

# Henry Thornton and Some of his Famous Readers: The Role of Gold in Classical Monetary Doctrine

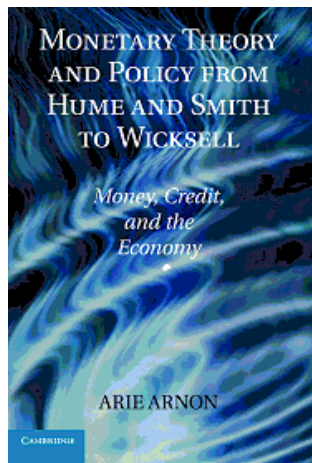
**Arie Arnon**

**Jérôme-Adolphe Blanqui Lecture**

**In the occasion of ESHET's Best Book Prize 2012**

**For**

***Monetary Theory and Policy from Hume and Smith to Wicksell:  
Money, Credit and the Economy***



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# Hicks (1967)

**“Monetary theory is less abstract than most economic theory; it cannot avoid a relation to reality, which in other economic theory is sometimes missing. It belongs to monetary history, in a way that economic theory does not always belong to economic history. ... Monetary theories arise out of monetary disturbances ... [and] money itself has been evolving.”**

# A Schematic Structure of the Banking System

## *The Bank of England*

### **Assets**

Gold  
Public Securities  
Private Securities

### **Liabilities**

Bank-notes  
Private Deposits  
London Banks' Deposits  
[small amount]

## *London's Private Banks*

### **Assets**

Gold  
Bank of England Notes  
Country Banks' Notes  
[small amount]  
Deposits with BoE  
Private Securities  
Public Securities

### **Liabilities**

Private Deposits  
Country Banks' Deposits

## *Country Banks*

### **Assets**

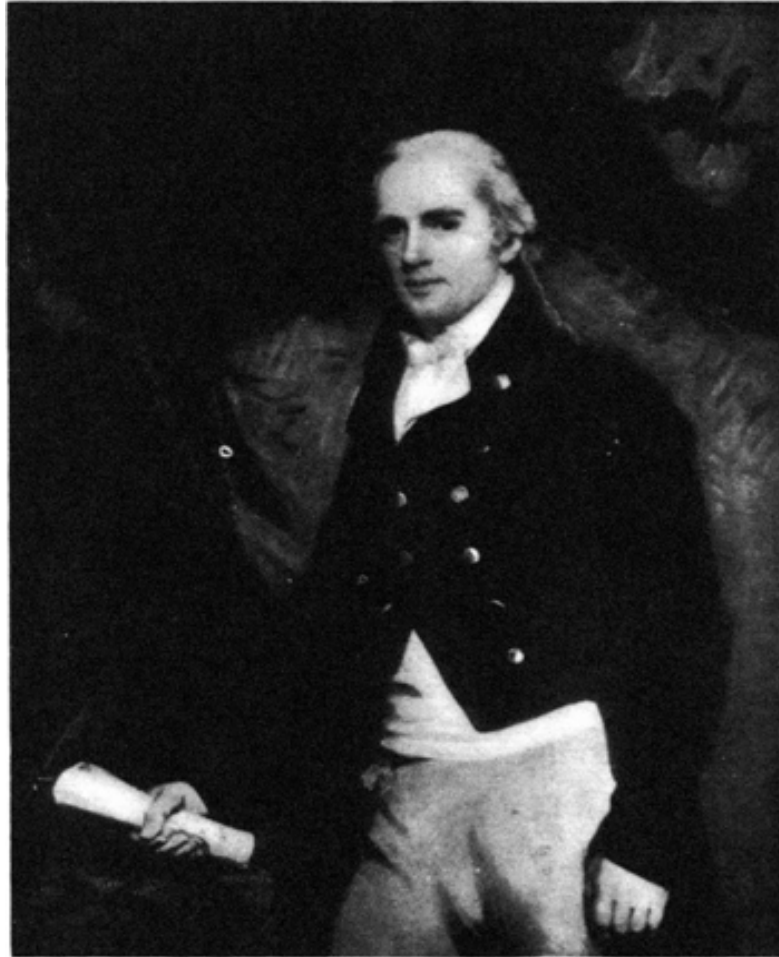
Gold  
Bank of England Notes  
Public Securities  
Private Securities  
Deposits with London's Banks  
(Deposits with BoE from 1825)

### **Liabilities**

Country Banks' Notes  
Private Deposits

- ❖ **The 1797 crisis and the creation of an inconvertible monetary system**
- ❖ **The debate between those objecting an early return to convertibility - the **anti bullionists** - and the supporters of a return to gold - the **bullionists****
- ❖ **Henry Thornton (1802) *An Enquiry into the Nature and Effects of the Paper Credit of Great Britain (1802) [Paper Credit]***
- ❖ **What was he in 1802? A Bullionist? An anti Bullionist?**

# Henry Thornton (1760-1815)



*[From the painting by J. Hoppner]*

AN  
*ENQUIRY*  
1810  
THE NATURE AND EFFECTS  
*of*  
THE PAPER CREDIT  
*of*  
GREAT BRITAIN.

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BY  
*HENRY THORNTON, ESQ.*  
M. P.

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LONDON:

PRINTED FOR J. WATKINS, BOOKSELLER TO THE QUEEN,  
(Opposite the Horse)  
PICCADILLY;

AND MESSRS. J. AND C. RITINGTON,  
ST. PAUL'S CHURCH-YARD.

1802

# Thornton's Monetary Contributions (1)

- **Defended the feasibility of a system without gold as its anchor**
- **Explained the importance of debts and credits, IOU's in modern terms**
- **Explained that a convertible as well as an inconvertible systems (i.e. based on gold or not) require management by a central body**
- **Argued that in England there exists such a body that can and should manage the system, the Bank of England (although at the time it was a private, joint stock bank).**

## **Thornton's Monetary Contributions (2)**

- Furthermore, the management of the banking system should be based on assessments of the current conditions in the economy and tuning the quantities of money and credit; i.e. modern monetary policy. And he**
  
- Understood that not only the payments system needs management, i.e. interventions, but also intermediation; i.e. the process of bridging savings and investments. In this context we find his analysis of the rate of interest and its relationship to the rate of profit. An early articulation of Wicksell's two rates analysis one hundred years later.**



## **Thornton's BoP Contributions (3)**

- **Concerning the balance of payments Thornton argued that imbalances could be the result of other reasons than too much money; thus, real causes (wars, bad seasons etc.) could explain gold flows; not just monetary expansions could cause gold flows.**

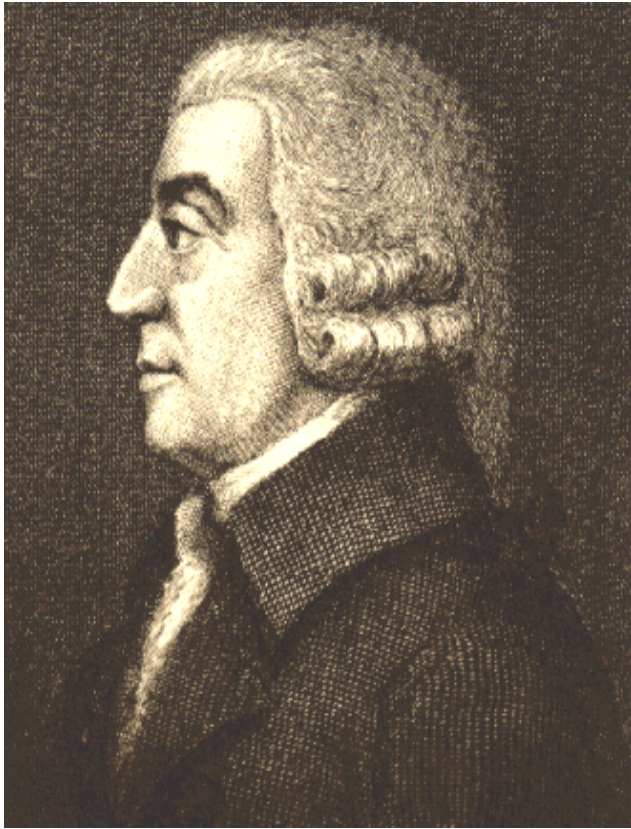
## Thornton's Contributions (4)

I will describe the claims concerning the monetary system as Thornton's **Monetary Innovations**, distinguishing between:

- The possibility of non-gold-standard, i.e. **Inconvertibility**,
- The importance of **Credits and Debts**
- The need for **Monetary Policy** and
- The **Two Rates** analysis;

○ And Thornton's claims concerning the Balance of Payments simply as his **BoP claims**.

**Adam Smith  
(1723-1790)**



**David Hume  
(1711-1776)**



# Hume & Smith

- **Convertibility i.e. “Gold Standard”.**

- **Hume and the Price-Specie-Flow-mechanism [PSF]**

- **Smith and free banking; the Real Bills Doctrine [RBD]**

**====→ No Interventions in the Monetary System**

# Paper Credit (1802)

## Real vs. Monetary Causes for Price Changes

**“Our two defective harvests, and the interventions experienced in our export trade, very sufficiently account for the late fluctuations of our exchanges.**

...

**there has been nothing which ought to be deemed extraordinary in the quantity of paper issued by the Bank of England.”**

**(225-6 emphasis added).**

## Paper Credit (1802)

Bank of England guiding the System between dangerous alternatives:

**“We have been lately placed between two dangers; between that of a depreciated paper currency on the one hand, and that of an interruption to our paper credit, and a consequent stagnation of our commerce and manufactures, on the other. And, on the whole, we have, perhaps, owed much to that liberal policy of the directors of the Bank of England ...”**

(226 emphasis added).

## Paper Credit (1802) Defending the Restriction

**"In a commercial country, subjected to that moderate degree of occasional alarm and danger which we have experienced, gold is by no means that kind of circulating medium which is the most desirable. It is apt to circulate with very different degrees of rapidity, and also to be suddenly withdrawn, in consequence of its being an article intrinsically valuable, and capable of being easily concealed."** (276, emphasis added).

## **Paper Credit (1802)**

### **Defending the Restriction**

**"If, during the war, it had been our only medium of payment, we might sometimes have been almost totally deprived of the means of carrying on our pecuniary transactions; and much confusion in the affairs of our merchants, great interruption of manufacturing labour, and very serious evils to the state, might have been the consequences."**      (276, emphasis added).



**Thornton's comments on King (1804)**  
**[written in his own copy around April 1804]**

**“A non-convertible Paper *which is limited* and is  
in full credit may maintain its price just as if it  
were convertible.”**

**[as they appear in Thornton’s copy of that important work, now in the  
Goldsmith library]**

**(Thornton 1804, 317; emphasis in the original).**

## Paper Credit (1802)

### The Bank as the regulator of the monetary system

**"The preceding observations explain the reason of a determination, adopted some time since by the bank directors, to limit the total weekly amount of loans furnished by them to the merchants. The adoption of a regulation for this purpose seems to have been rendered necessary by that impossibility of otherwise sufficiently limiting, at all times, the Bank of England paper . . . The regulation in question I consider as intended to confine within a specific, though in some degree fluctuating, sum, the loans of the bank, for the sake of restricting the paper."** (258)

## Paper Credit (1802)

**“the true policy of the directors of an institution circumstanced like that of the Bank of England”**

**"To limit the total amount of paper issued, and to resort for this purpose, whenever the temptation to borrow is strong, to some effectual principle of restriction; in no case, however, materially to diminish the sum in circulation, but to let it vibrate only within certain limits; to afford a slow and cautious extension of it, as the general trade of the kingdom enlarges itself; to allow of some special, though temporary, encrease in the event of any extraordinary alarm or difficulty, as the best means of preventing a great demand at home for guineas; and to lean to the side of diminution, in the case of gold going abroad, and of the general exchanges continuing long unfavourable." (259)**



## Three Early Readers: David Ricardo

**Ricardo, the Currency School and the  
Banking School all knew Thornton**

**Ricardo Read Thornton before the end of 1809  
and wrote the "Notes on Henry Thornton"**

**in Minor Papers on the Currency Question 1809-1823 (1932)  
edited by Jacob Hollander, pp.18-22.**

**The notes are focused on the causes of the high  
price of bullion and the links between the  
balance of trade, the price of gold and the  
quantity of notes.**

## Ricardo Conclusions in *The High Price of Bullion* Are Drawn Against Thornton

**"We should not import more goods than we export, unless we had a redundancy of currency, which it therefore suits us to make a part of our exports. **The exportation of the coin is caused by its cheapness, and is not the effect, but the cause of an unfavourable balance:** we should not export it, if we did not send it to a better market, or if we had any commodity which we could export more profitably. It is a salutary remedy for a redundant currency."**

# Ricardo

- **Disagrees with Thornton's Balance of Payments Arguments**
- **Ignores (or Rejects) his Monetary Innovations**

## Three Early Readers: Thomas Tooke



"In a work by the late Mr. Henry Thornton, [*Paper Credit*] which attracted considerable attention at the time, and which formed the subject of an article by Mr. Horner, in the first Number of the *Edinburgh Review* in 1802, there is a distinct and **full description of the manner in which bills of exchange performed in his time the function of money**; a description which is strictly applicable at the present day."

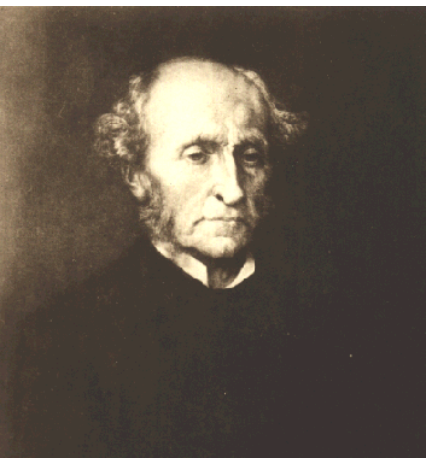
## Tooke

Adopted Thornton position on the **Balance of Payments**.

Did not adopt Thornton's other innovations, neither concerning **monetary policy nor that about the feasibility of inconvertibility**.

He was, however, **influenced by Thornton's analysis of credit in the economy**.





## Three Early Readers: John Stuart Mill on Credit

**"This work, published in 1802, is even now [1848] the clearest exposition that I am acquainted with, in the English language, of the modes in which credit is given and taken in a mercantile community."**

*Principles of Political Economy* (1848), p. 515n.

## **Three Early Readers: John Stuart Mill**

**"Mr. Attwood opines, that the multiplication of the circulating medium, and the consequent diminution of its value do not merely diminish the pressure of taxes and debts, and other fixed charges, but give employment to labour, and that to an indefinite extent. If we could work miracles, we would not be niggardly of them." (189)**

**Walter Bagehot**  
**(1826-1877)**



**Bagehot (1873) *Lombard Street: A Description of the Money Market***

**Knut Wicksell**  
**(1851-1926)**



***Geldzins und Guterpreise (1898)***

Translated in 1935 as: ***Interest and Prices A Study of the Causes Regulating the Value of Money***



## Three Twentieth Century Readers: Jacob Viner

**Thornton is described by Viner as the father of the correct mechanism that equalizes the balance of payments.**

**The mechanism has been attributed usually to JS Mill and also, by some, and mistakenly, to Ricardo, but is in fact outlined "apparently for the first time, by Henry Thornton in 1802."**

# Three Twentieth Century Readers: Jacob Viner

**Viner, as did Ricardo more than one hundred years before, addresses Thornton's contributions to the international mechanism;**

**however, all the other novelties in *Paper Credit* had to wait a few more years.**



## Three Twentieth Century Readers: Friedrich A. von Hayek

**“Henry Thornton, one of the most highly respected personalities in the City and a member of parliament, was equipped not only with unusually solid knowledge but also with a rare theoretical talent in his work.”**

(Hayek (1929/1991), 190-191)

## Three Twentieth Century Readers: Friedrich A. von Hayek

**“His book deserves to be ranked as one of the few outstanding achievements in the development of monetary theory. Its only flaw, a flaw that often mars theoretical investigations by practical men, is its unsystematic and incoherent structure, which makes it hard reading.”**

(Hayek (1929/1991), 190-191; my emphasis)



## Three Twentieth Century Readers: Friedrich A. von Hayek surprise!

“The major part of the first half of Thornton’s book is devoted to a detailed presentation of the dangers of such a scarcity of money. Suffice it to recognise **here its major contribution to economic science**: gaining acceptance for the principle that in the face of gold withdrawals caused by such a domestic shortage of money, that is, an ‘internal drain’, **the correct response for a note-issuing bank is to maintain the level of circulating money rather than decrease it, if a panic is to be avoided.**”

(194).

# Three Twentieth Century Readers: Friedrich A. von Hayek surprise!

**“Thornton raises the question whether there exists a natural tendency to keep note circulation within limits that exclude a dangerous devaluation of notes. In answering this question he first demonstrates that **neither reliance on the wealth of the borrower nor limitation to genuine commodity-backed notes can, offer assurance against this danger.** ... Thornton reiterates emphatically that every time the prevailing profit rate in business exceeded the interest rate of the bank, there would be a tendency to over-issue notes.”**

# Three Twentieth Century Readers: Friedrich A. von Hayek

Appreciated Thornton's position on the  
**Balance of Payments.**

Appreciated Thornton's other innovations,  
concerning **monetary analysis.**



## Three Twentieth Century Readers: John Hicks

**“When I wrote these papers, I was rather assuming that you had lost interest in economics, so that I could write about you almost as I have done about Dennis [Robertson], or even about Thornton himself! After your letter, I feel I must present it rather differently.”**

(Hicks to Hayek, Dec. 24, 1965; Hayek Papers, Hoover Archives, Box 24 folder 32)

## Three Twentieth Century Readers: John Hicks

Hayek's *Introduction* [to Thornton 1939] is "**in most ways an admirable Introduction**" writes Hicks, "**But there was one thing Hayek did not say.**" (1967, 174) Hayek read Thornton as a Bullionist, Hicks notes, one of the drafters of the Bullion Report and hence "**one of the fathers of the 'classical' tradition in monetary theory**" [the orthodoxy in Fetter's language]; however, Thornton was not one of Keynes's classicals, argues Hicks.

## Three Twentieth Century Readers: John Hicks

The route Thornton followed in his analysis, though it resulted in classical conclusions, "**incorporated some of the chief things which Keynes, 130 years later, was to rediscover.**" (174)

"It is not, I think, too much to claim, ... that he was quite clearly thinking in terms of what Keynes has taught us to call Liquidity Preference.... Thornton has started off on what we should consider a remarkably Keynesian tack." (177)

## Blanqui in the *History of Political Economy in Europe*

“One of the most interesting works published at this period by Mr. Henry Thornton, had for its aim **the justification of the suspension of specie payments;** and although it abounded in errors, no other work has ever given a clearer comprehension of **the advantages of the monetary circulation, whether in paper or specie.** The author maintained that banks could indefinitely favor labor and multiply production without having need of specie, on the single condition of prudently regulating their issues. He proclaimed the benefits of credit, in full view of a measure which would seem to have annihilated it; and **the future has justified his most reasonable predictions.**”

In Ch. XL "Political Economy in England from the beginning of the nineteenth century. – Pitt's system, supported by Thornton, attacked by Cobbett...." p. 455