currency, because it is the medium in which their own debts are computed.

§ 2. [*If regulated by the price of bullion, an inconvertible currency might be safe, but not expedient*] In order that the value of the currency may be secure from being altered by design, and may be as little as possible liable to fluctuation from accident, the articles least liable of all known commodities to vary in their value, the precious metals, have been made in all civilized countries the standard of value for the circulating medium; and no paper currency ought to exist of which the value cannot be made to conform to theirs. Nor has this fundamental maxim ever been entirely lost sight of, even by the governments which have most abused the power of creating inconvertible paper. If they have not (as they generally have) professed an intention of paying in specie at some indefinite future time, they have at least, by giving to their paper issues the names of their coins, made a virtual, though generally a false, profession of intending to keep them at a value corresponding to that of the coins. This is not impracticable,

[d-d]48, 49 grants [e-e]48, 49 a man [f-f]48, 49 men

even with an inconvertible paper. There is not indeed the self-acting check which convertibility brings with it. But there is a clear and unequivocal indication by which to judge whether the currency is depreciated, and to what extent. That indication is, the price of the precious metals. When holders of paper cannot demand coin to be converted into bullion, and when there is none left in circulation, bullion rises and falls in price like other things; and if it is above the Mint price, if an ounce of gold, which would be coined into the equivalent of *3l.* *17s.* *10½d.*, is sold for *4l.* or *5l.* in paper, the value of the currency has sunk just that much below what the value of a metallic currency would be. If, therefore, the issue of inconvertible paper were subjected to strict rules, one rule being that whenever bullion rose above the Mint price, the issues should be contracted until the market price of bullion and the Mint price were again in accordance, such a currency would not be subject to any of the evils usually deemed inherent in an inconvertible paper.

But also such a system of currency would have no advantages sufficient to recommend it to adoption. An inconvertible currency, regulated by the price of bullion, would conform exactly, in all its variations, to a convertible one; and the only advantage gained, would be that of exemption from the necessity of keeping any reserve of the precious metals; which is not a very important consideration, especially as a government, so long as its good faith is not suspected, needs not keep so large a reserve as private issuers, being not so liable to great and sudden demands, since there never can be any real doubt of its solvency. Against this small advantage is to be set, in the first place, the possibility of fraudulent tampering with the price of bullion for the sake of acting on the currency; in the manner of the fictitious sales of corn, to influence the averages, so much and so justly complained of while the corn laws were in force. But a still stronger consideration is the importance of adhering to a simple principle, intelligible to the most untaught capacity. Everybody can understand convertibility; every one sees that what can be at any moment exchanged for five pounds, is worth five pounds. Regulation by the price of bullion is a more complex idea, and does not recommend itself through the same familiar associations. There would be nothing like the same confidence, by the public generally, in an inconvertible currency so regulated, as in a convertible one: and the most instructed person might reasonably doubt whether such a rule would be as likely to be inflexibly adhered to. The grounds of the rule not being so well understood by the public, opinion would probably not enforce it with as much rigidity, and, in any circumstances of difficulty, would be likely to turn against it; while to the government itself a suspension of convertibility would appear a much stronger and more extreme measure, than a relaxation of what might possibly be considered a somewhat artificial rule.

There is therefore a great preponderance of reasons in favour of a convertible, in preference to even the best regulated inconvertible currency. The temptation to over-issue, in certain financial emergencies, is so strong, that nothing is admissible which can tend, in however slight a degree, to weaken the barriers that restrain it.

§ 3. [*Examination of the doctrine that an inconvertible currency is safe if representing actual property*] Although no doctrine in political economy rests on more obvious grounds than the mischief of a paper currency not maintained at the same value with a metallic, either by convertibility, or by some principal of limitation equivalent to it; and although, accordingly, this doctrine has, though not till after the discussions of many years, been tolerably effectually drummed into the public mind; yet dissentients are still numerous, and projectors every now and then start up, with plans for curing all the economical evils of society by means of an unlimited issue of inconvertible paper. There is, in truth, a great charm in the idea. To be able to pay off the national debt, defray the expenses of government without taxation, and in fine, to make the fortunes of the whole community, is a brilliant prospect, when once a man is capable of believing that printing a few characters on bits of paper will do it. The philosopher's stone could not be expected to do more.

As these projects, however often slain, always resuscitate, it is not superfluous to examine one or two of the fallacies by which the schemers impose upon themselves. One of the commonest is, that a paper currency cannot be issued in excess so long as every note issued *represents* property, or has a *foundation* of actual property to rest on. These phrases, of representing and resting, seldom convey any distinct or well-defined idea: when they do, their meaning is no more than this—that the issuers of the paper must *have* property, either of their own, or entrusted to them, to the value of all the notes they issue: though for what purpose does not very clearly appear; for if the property cannot be claimed in exchange for the notes, it is difficult to divine in what manner its mere existence can serve to uphold their value. I presume, however, it is intended as a guarantee that the holders would be finally reimbursed, in case any untoward event should cause the whole concern to be wound up. On this theory there have been many schemes for "coining the whole land of the country into money" and the like.

In so far as this notion has any connexion at all with reason, it seems to originate in confounding two entirely distinct evils, to which a paper currency is liable. One is, the insolvency of the issuers; which, if the paper is grounded on their credit—if it makes any promise of payment in cash, either on demand or at any future time—of course deprives the paper of any value which it derives from [a]the[a] promise. To this evil paper credit is equally liable, however moderately used; and against it, a proviso that all issues should be "founded on property," as for instance that notes should only be issued on the security of some valuable thing expressly pledged for their redemption, would really be efficacious as a precaution. But the theory takes no account of another evil, which is incident to the notes of the most solvent firm, company, or government; that of being depreciated in value from being issued in excessive quantity. The assignats, during the French Revolution were [b]an example[b] of a currency grounded on these principles. The assignats "represented" an immense amount of highly valuable property, namely the lands of the crown, the church, the monasteries, and the emigrants; amounting [c]possibly[c] to half the territory of France. They were, in fact, orders or assignments on this mass of land. The revolutionary government had the idea of "coining" these lands into money; but, to do them justice, they did not originally contemplate the immense multiplication of issues to which they were eventually driven by the failure of all other financial resources. They imagined that the assignats would come rapidly back to the issuers in exchange for land, and that they should be able to reissue them continually until the lands were all disposed of, without having at any time more than a very moderate quantity in circulation. Their hope was frustrated: the land did not sell so quickly as they expected; buyers were not inclined to invest their money in possessions which were likely to be resumed without compensation if the Revolution succumbed: the bits of paper which represented land, becoming prodigiously multiplied, could no more keep up their value than the land itself would have done if it had all been brought to market at once; and the result was that it at last required an assignat of [d]six[d] hundred francs to pay for a [e]pound of butter[e].

The example of the assignats has been said not to be conclusive, because an assignat only represented land in general, but not a definite quantity of land. To have prevented their depreciation, the proper course, it is affirmed, would have been to have made a valuation of all the confiscated property at its metallic value, and to have issued assignats up to, but not beyond, that limit; giving to the holders a right to demand any piece of land, at its registered valuation, in exchange for assignats to the same amount. There can be no question about the superiority of this plan over the one actually adopted. Had this course been followed, the assignats could never have been depreciated to the inordinate degree they were; for—as they would have retained all their purchasing power in relation to land, however much

[a-a]48, 49 that
[b-b]48, 49 a model
[c-c]48, 49, 52, 57 perhaps
[d-d]48, 49, 52, 57, 62 five
[e-e]48, 49, 52, 57, 62 cup of coffee

they might have fallen in respect to other things—before they had lost very much of their market value, they would probably have been brought in to be exchanged for land. It must be remembered, however, that their not being depreciated would presuppose that no greater number of them continued in circulation than would have circulated if they had been convertible into cash. However convenient, therefore, in a time of revolution, this currency convertible into land on demand might have been, as a contrivance for selling rapidly a great quantity of land with the least possible sacrifice; it is difficult to see what advantage it would have, as the permanent system of a country, over a currency convertible into coin: while it is not at all difficult to see what would be its disadvantages; since land is far more variable in value than gold and silver; and besides, land, to most persons, being rather an encumbrance than a desirable possession, except to be converted into money, people would submit to a much greater depreciation before demanding land, than they will before demanding gold or silver.*

[a]§ 4.[a] [[b]*Examination of the doctrine that an increase of the currency promotes industry*[b]] [c] Another of the fallacies from which the advocates

*Among the schemes of currency to which, strange to say, intelligent writers [48, 49 men] have been found to give their sanction, one is as follows: that the state should receive in pledge or mortgage, any kind or amount of property, such as land, stock, &c., and should advance to the owners inconvertible paper money to the estimated value. Such a currency would not even have the recommendations of the imaginary assignats supposed in the text: since those into whose hands the notes were paid by the persons who received them, could not return them to the Government, and demand in exchange land or stock which was only pledged, not alienated. There would be no reflux of such assignats as these, and their depreciation would be indefinite.

[a-a]49, 52, 57 §5. [*for* §4. *in* 49, 52, 57 *see* [b-b] *and* [c] *below*]

[b-b]49, 52, 57 *Examination of the doctrine that a convertible currency does not expand with the increase of wealth*

[c]49 One of the most transparent of the fallacies by which the principle of the convertibility of paper money has been assailed, is that which pervades a recent work by Mr. John Gray:* the author of the most ingenious, and least exceptionable plan of an inconvertible currency which I have happened to meet with. This writer has seized several of the leading doctrines of political economy with no ordinary grasp, and among others, the important one, that commodities are the real market for commodities, and that Production is essentially the cause and measure of Demand. But this proposition, true in a state of barter, he affirms to be false under a monetary system regulated by the precious metals, because if the aggregate of goods is increased faster than the aggregate of money, prices must fall, and all producers must be losers: now neither gold nor silver, nor any other valuable thing "can by any possibility be increased *ad libitum*, as fast as all other valuable things put together:" a limit, therefore, is arbitrarily set to the amount of production which can take place without loss to the producers: and on this foundation Mr. Gray accuses the existing system of rendering the produce of this country less by at least one hundred million

of an inconvertible currency derive support, is the notion that an increase of the currency quickens industry. This idea was set afloat by Hume, in his Essay on Money, and has had many devoted adherents since; witness the Birmingham currency school [d] , of whom Mr. Attwood was [e]at one[e] time the most conspicuous representative. Mr. Attwood maintained that a rise of prices produced by an increase of paper currency, stimulates every producer to his utmost [f]exertions[f], and brings all the capital and labour of the country into complete employment; and that this has invariably happened in all periods of rising prices, when the rise was on a sufficiently great scale. I presume, however, that the inducement which, according to Mr. Attwood, excited this unusual ardour in all persons engaged in production, must have been the expectation of getting more [g] commodities generally, more real wealth, in exchange for the produce of their labour, and not merely more pieces of paper. This expectation, however, must have been, by the very terms of the supposition, disappointed, since, all prices being supposed to rise equally, no one was really better paid for his goods than before. Those who agree with Mr. Attwood could only succeed

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pounds annually, than it would be under a currency which admitted of expansion in exact proportion to the increase of commodities.

But, in the first place, what hinders gold, or any other commodity whatever, from being "increased as fast as all other valuable things put together?" If the produce of the world, in all commodities taken together, should come to be doubled, what is to prevent the annual produce of gold from being doubled likewise? for that is all that would be necessary, and not, (as might be inferred from Mr. Gray's language) that it should be doubled as many times over as there are other "valuable things" to compare it with. Unless it can be proved that the production of bullion cannot be increased by the application of increased labour and capital, it is evident that the stimulus of an increased value of the commodity will have the same effect in extending the mining operations, as it is admitted to have in all other branches of production.

But, secondly, even if the currency could not be increased at all, and if every addition to the aggregate produce of the country must necessarily be accompanied by a proportional diminution of general prices; it is incomprehensible how any person who has attended to the subject can fail to see that a fall of price, thus produced, is no loss to producers: they receive less money; but the smaller amount goes exactly as far, in all expenditure, whether productive or personal, as the larger quantity did before. The only difference would be in the increased burthen of fixed money payments; and of that (coming, as it would, very gradually) a very small portion would fall on the productive classes, who have rarely any debts of old standing, and who would suffer almost solely in the increased onerousness of their contribution to the taxes which pay the interest of the National Debt. I should not have thought it necessary to be thus particular in pointing out so obvious a blunder, if the work of Mr. Gray had not been very widely circulated, and if the writer were not apparently capable of better things than he has in this instance exhibited. [*footnote:*] *"Lectures on the Nature and Use of Money. By John Gray." [Edinburgh: Black, 1848. *JSM quotes from* p. 250.]] 52, 57 *as* 49 . . . National Debt.

[d]48, 49 of the present day
[e-e]48, 49 for a
[f-f]48, 49 exertion [g]48, 49, 52, 57, 62 of

in winning people on to these unwonted exertions, by a prolongation of what would in fact be a delusion; contriving matters so, that by a progressive rise of money prices, every producer shall always seem to be in the very act of obtaining an increased remuneration which he never, in reality, does obtain. It is unnecessary to advert to any other of the objections to this plan, than that of its total impracticability. It calculates on finding the whole world persisting for ever in the belief that more pieces of paper are more riches, and never discovering that, with all their paper, they cannot buy more of anything that they could before. No such mistake was made during any of the periods of high prices, on the experience of which this school lays so much stress. At the periods which Mr. Attwood mistook for times of prosperity, and which were simply (as all periods of high prices, under a convertible currency, must be) times of speculation, the speculators did not think they were growing rich because the high prices would last, but because they would not last, and because whoever contrived to realize while they did last, would find himself, after the recoil, in possession of a greater number of pounds sterling, without their having become of less value. If, at the close of the speculation, an issue of paper had been made, sufficient to keep prices up to the point which they attained when at the highest, no one would have been more disappointed than the speculators; since the gain which they thought to have reaped by realizing in time (at the expense of their competitors, who bought when they sold, and had to sell after the revulsion) would have faded away in their hands, and instead of it they would have got nothing except a few more paper tickets to count by.

Hume's version of the doctrine differed in a slight degree from Mr. Attwood's. He thought that all commodities would not rise in price simultaneously, and that some persons therefore would obtain a real gain, by getting more money for what they had to sell, while the things which they wished to buy might not yet have risen. And those who would reap this gain would always be (he seems to think) the first comers. It seems obvious, however, that for every person who thus gains more than usual, there is necessarily some other person who gains less. The loser, if things took place as Hume supposes, would be the seller of the commodities which are slowest to rise; who, by the supposition, parts with his goods at the old prices, to purchasers who have already benefited by the new. This seller has obtained for his commodity only the accustomed quantity of money, while there are already some things of which that money will no longer purchase as much as before. If, therefore, he knows what is going on, he will raise his price, and then the buyer will not have the gain, which is supposed to stimulate his industry. But if, on the contrary, the seller does not know the state of the case, and only discovers it when he finds, in laying his money out, that it does not go so far, he then obtains less than the ordinary remuneration for his labour and capital; and if the other dealer's industry is encouraged, it should seem that his must, from the opposite cause, be impaired.

[a]§ 5.[a] [*Depreciation of currency is a tax on the community, and a fraud on creditors*] There is no way in which a general and permanent rise of prices, or in other words, depreciation of money, can benefit anybody, except at the expense of somebody else. The substitution of paper for [b] metallic currency is a national gain: any further increase of paper beyond this is but a form of robbery.

An issue of notes is a manifest gain to the issuers, who, until the notes are returned for payment, obtain the use of them as if they were a real capital: and so long as the notes are no permanent addition to the currency, but merely supersede gold or silver to the same amount, the gain of the issuer is a loss to no one; it is obtained by saving to the community the expense of the more costly material. But if there is no gold or silver to be superseded—if the notes are added to the currency, instead of being substituted for the metallic part of it—all holders of currency lose, by the depreciation of its value, the exact equivalent of what the issuer gains. A tax is virtually levied on them for his benefit. It will be objected by some, that gains are also made by the producers and dealers who, by means of the increased issue, are accommodated with loans. Theirs, however, is not an additional gain, but a portion of that which is reaped by the issuer at the expense of all possessors of money. The profits arising from the contribution levied upon the public, he does not keep to himself, but divides with his customers.

But besides the benefit reaped by the issuers, or by others through them, at the expense of the public generally, there is another unjust gain obtained by a larger class, namely by those who are under fixed pecuniary obligations. All such persons are freed, by a depreciation of the currency, from a portion of the burthen of their debts or other engagements: in other words, part of the property of their creditors is gratuitously transferred to them. On a superficial view it may be imagined that this is an advantage to industry; since the productive classes are great borrowers, and generally owe larger debts to the unproductive (if we include among the latter all persons not actually in business) than the unproductive classes owe to them; especially if the national debt be included. It is only thus that a general rise of prices can be a source of benefit to producers and dealers; by diminishing the pressure of their fixed burthens. And this might be accounted an advantage, if integrity and good faith were of no importance

[a-a]49, 52, 57 §6. [b]48 a

to the world, and to industry and commerce in particular. Not many, however, have been found to say that the currency ought to be depreciated on the simple ground of its being desirable to rob the national creditor and private creditors of a part of what is in their bond. The schemes which have tended that way have almost always had some appearance of special and circumstantial justification, such as the necessity of compensating for a prior injustice committed in the contrary direction.

[a]§ 6.[a] [*Examination of some pleas for committing this fraud*] Thus in England, [b]for many years subsequent to 1819, it was[b] pertinaciously contended, that a large portion of the national debt, and a multitude of private debts still in existence, were contracted between 1797 and 1819, when the Bank of England was exempted from giving cash for its notes; and that it is grossly unjust to borrowers, (that is, in the case of the national debt, to all tax-payers) that they should [c] be paying interest on the same nominal sums in a currency of full value, which were borrowed in a depreciated one. The depreciation, according to the views and objects of the particular writer, [d]was[d] represented to have averaged thirty, fifty, or even more than fifty per cent: and the conclusion [e]was[e], that either we ought to return to this depreciated currency, or to strike off from [f]the national debt, and from mortgages or other private debts of old standing[f], a percentage corresponding to the estimated amount of the depreciation.

To this doctrine, the following [g]was[g] the answer usually made. Granting that, by returning to cash payments without lowering the standard, an injustice was done to debtors, in holding them liable for the same amount of a currency enhanced in value, which they had borrowed while it was depreciated; it is now too late to make reparation for this injury. The debtors and creditors of to-day are not the debtors and creditors of 1819: the lapse of years has entirely altered the pecuniary relations of the community; and it being impossible now to ascertain the particular persons who were either benefited or injured, to attempt to retrace our steps would [h]not be[h] redressing a wrong, but superadding a second act of wide-spread injustice to the one already committed. This argument is certainly conclusive on the practical question; but it places the honest conclusion on too narrow and too low a ground. It concedes that the measure of 1819, called

[a-a]49, 52, 57 §7.
[b-b]48, 49, 52, 57 from 1819 to the present time, it has been
[c]48, 49, 52, 57 now
[d-d]48, 49, 52, 57 is
[e-e]48, 49, 52, 57 is
[f-f]48, 49 private debts of old standing (such as mortgages)
[g-g]48, 49, 52, 57 is
[h-h]48, 49, 52, 57, 62, 65 be not

Peel's Bill, by which cash payments were resumed at the original standard of 3*l.* 17*s.* 10½*d.*, was really the injustice it [i]was[i] said to be. This is an admission wholly opposed to the truth. Parliament had no alternative; it was absolutely bound to adhere to the acknowledged standard; as may be shown on three distinct grounds, two of fact, and one of principle.

The reasons of fact are these. In the first place it is not true that the debts, private or public, incurred during the Bank restriction, were contracted in a currency of lower value than that in which the interest is now paid. It is indeed true that the suspension of the obligation to pay in specie, did put it in the power of the Bank to depreciate the currency. It is true also that the Bank really exercised that power, though to a far less extent than is often pretended; since the difference between the market price of gold and the Mint valuation, during the greater part of the interval, was very trifling, and when it was greatest, during the last five years of the war, did not much exceed thirty per cent. To the extent of that difference, the currency was depreciated, that is, its value was below that of the standard to which it professed to adhere. But the state of Europe at that time was such—there was so unusual an absorption of the precious metals, by hoarding, and [j]in[j] the military chests of the vast armies which then desolated the Continent, that the value of the standard itself was very considerably raised: and the best authorities, among whom it is sufficient to name Mr. Tooke, have, after an elaborate investigation, satisfied themselves that the difference between paper and bullion was not greater than the enhancement in value of gold itself, and that the paper, though depreciated relatively to the then value of gold, did not sink below the ordinary value, at other times, either of gold or of a convertible paper. If this be true (and the evidences of the fact are conclusively stated in Mr. Tooke's *History of Prices*) the foundation of the whole case against the fundholder and other creditors on the ground of depreciation is subverted.

But, secondly, even if the currency had really been lowered in value at each period of the Bank restriction, in the same degree in which it was depreciated in relation to its standard, we must remember that a part only of the national debt, or of other permanent engagements, [k]was[k] incurred during the Bank restriction. A large part had been contracted before 1797; a still larger during the early years of the restriction, when the difference between paper and gold was yet small. To the holders of the former part, an injury was done, by paying the interest for twenty-two years in a depreciated currency: those of the second, suffered an injury during the years in which the interest was paid in a currency more depreciated than that in which the loans were contracted. To have resumed cash payments at a lower standard would have been to perpetuate the injury to these two

[i-i]48, 49, 52, 57 is [j-j]48, 49, 52, 57 by [k-k]48, 49, 52 were

classes of creditors, in order to avoid giving an undue benefit to a third class, who had lent their money during the few years of greatest depreciation. As it is, there was an underpayment to one set of persons, and an overpayment to another. The late Mr. Mushet took the trouble to make an arithmetical comparison between the two amounts. He ascertained by calculation, that if an account had been made out in 1819, of what the fundholders had gained and lost by the variation of the paper currency from its standard, they would have been found as a body to have been losers; so that if any compensation was due on the ground of depreciation, it would not be [l]from[l] the fundholders collectively, but [m]to[m] them.

Thus it is with the facts of the case. But these reasons of fact are not the strongest. There is a reason of principle, still more powerful. Suppose that, not a part of the debt merely, but the whole, had been contracted in a depreciated currency, depreciated not only in comparison with its standard, but with its own value before and after; and that we [n]were[n] now paying the interest of this debt in a currency fifty or even a hundred per cent more valuable than that in which it was contracted. What difference would this make in the obligation of paying it, if the condition that it should be so paid was part of the original compact? Now this is not only truth, but less than the truth. The compact stipulated better terms for the fundholder than he has received. During the whole continuance of the Bank restriction, there was a parliamentary pledge, by which the legislature was as much bound as any legislature is capable of binding itself, that cash payments should be resumed on the original footing, at farthest in six months after the conclusion of a general peace. This was therefore an actual condition of every loan; and the terms of the [o]loan[o] were more favourable in consideration of it. Without some such stipulation, the Government could not have expected to borrow, unless on the terms on which [p]loans are made[p] to the native princes of India. If it had been understood and avowed that, after borrowing the money, the standard at which it was [q]commuted[q] might be permanently lowered, to any extent which to the "collective wisdom" of a legislature of borrowers might seem fit—who can say what rate of interest would have been a sufficient inducement to [r]persons[r] of common sense to risk [s]their[s] savings in such an adventure? However much the fundholders had gained by the resumption of cash pay-

[l-l]48, 49, 52, 57, 62, 65 *from*
[m-m]48, 49, 52, 57, 62 *to*
[n-n]48, 49, 52, 57 are
[o-o]48, 49, 52 loans
[p-p]48, 49 men lend
[q-q]48, 49, 52, 57, 62, 65 computed [*printer's error?*]
[r-r]48, 49 a person
[s-s]48, 49 his

ments, the terms of the contract insured their giving ample value for it. They gave value for more than they received; since cash payments were not resumed in six months, but in as many years, after the peace. So that waving all our arguments except the last, and conceding all the facts asserted on the other side of the question, the fundholders, instead of being unduly benefited, are the injured party; and would have a claim to compensation, if such claims were not very properly barred by the impossibility of adjudication, and by the salutary general maxim of law and policy, "quod interest reipublicæ ut sit finis litium."

CHAPTER XIV

Of Excess of Supply

§ 1. [*Can there be an oversupply of commodities generally?*] After the elementary exposition of the theory of money contained in the last few chapters, we shall return to a question in the general theory of Value, which could not be satisfactorily discussed until the nature and operations of Money were in some measure understood, because the errors against which we have to contend mainly originate in a misunderstanding of those operations.

We have seen that the value of everything gravitates towards a certain medium point (which has been called the Natural Value), namely, that at which it exchanges for every other thing in the ratio of their cost of production. We have seen, too, that the actual or market value coincides, or nearly so, with the natural value, only on an average of years; and is continually either rising above, or falling below it, from alterations in the demand, or casual fluctuations in the supply: but that these variations correct themselves, through the tendency of the supply to accommodate itself to the demand which exists for the commodity at its natural value. A general convergence thus results from the balance of opposite divergences. Dearth, or scarcity, on the one hand, and over-supply, or in mercantile language, glut, on the other, are incident to all commodities. In the first case, the commodity affords to the producers or sellers, while the deficiency lasts, an unusually high rate of profit: in the second, the supply being in excess of that for which a demand exists at such a value as will afford the ordinary profit, the sellers must be content with less, and must [a], in extreme cases, submit to a loss.

Because this phenomenon of over-supply, and consequent inconvenience or loss to the producer or dealer, may exist in the case of any one commodity whatever, many persons, including some distinguished political economists, have thought that it may exist with regard to all commodities; that there may be a general over-production of wealth; a supply of commodities in the aggregate, surpassing the demand; and a consequent depressed condition of all classes of producers. Against this doctrine, of which Mr. Malthus and Dr. Chalmers in this country, and M. de Sismondi

[a]48, 49 even

on the Continent, were the chief apostles, I have already contended in the First Book;* but it was not possible, in that stage of our inquiry, to enter into a complete examination of an error (as I conceive) essentially grounded on a misunderstanding of the phenomena of Value and Price.

The doctrine appears to me to involve so much inconsistency in its very conception, that I feel considerable difficulty in giving any statement of it which shall be at once clear, and satisfactory to its supporters. They agree in maintaining that there may be, and sometimes is, an excess of productions in general beyond the demand for them; that when this happens, purchasers cannot be found at prices which will repay the cost of production with a profit; that there ensues a general depression of prices or values (they are seldom accurate in discriminating between the two), so that producers, the more they produce, find themselves the poorer, instead of richer; and Dr. Chalmers accordingly inculcates on capitalists the practice of a moral restraint in reference to the pursuit of gain; while Sismondi deprecates machinery, and the various inventions which increase productive power. They both maintain that accumulation of capital may proceed too fast, not merely for the moral, but for the material interests of those who produce and accumulate; and they enjoin the rich to guard against this evil by an ample unproductive consumption.

§ 2. [*The supply of commodities in general cannot exceed the power of purchase*] When these writers speak of the supply of commodities as outrunning the demand, it is not clear which of the two elements of demand they have in view—the desire to possess, or the means of purchase; whether their meaning is that there are, in such cases, more consumable products in existence than the public desires to consume, or merely more than it is able to pay for. In this uncertainty, it is necessary to examine both suppositions.

First, let us suppose that the quantity of commodities produced is not greater than the community would be glad to consume: is it, in that case, possible that there should be a deficiency of demand for all commodities, for want of the means of payment? Those who think so cannot have considered what it is which constitutes the means of payment for commodities. It is simply commodities. Each person's means of paying for the productions of other people consists of those which he himself possesses. All sellers are inevitably and *ex vi termini* buyers. Could we suddenly double the productive powers of the country, we should double the supply of commodities in every market; but we should, by the same stroke, double the purchasing power. Everybody would bring a double demand as well as supply: everybody would be able to buy twice as much, because every one

*Supra, vol. i. pp. 66–8.

would have twice as much to offer in exchange. It is probable, indeed, that there would now be a superfluity of certain things. Although the community would willingly double its aggregate consumption, it may already have as much as it desires of some commodities, and it may prefer to do more than double its consumption of others, or to exercise its increased purchasing power on some new thing. If so, the supply will adapt itself accordingly, and the values of things will continue to conform to their cost of production. At any rate, it is a sheer absurdity that all things should fall in value, and that all producers should, in consequence, be insufficiently remunerated. If values remain the same, what becomes of prices is immaterial, since the remuneration of producers does not depend on how much money, but on how much of consumable articles, they obtain for their goods. Besides, money is a commodity; and if all commodities are supposed to be doubled in quantity, we must suppose money to be doubled too, and then prices would no more fall than values would.

§ 3. [*The supply of commodities in general never does exceed the inclination to consume*] A general over-supply, or excess of all commodities above the demand, so far as demand consists in means of payment, is thus shown to be an impossibility. But it may perhaps be supposed that it is not the ability to purchase, but the desire to possess, that falls short, and that the general produce of industry may be greater than the community desires to consume—the part, at least, of the community which has an equivalent to give. It is evident enough, that produce makes a market for produce, and that there is wealth in the country with which to purchase all the wealth in the country; but those who have the means, may not have the wants, and those who have the wants may be without the means. A portion, therefore, of the commodities produced may be unable to find a market, from the absence of means in those who have the desire to consume, and the want of desire in those who have the means.

This is much the most plausible form of the doctrine, and does not, like that which we first examined, involve a contradiction. There may easily be a greater quantity of any particular commodity than is desired by those who have the ability to purchase, and it is abstractedly conceivable that this might be the case with all commodities. The error is in not perceiving that though all who have an equivalent to give, *might* be fully provided with every consumable article which they desire, the fact that they go on adding to the production proves that this is not *actually* the case. Assume the most favourable hypothesis for the purpose, that of a limited community, every member of which possesses as much of necessaries and of all known luxuries as he desires: and since it is not conceivable that persons whose wants were completely satisfied would labour and economize to obtain what they did not desire, suppose that a foreigner arrives and produces an additional quantity of something of which there was already enough. Here, it will be said, is over-production: true, I reply; over-production of that particular article: the community wanted no more of that, but it wanted something. The old inhabitants, indeed, wanted nothing; but did not the foreigner himself want something? When he produced the superfluous article, was he labouring without a motive? He has produced, but the wrong thing instead of the right. He wanted, perhaps, food, and has produced watches, with which everybody was sufficiently supplied. The new comer brought with him into the country a demand for commodities, equal to all that he could produce by his industry, and it was his business to see that the supply he brought should be suitable to that demand. If he could not produce something capable of exciting a new want or desire in the community, for the satisfaction of which some one would grow more food and give it to him in exchange, he had the alternative of growing food for himself; either on fresh land, if there was any unoccupied, or as a tenant, or partner, or servant, of some former occupier, willing to be partially relieved from labour. He has produced a thing not wanted, instead of what was wanted; and he himself, perhaps, is not the kind of producer who is wanted; but there is no over-production; production is not excessive, but merely ill assorted. We saw before, that whoever brings additional commodities to the market, brings an additional power of purchase; we now see that he brings also an additional desire to consume; since if he had not that desire, he would not have troubled himself to produce. Neither of the elements of demand, therefore, can be wanting, when there is an additional supply; though it is perfectly possible that the demand may be for one thing, and the supply may unfortunately consist of another.

Driven to his last retreat, an opponent may perhaps allege, that there are persons who produce and accumulate from mere habit; not because they have any object in growing richer, or desire to add in any respect to their consumption, but from *vis inertiæ*. They continue producing because the machine is ready mounted, and save and re-invest their savings because they have nothing on which they care to expend them. I grant that this is possible, and in some few instances probably happens; but these do not in the smallest degree affect our conclusion. For, what do these persons do with their savings? They invest them productively; that is, expend them in employing labour. In other words, having a purchasing power belonging to them, more than they know what to do with, they make over the surplus of it for the general benefit of the labouring class. Now, will that class also not know what to do with it? Are we to suppose that they too have their wants perfectly satisfied, and go on labouring from mere habit? Until this is the case; until the working classes have also reached the point of satiety—there will be no want of demand for the produce of capital, however rapidly it may accumulate: since, if there is nothing else for it to do, it can always find employment in producing the necessaries or luxuries of the labouring class. And when they too had no further desire for necessaries or luxuries, they would take the benefit of any further increase of wages by diminishing their work; so that the over-production which then for the first time would be possible in idea, could not even then take place in fact, for want of labourers. Thus, in whatever manner the question is looked at, even though we go to the extreme verge of possibility to invent a supposition favourable to it, the theory of general over-production implies an absurdity.

§ 4. [*Origin and explanation of the notion of general oversupply*] What then is it by which men who have reflected much on economical phenomena, and have even contributed to throw new light upon them by original speculations, have been led to embrace so irrational a doctrine? I conceive them to have been deceived by a mistaken interpretation of certain mercantile facts. They imagined that the possibility of a general over-supply of commodities was proved by experience. They believed that they saw this phenomenon in certain conditions of the markets, the true explanation of which is totally different.

I have already described the state of the markets for commodities which accompanies what is termed a commercial crisis. At such times there is really an excess of all commodities above the money demand: in other words, there is an under-supply of money. From the sudden annihilation of a great mass of credit, every one dislikes to part with ready money, and many are anxious to procure it at any sacrifice. Almost everybody therefore is a seller, and there are scarcely any buyers; so that there may really be, though only while the crisis lasts, an extreme depression of general prices, from what may be indiscriminately called a glut of commodities or a dearth of money. But it is a great error to suppose, with Sismondi, that a commercial crisis is the effect of a general excess of production. It is simply the consequence of an excess of speculative purchases. It is not a gradual advent of low prices, but a sudden recoil from prices extravagantly high: its immediate cause is a contraction of credit, and the remedy is, not a diminution of supply, but the restoration of confidence. It is also evident that this temporary derangement of markets is an evil only because it is temporary. The fall being solely of money prices, if prices did not rise again no dealer would lose, since the smaller price would be worth as much to him as the larger price was before. In no [a]manner[a] does this phenomenon answer to the description which these celebrated economists

[a-a]62 matter [*printer's error?*]

have given of the evil of over-production. [b]The[b] permanent decline in the circumstances of producers, for want of markets, which those writers contemplate, is a conception to which the nature of a commercial crisis gives no support.

The other phenomenon from which the notion of a general excess of wealth and superfluity of accumulation seems to derive countenance, is one of a more permanent nature, namely, the fall of profits and interest which naturally takes place with the progress of population and production. The cause of this decline of profit is the increased cost of maintaining labour, which results from an increase of population and of the demand for food, outstripping the advance of agricultural improvement. This important feature in the economical progress of nations will receive full consideration and discussion in the succeeding Book.* It is obviously a totally different thing from a want of market for commodities, though often confounded with it in the complaints of the producing and trading classes. The true interpretation of the modern or present state of industrial economy, is, that there is hardly any amount of business which may not be done, if people will be content to do it on small profits; and this, all active and intelligent persons in business perfectly well know: but even those who comply with the necessities of their time, grumble at what they comply with, and wish that there were less capital, or as they express it, less competition, in order that there might be greater profits. Low profits, however, are a different thing from deficiency of demand; and the production and accumulation which merely reduce profits, cannot be called excess of supply or of production. What the phenomenon really is, and its effects and necessary limits, will be seen when we treat of that express subject.

I know not of any economical facts, except the two I have specified, which can have given occasion to the opinion that a general over-production of commodities ever presented itself in actual experience. I am convinced that there is no fact in commercial affairs, which, in order to its explanation, stands in need of that chimerical supposition.

The point is fundamental; any difference of opinion on it involves radically different conceptions of Political Economy, especially in its practical aspect. On the one view, we have only to consider how a sufficient production may be combined with the best possible distribution; but on the other there is a third thing to be considered—how a market can be created for produce, or how production can be limited to the capabilities of the market. Besides; a theory so essentially self-contradictory cannot intrude itself without carrying confusion into the very heart of the subject, and making it impossible even to conceive with any distinctness many of the

*Infra, book iv. chap. 4 [pp. 733–46].

[b-b]48, 49, 52, 57, 62, 65 That

more complicated economical workings of society. This error has been, I conceive, fatal to the systems, as systems, of the three distinguished economists to whom I before referred, Malthus, Chalmers, and Sismondi; all of whom have admirably conceived and explained several of the elementary theorems of political economy, but this fatal misconception has spread itself like a veil between them and the more difficult portions of the subject, not suffering one ray of light to penetrate. Still more is [c]this[c] same confused idea constantly crossing and bewildering the speculations of minds inferior to theirs. It is but justice to two eminent names, to call attention to the fact, that the merit of having placed this most important point in its true light, belongs principally, on the Continent, to the judicious J. B. Say, and in this country to Mr. Mill; who (besides the conclusive exposition which he gave of the subject in his Elements of Political Economy) had set forth the correct doctrine with great force and clearness in an early pamphlet, called forth by a temporary controversy, and entitled, "Commerce Defended;"[*] the first of his writings which attained any celebrity, and which he prized more as having been his first introduction to the friendship of David Ricardo, the most valued and most intimate friendship of his life.

[*Mill, James. *Commerce Defended. An Answer to the Arguments by which Mr. Spence, Mr. Cobbett, and others, have attempted to prove that Commerce is not a Source of National Wealth.* London: Baldwin, 1808.]

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