**Description**

This section is from the book "[The Elements Of Banking](http://chestofbooks.com/finance/banking/Elements-Banking/index.html)", by Henry Dunning Macleod.

**Chapter VIII. On The Bank Charter Act Of 1844**

1. We shall now endeavour to explain as clearly as our [limits](http://chestofbooks.com/finance/banking/Elements-Banking/On-The-Limits-And-Extinction-Of-Credit.html) allow us - 1st. The Causes which led to the enactment of the Bank Charter Act of 1844; 2ndly. The Objects intended to be effected by that Act; 3rdly. The Mechanism devised for effecting those objects.

When the Bank of England was founded it [lent](http://chestofbooks.com/finance/banking/Elements-Banking/Lent.html) all its Capital to Government, and was allowed to issue an exactly equal amount of Notes. On several subsequent occasions its Capital was increased, and at the same time it was allowed to issue an equal amount of Notes. Thus for a considerable time its power of issuing Notes was strictly limited to the amount of its Capital, and it was provided that if the Directors issued Notes exceeding the amount of their Capital they should be liable in their private capacity. Afterwards they were released from this limitation, and they were allowed to issue Notes to any amount they pleased, provided always that they were payable in specie on demand.

2. In 1797 the Bank suspended [payments](http://chestofbooks.com/finance/banking/Elements-Banking/Payments.html) in cash, from causes which we need not detail here. But during the war, being endowed with the power of issuing any quantity of Notes they pleased, they gave countenance to very wild speculations, and at the same time an immense number of country banks started issuing torrents of Notes. The natural result of this was a heavy Depreciation of the Paper Currency. In February 1810, the Market, or Paper, [Price](http://chestofbooks.com/finance/banking/Elements-Banking/On-Price-Discount-And-Interest.html) of gold had risen to £4 10s., and the [Foreign Exchanges](http://chestofbooks.com/finance/banking/Elements-Banking/On-Foreign-Exchange.html) had fallen to a similar extent. Guineas commonly passed for a £1 note and 6s. or 7s.

This state of matters caused such a derangement of commerce that the Bullion Committee was appointed, who came to the resolution that this effect was caused by the excessive issues of Notes. They said that the true [value](http://chestofbooks.com/finance/banking/Elements-Banking/Chapter-II-On-Value.html) of the Paper was to be estimated by the Market or Paper Price of gold, and the state of the Foreign Exchanges. In former times a high price of bullion and an adverse state of the Exchanges, had compelled the Directors to reduce their issues to counteract the drain of guineas, and to preserve their own safety. Since the restriction they had not followed the same principles, as they did not feel the inconvenience. Nevertheless they ought to observe the same rules as before the restriction, and to continue to regulate their issues by the Market Price of bullion, and the state of the Foreign Exchanges.

Some proposals had been made of remedying the evil by a compulsory limitation of the Bank's power of issuing Notes. But the Committee entirely discountenanced the plan of imposing a numerical limit on the Bank's issues, because the necessary quantity could never be fixed: and such a course might very much aggravate the severity of a temporary pressure.

A very important distinction however was to be observed between a demand for gold for domestic purposes, sometimes great and sudden, and caused by a temporary failure of confidence, and a drain arising from the unfavourable state of the Foreign Exchanges: that a judicious increase of accommodation was the proper remedy for the former phenomenon: but a diminution of its issues the correct course to adopt in the latter.

The Report emphatically declared that the mere numerical amount of notes in [circulation](http://chestofbooks.com/finance/banking/Elements-Banking/On-Sale-Or-Circulation.html) at any time was no criterion whatever of their being excessive: the only sure criterion was to be found in the Price of gold bullion and the state of the Exchanges.

3. The House of Commons, however, rejected the Report of the Committee: and the Bank being freed from all restraint, still further increased its issues, which became still more depreciated, until in August 1813, the price of gold bullion rose to £5 10s., and the real value of the note was about 14s. 2c?.

In 1814-15-16 an immense number of country banks failed, which reduced the Paper Currency to about one-half: and the effect of this was that in October 1816 the Paper Price of gold had fallen to £3 18s. 6d. Thus the truth of the principles of the Bullion Report was clearly proved.

The Bank Note was now so nearly brought to par, that in November 1816, the Bank gave notice of their intention to pay off all notes dated before the 1st of January 1812: and in April 1817, all their notes dated before the 1st of January 1816.

But in April 1817 a drain of gold began: the Bank took no measures to stop it: the Paper Price of gold began to rise and the Foreign Exchange to fall. In January 1819, the Paper Price of gold was £4 3s., and the Exchange on Paris 23·50: the Bank would have been very soon drained of all its gold: and an Act was passed in April 1819 forbidding the Bank to make any payments in gold whatever.

4. The Bullion Report had been contumeliously rejected by Parliament: but it had been vehemently discussed by the press, and in 1819 it had entirely converted the mercantile world. The evidence given in its favour in 1819 was just as strong, as it had been adverse in 1810: and among other persons, it converted Peel, the chairman of the Commons' Committee in 1819, who said in his speech that there was no test of the excess or deficiency of the notes but a comparison with the price of gold. He also resisted the imposition of a limit on the issues of the Bank as a very unwise position, because there were occasions when what was called a run on the Bank might be arrested in its injurious effects by an increase of its issues. It was, therefore, impossible to prescribe any specific limitation of issues to be brought into operation at any period how remote so ever.

An Act was passed in 1819, commonly called Peel's Act, that the Acts in force for restraining cash payments should be continued till the 1st May 1823, when they were finally to cease. During the intervening period they might pay in bars or ingots of gold bullion of 60 oz. at certain prices: after the 1st of May 1823, they were to pay in gold coin as usual. This was Peel's Act which has been so much talked about: but it never came into operation at all. In 1821 the Directors having accumulated a large amount of treasure procured an Act by which they were allowed to resume cash payments on the 1st May 1821.

5. In 1824 a rapid drain began from the Bank, which took no measures to stop it; this went on all through 1824 and 1825, when the bullion which was above 13 millions in January 1824 was reduced to little over one million in December 1825. A great [monetary](http://chestofbooks.com/finance/banking/Elements-Banking/On-Monetary-And-Political-Convulsions-As-Influencing-The-Exchanges.html) crisis took place in this month, which was only arrested by the Bank making very liberal issues of notes to support solvent houses.

6. In 1827 the Bank was at last convinced of the truth of the principles of the Bullion Report and endeavoured to adopt them. The plan it devised was this - To keep their "[securities](http://chestofbooks.com/finance/banking/Elements-Banking/On-Foreign-Loans-Securities-And-Remittances-As-Affecting-The-Exchanges.html)" as nearly equal as possible: their cash and bullion at one-half of their securities: and consequently equal to one-third of their "liabilities." But on several occasions the bullion had fallen to about one-fifth instead of one-third. There were very severe monetary pressures in 1836 and 1837, but in the spring of 1838 the Bank was again got into its normal position. But about the end of 1838 another period of disorganisation commenced as shewn by the following figures -

|  |  |  |  |
| --- | --- | --- | --- |
| Date | Liabilities | Securities | Specie |
|  | £ | £ | £ |
| 1838 December 10 . | 28,120,000 | 20,776,000 | 9,794,000 |
| 1839 January 15 . | 30,305,000 | 24,529,000 | 8,336,000 |
| „ February 12 | 26,939,000 | 22,628,000 | 7,047,000 |
| „ March 12 . | 26,088,000 | 22,173,000 | 6,580,000 |
| „ April 30 . | 26,475,000 | 24,536,000 | 4,455,000 |
| „ May 14 . | 25,711,000 | 24,098,000 | 4,117,000 |
| „ July 16 . | 28,860,000 | 28,846,000 | 2,987,000 |

The Bank was thus rapidly drifting into bankruptcy; and was only saved from stopping [payment](http://chestofbooks.com/finance/banking/Elements-Banking/Payments.html) by negotiating foreign loans at Paris and Hamburg to the amount of £3,500,000.

There being shewn to be something radically defective in the management of the Bank led to the appointment of a Committee of the House of Commons in 1840, which condemned the principle upon which the Directors professed to act, but nothing could be done, as the Charter of the Bank did not expire till 1844.

7. In the meantime an influential sect of Currency writers had arisen, the most prominent of whom were Colonel Torrens, Lord Overstone, Mr. Norman, and others. They maintained the following principles -

1. That Bank Notes, i.e. the Promises of bankers to pay [money](http://chestofbooks.com/finance/banking/Elements-Banking/On-Money-And-Credit.html) on demand, alone are "Currency," and that no other forms of Paper Credit are Currency.

2. That if Banks are permitted to issue Notes they ought to be only exactly equal in amount to what the specie would have been if there were no Notes.

3. That any excess of Notes above the specie they displace is a Depreciation of the Currency.

Lord Overstone observed in his evidence before the Committee of the House of Commons in 1840 that it was a fundamental vice of the principle devised by the Directors in 1832 to carry out the doctrines of the Bullion Report, that the gold might all leave the country without causing any diminution of the amount of Notes in the hands of the public : we have seen that this assertion was completely verified in 1839.

8. The above-named writers being of great influence, converted Sir Robert Peel to their views, and his Bank Act of 1844 was expressly devised for the purpose of carrying these principles into effect: and the machinery adopted was as follows -

The Bank was divided into two Departments: the Issue Department, and the Banking Department.

The Directors were to [transfer](http://chestofbooks.com/finance/banking/Elements-Banking/On-Renewal-Or-Transfer-Or-Novation.html) to the Issue Department Securities to the [value](http://chestofbooks.com/finance/banking/Elements-Banking/Chapter-II-On-Value.html) of £14,000,000, of which the [debt](http://chestofbooks.com/finance/banking/Elements-Banking/On-The-Relation-Of-A-Banker-To-His-Customer-As-The-Purchaser-From-Him-Of-Money-O.html) due by the public to the Bank was to be a part: and also so much of the gold coin and gold and [silver](http://chestofbooks.com/finance/banking/Elements-Banking/On-The-Meaning-Of-The-Mint-Price-And-Market-Price-Of-Gold-And-Silver.html) bullion as should not be required for the banking department. The Issue Department was then to deliver over to the Banking Department an amount of Notes exactly equal to the Securities, Coin, and Bullion so deposited with them. The Banking Department was forbidden to issue Notes to any person whatever, except in exchange for other Notes, or such as they received from the Issue Department in terms of the Act.

No Banks or private bankers were allowed to commence issuing bank notes after the 6th May 1844 : and if any ceased to issue Notes after that date, the Bank might be authorised by the Crown in Council to increase the amount of Securities in the Issue Department to two-thirds of the Notes so withdrawn from [circulation](http://chestofbooks.com/finance/banking/Elements-Banking/On-Sale-Or-Circulation.html). Since 1844 several private bankers have ceased from business; and in terms of the Act the Bank's power of issuing Notes on securities has been increased to £15,000,000. Consequently its total power of issuing Notes is now limited to £15,000,000 plus the amount of bullion held by the Issue Department.

It was supposed that these provisions ensured that the Quantity of Notes in circulation, i.e. in the hands of the public, would be exactly equal to what a metallic Currency would have been, and that the outflow of bullion would by its own natural operation, have the mechanical effect of withdrawing Notes from the public to an equal amount. Having made these provisions, the framers of the Act supposed that they had taken out of the hands of the Bank all power of mismanaging the Currency, and that they might manage the banking department at their own discretion.

To say that the amount of Notes should only be equal to what a Metallic Currency would have been, is a very intelligible proposition; and as we have observed, several Banks have been constructed on that principle. But no banks constructed on this principle ever did, or by any possibility could do, banking business for profit. Every time that a Bank [discounts](http://chestofbooks.com/finance/banking/Elements-Banking/On-Price-Discount-And-Interest.html) a bill it is a violation of the "[Currency Principle](http://chestofbooks.com/finance/banking/Elements-Banking/On-The-Currency-Principle.html)." The Banks constructed on the Currency Principle were pure Banks of Deposit: they never did any discount business: they did nothing but exchange Credit for specie and specie for Credit: and if the Bank of England were forbidden to discount, there is no reason why it should not be reconstructed on this principle.

But to suppose that the Bank Act really does carry out this principle is a most manifest error. In the first place it is evident that the £15,000,000 of Notes issued against the Public Debt and Securities are a direct violation of the "Currency Principle." How did the Bank obtain these securities? By purchase. Now the purchase money of these securities is in circulation, and the Notes created on their security as well. Is it not clear that these 15 millions of Notes are an augmentation of Currency to that amount? If it be true that these 15 millions of Notes are not a violation of the "Currency Principle " then the very same argument would show that the whole National Debt might be coined into Notes, and then there would be no more Paper in circulation than under a purely Metallic Currency! Certainly it is an excellent plan for every one to buy the Funds with their cash, and then to be allowed to have it too in the form of Notes! This was exactly John Law's principle, and if we may coin the Funds into money we may just as well coin the land into money.

But this does not show the full extent of the error of those who think that the Bank Act enforces the "[Currency Principle](http://chestofbooks.com/finance/banking/Elements-Banking/On-The-Currency-Principle.html)." The Banking Department does business like any other bank. It purchases or [discounts](http://chestofbooks.com/finance/banking/Elements-Banking/On-Price-Discount-And-Interest.html) [Bills of Exchange](http://chestofbooks.com/finance/banking/Elements-Banking/On-Bills-Of-Exchange-And-Promissory-Notes.html) by creating [Credit](http://chestofbooks.com/finance/banking/Elements-Banking/On-Money-And-Credit.html) in its books; that it increases its liabilities in another form besides Notes. This Credit is equally in excess of the Metallic Currency.

Therefore it is quite clear that those who seriously maintain that the Bank Act really carries out the Currency Principle must maintain this proposition -

Twice 15 millions + an indefinite number of millions=15 millions.

In Banks constructed on the "Currency Principle" the Credit created is always exactly equal in quantity to the money deposited and kept in the bank. But how does this matter stand in regard to the Bank ? To test this we need only take any one of its published returns at random. On the 27th March 1873, it appears that the Credit created by the Bank amounted to £61,021,187, and the specie held by the Bank amounted to £23,886,372 or about 26 to 1. If therefore it be maintained that the Bank is constructed on the "Currency Principle" it must also be maintained that 2·6 are equal to 1.

As a matter of pure arithmetic, therefore, it is perfectly clear that the Bank Act completely fails to carry out the "Principle" it was intended to enforce. In fact the framers of the Act had a [Theory](http://chestofbooks.com/finance/banking/Elements-Banking/The-Theory-And-Practice-Of-Banking.html), and they passed an Act: but they never took the slightest pains to ascertain whether the Act corresponds with the Theory.

9. The expressed purpose of the Act was to cause a withdrawal of Notes from [circulation](http://chestofbooks.com/finance/banking/Elements-Banking/On-Sale-Or-Circulation.html), i.e. from the public, exactly-equal in quantity to the gold withdrawn from the Bank - in strict accordance with the "Currency Principle;" and it was supposed that if the Directors neglected this duty, the "mechanical" action of the Act would compel them to fulfil it. It is now to be seen how this expectation was fulfilled.

No occasion arose for testing the powers of the Act till April 1847. The well-known disasters of 1846 caused a steady drain of bullion from the Bank to commence in 1846. But the Bank made no alteration in the Rate of Discount till 1847, when the bullion was below 14 millions, and the bank raised its discount to 3 1/2. Having lost another million in a fortnight it raised discount to 4 per cent. But it made no further alteration till it had lost three millions more, and then it raised its discount to 5 per cent. Here we have the same inveterate error committed by the Bank as on so many previous occasions - an immense drain of bullion, and none but the most feeble and inefficient means taken to stop it. But this pressure is an excellent example to test the alleged "mechanical" action of the Act. We shall now see - 1st: How the Bank was inclined to act on the principle. 2nd: Supposing they were disinclined to do so, how far the Act, by its self-acting principles, could compel them to do so The following figures speak for themselves -

|  |  |  |  |
| --- | --- | --- | --- |
| Date | Bank Notes | Total Amount of Bullion | MinimumRate ofDiscountper cent. |
| Held by the Public | Held in He-serve by the Bank of England |
| 1846 August 29 . | 20,426,000 | 9,450.000 | 16,336,000 | 3 |
| ,, October 3 . | 20,551,000 | 8,809,000 | 15,817,000 | 3 |
| „ November 7 | 20,971,000 | 7,265,000 | 14,760,000 | 3 |
| „ December 19 | 19,549,000 | 8,864,000 | 15,163,000 | 3 |
| 1847 January 9 . | 20,837,000 | 6,715,000 | 14,308,000 | 3 |
| „ „ 16 . | 20,679,000 | 6,546,000 | 13,949,000 | 3 1/2 |
| ,, ,, 30 . | 20,469,000 | 5,704,000 | 12,902,000 | 4 |
| „ February 20 | 19,482,000 | 5,917,000 | 12,215,000 | 4 |
| „ March 6 | 19,279,000 | 5,715,000 | 11,596,000 | 4 |
| " 20 . | 19,069,000 | 5,419,000 | 11,232,000 | 4 |
| „ April 3 | 19,855,000 | 3,700,000 | 10,246,000 | 4 |
| " 10 | 20,243,000 | 2,558,000 | 9,867,000 | 5 |

These figures show the utter futility of the idea that, as the bullion diminished, the Act could compel a reduction of notes in the hands of the public, for the notes in circulation were within an insignificant trifle as large in amount when the bullion was only £9,867,000, as when it was £16,366,000. Consequently, nothing could be a more total and complete failure of the Act of 1844, on the very first occasion its services were required.

Lord Overstone complained to the Committee of 1840 that the principle laid down by the Directors for managing the Bank in 1832, provided no security that Notes should be withdrawn from circulation as the gold was withdrawn from the Bank: and it was the precise purpose of the Act of 1844 to compel the withdrawal of Notes from the public exactly in the same degree as gold was withdrawn from the Bank: and yet the foregoing figures show that the Bank Act failed on the very point it was expected to effect; and that it provided no effectual check whatever against mismanagement on the part of the Bank.

Whence did this failure arise? From this very simple circumstance. The framers of the Act supposed that there is only one way of extracting gold from the Bank, namely, by means of its Notes; and that if people want gold they must bring in Notes, and consequently, that as the gold comes out, Notes must go in.

But as a matter of simple banking business, there are two methods of extracting gold from the Bank - namely by Notes and [Cheques](http://chestofbooks.com/finance/banking/Elements-Banking/On-Cheques.html). Those persons who have Credit in its books may go and present Cheques, and thus draw out every ounce of gold from the banking department, without a single Bank Note being withdrawn from the public.

In fact instead of withdrawing the notes from the public, as was intended by the Act, the Directors threw the whole effect of the drain of gold on their own reserves. And that happened in this way. The public has two methods of extracting gold from the Banking Department, namely by Notes and Cheques: but the Banking Department has only one method of extracting gold from the Issue Department, namely, its Notes in reserve. And when the Banking Department felt a drain on its gold, it had to replenish it by obtaining a fresh supply from the Issue Departmerit, at the same time giving up an exactly equal amount of Notes. And thus the whole drain fell on its own reserves, without withdrawing a Note from the public.

No legislation can prevent this power of extracting gold from the Bank by means of Cheques. And thus is explained the complete failure of the "mechanical" action of the Act to compel the Directors to carry out the "Currency Principle." The Directors were able to commit, and actually did commit, the very same error as they had done before the Act - which Lord Over-stone had truly said was the fundamental vice of the Bank principle of 1832 - and it was powerless to prevent them.

And this simple fact completely upsets the whole theory of the Act.

The fact is that there are two leaks to the ship. The framers of the Act could only perceive one: and they only provided against one: and they were utterly astonished to find the ship rapidly sinking from the other leak they had forgotten.

10. Now as the Act notoriously and manifestly failed in this most important point, which it was supposed to have rendered so secure, and which was fully and candidly admitted by Sir Robert Peel, it becomes a natural inquiry to ask why it failed. The reply to this is that the Act failed because it aimed at the wrong mark altogether. It wholly missed the true point in the case.

In former times it was a mercantile dogma that the Exchanges could only be against the country in consequence of its being indebted to other countries. Nothing can be more striking than the vicious circle in which the Commercial witnesses argued before the Bullion Committee of 1810. They maintained with unflinching perseverance that the Exchanges could only be adverse because the country was indebted: and as the Exchanges were adverse, they maintained that the country must be indebted (without the slightest inquiry into the fact) because the exchanges were adverse.

However the Bullion Committee completely disproved this Commercial dogma: and they demonstrated beyond dispute that the depreciated Paper Currency was the cause of the Exchanges being apparently adverse: but that when this depreciated Paper Currency was reduced to its true [value](http://chestofbooks.com/finance/banking/Elements-Banking/Chapter-II-On-Value.html) in gold, the Exchanges were in reality in favour of the country.

The Commercial witnesses maintained that when the indebtedness was paid off, the drain of bullion would cease of itself. But the Bullion Committee proved that with a Paper Currency so depreciated as Bank Notes then were, the drain would not cease until all the specie in [circulation](http://chestofbooks.com/finance/banking/Elements-Banking/On-Sale-Or-Circulation.html) had left the country; which was amply verified in England at that period, and has been fully verified in many countries since.

The Bullion Committee thus shewed that there are two causes of a drain of bullion - 1st, the indebtedness of the country : 2nd, a depreciated Paper Currency.

But in our [Theory](http://chestofbooks.com/finance/banking/Elements-Banking/The-Theory-And-Practice-Of-Banking.html) and Practice of Banking first published in 1856, we shewed that there is a third cause of a drain of Bullion, and an adverse Exchange, which, however it might be known among commercial men, had never yet, that we have seen, found its way into any commercial book whatever, and most certainly had never been brought prominently before the public in Currency discussions, as a cause of an adverse Exchange, wholly irrespective of any indebtedness of the country, or of the state of the Paper Currency.

The principle is this -

That when the Rate of [Discount](http://chestofbooks.com/finance/banking/Elements-Banking/On-Price-Discount-And-Interest.html) between any two places differs by more than sufficient to pay the cost of transmitting bullion from one place to the other, bullion will flow from where discount is lower to where it is higher.

We have fully explained this principle in the preceding chapter, so that we need not repeat the explanation here. Hence if such a state of things arises, the Bank must, as an indispensable measure to preserve its own security, raise its Rate of Discount so as to destroy these profits; and so arrest the drain, which is exclusively caused by the difference of the Rates of Discount in the two places.

Now when bullion dealers fabricate Bills for the purpose of buying gold for exportation, this practice causes no increase of the Bank Notes in circulation: on the contrary, they are not wanted : it is gold that is demanded and taken for export, and it steals out of the country noiselessly and unobserved. Also if bankers in this country will perversely maintain the Rate of Discount lower here than in neighbouring countries, and, therefore, lower than the natural Rate, persons in foreign countries send their [debts](http://chestofbooks.com/finance/banking/Elements-Banking/On-The-Relation-Of-A-Banker-To-His-Customer-As-The-Purchaser-From-Him-Of-Money-O.html) or [securities](http://chestofbooks.com/finance/banking/Elements-Banking/On-Foreign-Loans-Securities-And-Remittances-As-Affecting-The-Exchanges.html) over here for sale, and the proceeds are remitted abroad. Consequently this practice causes an export of gold without diminishing the Notes in circulation. Of all species of property Debts are the most easily transportable. The charges on the transmission of gold even, are heavy compared to those on the transmission of Debts. Debts to any amount can be transmitted from one country to another at the mere expense of the postage. Consequently if the Americans can only get £85 per cent, for their Debts in their own country, and they can get £96 per cent, in England, of course, they will send them here in vast quantities for realisation. This was eminently and notoriously the case in 1839, when the Bank of England kept its Rate so perversely below the natural Rate, and it was the cause which aggravated the drain of bullion to so alarming an extent. Hence we have shewn that besides the causes universally known for a drain of bullion - the indebtedness of the country and a depreciated Paper Currency - there is another and most potent cause whose importance has only been recently sufficiently recognised, namely - an unnatural depression of the Bate of Discount below that of neighbouring countries.

Now this principle was not understood at the time the Bank Act of 1844 was passed: and in our work on Banking (1856) we stated this as a fundamental principle of the Currency -

An improperly low Rate of Discount is in its practical effects, a depreciation of the currency.

We therefore shewed that the only true method of striking at this demand for gold is by raising the Rate of Discount: and that the true supreme power of governing and controlling [Credit](http://chestofbooks.com/finance/banking/Elements-Banking/On-Money-And-Credit.html), or the Paper Currency, is by carefully adjusting the Rate of Discount by the state of the [Foreign Exchanges](http://chestofbooks.com/finance/banking/Elements-Banking/On-Foreign-Exchange.html), and the state of the Bullion in the Bank.

The fact is that bullion dealers are the natural enemies of bankers, and they are constantly on the watch to take any advantage they can of the weakness of bankers, if they sell gold too cheaply: and they want this gold, not for the purpose of the internal commerce of the country, as other traders do, but for the express purpose of sending it to be sold in other countries where it has a higher value. They act exactly as people would do with corn dealers if they were so foolish as to sell their wheat at half the price it was selling at in neighbouring markets. If the farmers were to keep selling their wheat at 40s. a quarter in England, while the price was 80s. in Paris, of course corn dealers would buy up the wheat in England and export it to France.

#  Now the weak point in the Act of 1844 is that it takes no notice of this grand principle: it takes no precaution that the Directors of the Bank of England shall recognise it, and counteract it. On the contrary it leaves them in full power to repeat their oft committed error of causing a depreciation of the Currency from an unnaturally low Rate of [Discount](http://chestofbooks.com/finance/banking/Elements-Banking/On-Price-Discount-And-Interest.html). And thus the fundamental vice of the Bank Act of 1844 is exactly the same as Lord Overstone said was the fundamental vice of the Bank principle of 1832. The whole of the gold may be drawn out of the Bank without withdrawing a single Note from [circulation](http://chestofbooks.com/finance/banking/Elements-Banking/On-Sale-Or-Circulation.html), i.e. from the hands of the public.

11. This principle was extremely little understood in 1856, when our work was published; but its truth was soon signally verified and acknowledged to be true by the most competent authorities. After the great crisis of 1857, a Committee of the House of Commons was appointed to investigate its causes, and Mr. Norman, a Director of the Bank of England, and one of the most prominent and influential advocates of the "[Currency Principle](http://chestofbooks.com/finance/banking/Elements-Banking/On-The-Currency-Principle.html)" and of the Bank Act of 1844 was asked -

Q. 3529. Is it not principally by raising the Rate of Interest that you check the amount of discounts which may be demanded of you ? - Yes: we have found, contrary to what would have been anticipated, that the power we possess, and which we exercise, of raising the Rate of Discount, keeps the demand upon us within manageable dimensions. There are other restrictions which are less important. The Rate we charge for our Discounts, we find in general, is a sufficient check.

In 1861 Mr. Goschen published his [Theory](http://chestofbooks.com/finance/banking/Elements-Banking/The-Theory-And-Practice-Of-Banking.html) of the [Foreign Exchanges](http://chestofbooks.com/finance/banking/Elements-Banking/On-Foreign-Exchange.html), in it he says "The efficacy of that corrective of an unfavourable state of the Exchanges, on which we have been dilating (i.e. raising the Rate of Discount) has been most thoroughly tested by late events. Every advance in the Bank Rate of Discount has been followed by a turn of the Exchanges in favour of England, and vice versâ, as soon as the Rate of Interest was lowered, the Exchanges became less favourable."

It is quite needless to quote any more evidence in favour of this principle: its truth is now as universally admitted by all competent persons as the Newtonian Law of Gravity. It is the acknowledged principle upon which the Bank of England is now managed: after our work was published in 1856, the Usury Laws in France were modified in order to enable the Bank of France to adopt it: and in fact it is now adopted by every Bank in the world.

In former times when the only communication between different countries was by means of sailing ships and common roads, and therefore very slow, expensive, and uncertain, this principle, though actually true, could seldom be called into action, because the cost and delay in the transport of gold would far exceed any profit to be made out of the difference in the Rates of Discount, in quiet times. It was like some mechanical force, which actually exists, but which is overpowered and prevented from producing any visible effect, in consequence of friction. But it did act in times of commercial crisis, when the Rate of Discount became extreme. In 1799 enormous failures took place at Hamburg: discount rose to 15 per cent., and this rate immediately drew gold away from England.

But in modern times, since communications have been so much accelerated and cheapened, even since the Act of 1844, by means of railroads and steamers, this friction, as we may call it, has been immensely diminished: and this great principle is called into action with a much less difference between the Rate3 of Discount than at any former period. Bullion would probably have taken ten days to go from London to Paris : it can now go in ten hours, and at probably the tenth part of the expense. A difference of 2 per cent, between the Rates of Discount in London and Paris will now draw bullion from one place to the other.

* next: [On The Causes Which Compelled The Suspension Of The Bank Act In 1847, 1857, And 1866](http://chestofbooks.com/finance/banking/Elements-Banking/On-The-Causes-Which-Compelled-The-Suspension-Of-The-Bank-Act-In-1847-1857-And.html)

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