The Principles of Political Economy

John Stuart Mill

Exchange

1Value

The subject on which we are now about to enter fills soand conspicuous a position in political economy, thatthe apprehension of some thinkers its boundaries confoundwith those of the science itself. One eminent writerproposed as a name for Political Economy, "Catallactics," orscience of exchanges: by others it has been called theof Values. If these denominations had appeared to mecorrect, I must have placed the discussion of thelaws of value at the commencement of our inquiry,of postponing it to the Third Part; and the possibilityso long deferring it is alone a sufficient proof that thisof the nature of Political Economy is too confined. It isthat in the preceding Books we have not escaped theof anticipating some small portion of the theory of, especially as to the value of labour and of land. It isevident, that of the two great departments ofEconomy, the production of wealth and its distribution,consideration of Value has to do with the latter alone; andthat, only so far as competition, and not usage or custom,the distributing agency. The conditions and laws of Productionbe the same as they are, if the arrangements of society diddepend on Exchange, or did not admit of it. Even in thesystem of industrial life, in which employments aresubdivided, and all concerned in production depend forremuneration on the price of a particular commodity,is not the fundamental law of the distribution of the, no more than roads and carriages are the essential lawsmotion, but merely a part of the machinery for effecting it.confound these ideas, seems to me, not only a logical, but ablunder. It is a case of the error too common ineconomy, of not distinguishing between necessitiesfrom the nature of things, and those created by social: an error, which appears to me to be at all timestwo opposite mischiefs; on the one hand, causingeconomists to class the merely temporary truths ofsubject among its permanent and universal laws; and on the, leading many persons to mistake the permanent laws of(such as those on which the necessity is grounded ofpopulation) for temporary accidents arising from theconstitution of society-which those who would frame asystem of social arrangements, are at liberty to disregard.

In a state of society, however, in which the industrialis entirely founded on purchase and sale, each individual,the most part, living not on things in the production ofhe himself hears a part, but on things obtained by a double, a sale followed by a purchase-the question of Value is. Almost every speculation respecting the economicalof a society thus constituted, implies some theory of: the smallest error on that subject infects witherror all our other conclusions; and anything vaguemisty in our conception of it, creates confusion andin everything else. Happily, there is nothing in theof Value which remains for the present or any future writerclear up; the theory of the subject is complete: the onlyto be overcome is that of so stating it as to solve bythe chief perplexities which occur in applying it:to do this, some minuteness of exposition, and considerableon the patience of the reader, are unavoidable. He willamply repaid, however (if a stranger to these inquiries), byease and rapidity with which a thorough understanding of thiswill enable him to fathom most of the remaining questionspolitical economy.

We must begin by settling our phraseology. Adam Smith, inpassage often quoted, has touched upon the most obviousof the word value; which, in one of its senses,usefulness, in another, power of purchasing; in his own, value in use and value in exchange. But (as Mr. Dehas remarked) in illustrating this double meaning, Adamhas himself fallen into another ambiguity. Things (he says)have the greatest value in use have often little or noin exchange; which is true, since that which can bewithout labour or sacrifice will command no price,useful or needful it may be. But he proceeds to add, thatwhich have the greatest value in exchange, as a diamondexample, may have little or no value in use. This isthe word use, not in the sense in which politicalis concerned with it, but in that other sense in whichis opposed to pleasure. Political economy has nothing to dothe comparative estimation of different uses in the judgmenta philosopher or a moralist. The use of a thing, in political, means its capacity to satisfy a desire, or serve a. Diamonds have this capacity in a high degree, and unlesshad it, would not bear any price. Value in use, or as Mr. Decalls it, teleologic value, is the extreme limit of valueexchange. The exchange value of a thing may fall short, to any, of its value in use; but that it can ever exceed thein use, implies a contradiction; it supposes that personsgive, to possess a thing, more than the utmost value whichthemselves put upon it as a means of gratifying their.

The word Value, when used without adjunct, always means, ineconomy, value in exchange; or as it has been called bySmith and his successors, exchangeable value, a phrase whichamount of authority that can be quoted for it can make otherbad English. Mr. De Quincey substitutes the term Exchange, which is unexceptionable.

Exchange value requires to be distinguished from Price. TheValue and Price were used as synonymous by the earlyeconomists, and are not always discriminated even by. But the most accurate modern writers, to avoid theexpenditure of two good scientific terms on a single, have employed Price to express the value of a thing into money; the quantity of money for which it will. By the price of a thing, therefore, we shall henceforthits value in money; by the value, or exchange value ofthing, its general power of purchasing; the command which itsgives over purchaseable commodities in general.

But here a fresh demand for explanation presents itself.is meant by command over commodities in general? The sameexchanges for a great quantity of some commodities, and forvery small quantity of others. A suit of clothes exchanges forgreat quantity of bread, and for a very small quantity ofstones. The value of a thing in exchange for somemay be rising, for others falling. A coat mayfor less bread this year than last, if the harvest hasbad, but for more glass or iron, if a tax has been taken offcommodities, or an improvement made in their manufacture.the value of the coat, under these circumstances, fallen or? It is impossible to say. all that can be said is, that itfallen in relation to one thing, and risen in respect to. But there is another case, in which no one would havehesitation in saying what sort of change had taken place invalue of the coat: namely, if the cause in which theof exchange values originated, was something directlythe coat itself, and not the bread or the glass., for example, that an invention had been made in, by which broadcloth could be woven at half the former. The effect of this would be to lower the value of a coat,if lowered by this cause, it would he lowered not in relationbread only or to glass only, but to all purchaseable things,such as happened to be affected at the very time by adepressing cause. We should therefore say, that there hada fall in the exchange value or

general purchasing power ofcoat. The idea of general exchange value originates in the, that there really are causes which tend to alter the valuea thing in exchange for things generally, that is, for allwhich are not themselves acted upon by causes of similar.

In considering exchange value scientifically, it is expedientabstract from it all causes except those which originate invery commodity under consideration. Those which originate incommodities with which we compare it, affect its value into those commodities; but those which originate in, affect its value in relation to all commodities. In ordermore completely to confine our attention to these last, it isto assume that all commodities but the one in questioninvariable in their relative values. When we arethe causes which raise or lower the value of corn, wethat woollens, silks, cutlery, sugar, timber, &c., whilein their power of purchasing corn, remain constant in thein which they exchange for one another. On this, any one of them may be taken as a representative ofthe rest; since in whatever manner corn varies in value withto any one commodity, it varies in the same manner andwith respect to every other; and the upward or downwardof its value estimated in some one thing, is all thatbe considered. Its money value, therefore, or price, willas well as anything else its general exchange value, orpower; and from an obvious convenience, will often beby us in that representative character; with the provisomoney itself do not vary in its general purchasing power,that the prices of all things, other than that which weto be considering, remain unaltered.

The distinction between Value and Price, as we have nowthem, is so obvious, as scarcely to seem in need of any. But in political economy the greatest errors ariseoverlooking the most obvious truths. Simple as thisis, it has consequences with which a readerwith the subject would do well to begin early byhimself thoroughly familiar. The following is one of the. There is such a thing as a general rise of prices. Allmay rise in their money price. But there cannot be arise of values. It is a contradiction in terms. A canrise in value by exchanging for a greater quantity of B and; in which case these must exchange for a smaller quantity of A.things cannot rise relatively to one another. If one-half ofcommodities in the market rise in exchange value, the veryimply a fall of the other half; and reciprocally, the falla rise. Things which are exchanged for one another can noall fall, or all rise, than a dozen runners can each outrunthe rest, or a hundred trees all overtop one another. Simplethis truth is, we shall presently see that it is lost sight ofsome of the most accredited doctrines both of theorists and ofare called practical men. And as a first specimen, we maythe great importance attached in the imagination of mostto a rise or fall of general prices. Because when theof any one commodity rises, the circumstance usuallya rise of its value, people have an indistinct feelingall prices rise, as if all things simultaneously had risenvalue, and all the possessors had become enriched. That theprices of all things should rise or fall, provided they allor fall equally, is in itself, and apart from existing, of no consequence. It affects nobody's wages, profits,rent. Every one gets more money in the one case and less inother; but of all that is to be bought with money they getmore nor less than before. It makes no other differencethat of using more or fewer counters to reckon by. The onlywhich in this case is really altered in value is money; andonly persons who either gain or lose are the holders of, or those who have to receive or to pay fixed sums of it.is a difference to annuitants and to creditors the one way,to those who are burthened with annuities, or with debts, theway. There is a disturbance, in

short, of fixed money; and this is an evil, whether it takes place in the's favour or in the creditor's. But as to futurethere is no difference to any one. Let it thereforeremembered (and occasions will often arise for calling it to) that a general rise or a general fall of values is a; and that a general rise or a general fall ofis merely tantamount to an alteration in the value of, and is a matter of complete indifference, save in so farit affects existing contracts for receiving and paying fixedamounts, and (it must be added) as it affects theof the producers of money.

Before commencing the inquiry into the laws of value and, I have one further observation to make. I must give, once for all, that the cases I contemplate are those invalues and prices are determined by competition alone. Infar only as they are thus determined, can they be reduced toassignable law. The buyers must be supposed as studious tocheap, as the sellers to sell dear. The values and prices,, to which our conclusions apply, are mercantile valuesprices; such prices as are quoted in price-currents; pricesthe wholesale markets, in which buying as well as selling is aof business; in which the buyers take pains to know, anddo know, the lowest price at which an article of aquality can he obtained; and in which, therefore, the axiomtrue, that there cannot be for the same article, of the same, two prices in the same market. Our propositions will bein a much more qualified sense, of retail prices; the pricesin shops for articles of personal consumption. For suchthere often are not merely two, but many prices, inshops, or even in the same shop; habit and accidentas much to do in the mater as general causes. Purchasesprivate use, even by people in business, are not always madebusiness principles: the feelings which come into play in theof getting, and in that of spending their income, areextremely different. Either from indolence, or, or because people think it fine to pay and ask no, three-fourths of those who can afford it give muchprices than necessary for the things they consume; whilepoor often do the same from ignorance and defect of judgment,of time for searching and making inquiry, and notfrom coercion, open or disguised. For these reasons,prices do not follow with all the regularity which mightexpected, the action of the causes which determine wholesale. The influence of those causes is ultimately felt in themarkets, and is the real source of such variations inprices as are of a general and permanent character. Butis no regular or exact correspondence. Shoes of equallyquality are sold in different shops at prices which differ; and the price of leather may fall without causingricher class of buyers to pay less for shoes. Nevertheless,do sometimes fall in price; and when they do, the cause issome such general circumstance as the cheapening of: and when leather is cheapened, even if no differenceitself in shops frequented by rich people, the artizan andlabourer generally get their shoes cheaper, and there is adiminution in the contract prices at which shoes arefor the supply of a workhouse or of a regiment. In allabout prices, the proviso must be understood,"supposing all parties to take care of their own interest." Into these distinctions has led to improper applicationsthe abstract principles of political economy, and stillto an undue discrediting of those principles, throughbeing compared with a different sort of facts from thosethey contemplate, or which can fairly be expected to accordthem.

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3, Distribution

2Demand and Supply in Their Relation to Value

1. That a thing may have any value in exchange, twoare necessary. It must be of some use; that is (asexplained) it must conduce to some purpose, satisfy some. No one will pay a price, or part with anything whichsome of his purposes, to obtain a thing which serves nonethem. But, secondly, the thing must not only have some, there must also be some difficulty in its attainment."Any article whatever," says Mr De Quincey,(1*) "to obtain thatsort of value which is meant by exchange value, mustby offering itself as a means to some desirable purpose;secondly, even though possessing incontestably thisadvantage, it will never ascend to an exchange valuecases where it can be obtained gratuitously and without; of which last terms both are necessary as limitations.often it will happen that some desirable object may begratuitously; stoop, and you gather it at your feet; but, because the continued iteration of this stooping exacts aeffort, very soon it is found, that to gather forvirtually is not gratuitous. In the vast forests of the, at intervals, wild strawberries may be gratuitouslyby shiploads: yet such is the exhaustion of a stooping, and of a labour so monotonous, that everybody is soonto resign the service into mercenary hands."

As was pointed out in the last chapter, the utility of ain the estimation of the purchaser, is the extreme limit ofexchange value: higher the value cannot ascend; peculiarare required to raise it so high. This topic isillustrated by Mr. De Quincey. "Walk into almost anyshop, buy the first article you see; what will determineprice? In the ninety-nine cases out of a hundred, simply theD — difficulty of attainment. The other element U, orutility, will be perfectly inoperative. Let the thing(measured by its uses) be, for your Purposes, worth ten guineas,that you would rather give ten guineas than lose it; yet, ifdifficulty of producing it be only worth one guinea, oneis the price which it will bear. But still not the less,U is inoperative, can U be supposed absent? By no; for, if it had been absent, assuredly you would notbought the article even at the lowest price. U acts upon, though it does not act upon the price. On the other hand, inhundredth case, we will suppose the circumstances reversed:are on Lake Superior in a steam-boat, making your way to anregion 800 miles a-head of civilization, andwith no chance at all of purchasing any luxury, little luxury or big luxury, for the space of tento come. One fellow-passenger, whom you will part withsunset, has a powerful musical snuff-box; knowing bythe power of such a toy over your own feelings, thewith which at times it lulls your agitations of mind, youvehemently desirous to purchase it. In the hour of leavingyou had forgot to do so; here is a final chance. But the, aware of your situation not less than yourself, isto operate by a strain pushed to the very uttermostU, upon the intrinsic worth of the article in yourestimate for your individual purposes. He will notof D as any controlling power or mitigating agency in the; and finally, although at six guineas a-piece in London oryou might have loaded a waggon with such boxes, you payrather than lose it when the last knell of the clock has, which summons you to buy now or to forfeit for ever., as before, only one element is operative; before it was D,it is U. But after all, D was not absent,

though inoperative.inertness of D allowed U to put forth its total effect. Thecompression of D being withdrawn, U springs up likein a pump when released from the pressure of air. Yet stillD was present to your thoughts, though the price wasregulated, is evident; both because U and D mustin order to found any case of exchange value whatever,because undeniably you take into very particularthis D, the extreme difficulty of attainment (whichis the greatest possible, viz. an impossibility) before youto have the price racked up to U. The special D has; but it is replaced in your thoughts by an unlimited D.you have submitted to U in extremity as theforce of the price; but it was under a sense of D'spresence. Yet D is so far from exerting any positive, that the retirement of D from all agency whatever on thethis it is which creates as it were a perfect vacuum, andthat vacuum U rushes up to its highest and ultimate."

This case, in which the value is wholly related by theor desires of the purchaser, is the case of strictabsolute monopoly; in which, the article desired being onlyfrom one person, he can exact any equivalent, short ofpoint at which no purchaser could be found. But it is not aconsequence, even of complete monopoly, that the valuebe forced up to this ultimate limit; as will be seen whenhave considered the law of value in so far as depending on theelement, difficulty of attainment.

2. The difficulty of attainment which determines value, isalways the same kind of difficulty. It sometimes consists inabsolute limitation of the supply. There are things of whichis physically impossible to increase the quantity beyondnarrow limits. Such are those wines which can be grownin peculiar circumstances of soil, climate, and exposure.also are ancient sculptures; pictures by old masters; rareor coins, or other articles of antiquarian curiosity. Amongmay also be reckoned houses and building-ground, in a towndefinite extent (such as Venice, or any fortified town whereare necessary to security); the most desirablein any town whatever; houses and parks peculiarly favourednatural beauty, in places where that advantage is uncommon., all land whatever is a commodity of this class; andbe practically so, in countries fully occupied and.

But there is another category (embracing the majority of allthat are bought and sold), in which the obstacle toconsists only in the labour and expense requisite tothe commodity. Without a certain labour and expense itbe had: but when any one is willing to incur these, therebe no limit to the multiplication of the product. If therelabourers enough and machinery enough, cottons, woollens, ormight be produced by thousands of yards for every singlenow manufactured. There would be a point, no doubt, whereincrease would be stopped by the incapacity of the earthafford more of the material. But there is no need, for anyof political economy, to contemplate a time when thislimit could become a practical one.

There is a third case, intermediate between the two, and rather more complex, which I shall at presentindicate, but the importance of which in political economyextremely great. There are commodities which can be multipliedan indefinite extent by labour and expenditure, but not by aamount of labour and expenditure. Only a limited quantitybe produced at a given cost: if more is wanted, it must beat a greater cost. To this class, as has been often, agricultural produce belongs; and generally all theproduce of the earth; and this peculiarity is a source ofimportant consequences; one of which is the necessity of ato population; and another, the payment of rent.

3. These being the three classes, in one or other of whichthings that are bought and sold must take their place, weconsider them in their order. And first, of thingslimited in quantity, such as ancient sculptures or.

Of such things it is commonly said, that their value dependstheir scarcity: but the expression is not sufficientlyto serve our purpose. Others say, with somewhat greater, that the value depends on the demand and the supply.even this statement requires much explanation, to make it aexponent of the relation between the value of a thing, andcauses of which that value is an effect.

The supply of a commodity is an intelligible expression: itthe quantity offered for sale; the quantity that is to be, at a given time and place, by those who wish to purchase it.what is meant by the demand? Not the mere desire for the. A beggar may desire a diamond; but his desire, however, will have no influence on the price. Writers havegiven a more limited sense to demand, and have defined, the wish to possess, combined with the power of purchasing.distinguish demand in this technical sense, from the demandis synonymous with desire, they call the former effectual.(2*) After this explanation, it is usually supposed thatremains no further difficulty, and that the value dependsthe ratio between the effectual demand, as thus defined, andsupply.

These phrases, however, fail to satisfy any one who requiresideas, and a perfectly precise expression of them. Somemust always attach to a phrase so inappropriate as thata ratio between two things not of the same denomination. Whatcan there be between a quantity and a desire, or even acombined with a power? A ratio between demand and supplyonly intelligible if by demand we mean the quantity demanded,if the ratio intended is that between the quantity demandedthe quantity supplied. But again, the quantity demanded isa fixed quantity, even at the same time and place; it variesto the value; if the thing is cheap, there is usually afor more of it than when it is dear. The demand,, partly depends on the value. But it was before laidthat the value depends on the demand. From thishow shall we extricate ourseLves? How solve the, of two things, each depending upon the other?

Though the solution of these difficulties is obvious enough,difficulties themselves are not fanciful; and I bring themthus prominently, because I am certain that theyhaunt every inquirer into the subject who has notfaced and distinctly realized them. Undoubtedly the truemust have been frequently given, though I cannot call toany one who had given it before myself, except the eminentlythinker and skilful expositor, J.B. Say. I should have, however, that it must be familiar to all political, if the writings of several did not give evidence ofwant of clearness on the point, and if the instance of Mr.Quincey did not prove that the complete non-recognition anddenial of it are compatible with great intellectual, and close intimacy with the subject matter.

4. Meaning, by the word demand, the quantity demanded, andthat this is not a fixed quantity, but in generalaccording to the value, let us suppose that the demand atparticular time exceeds the supply, that is, there areready to buy, at the market value, a greater quantityis offered for sale. Competition takes place on the side ofbuyers, and the value rises: but how much? in the ratio (somesuppose) of the deficiency: if the demand exceeds the supplyone-third, the value rises one-third. By no means: for whenvalue has

risen one-third, the demand may still exceed the; there may, even at that higher value, be a greaterwanted than is to be had; and the competition of buyersstill continue. If the article is a necessary of life, which,than resign, people are willing to pay for at any price, aof one-third may raise the price to double, triple, or.(3*) Or, on the contrary, the competition may ceasethe value has risen in even the proportion of the. A rise, short of one-third, may place the articlethe means, or beyond the inclinations, of purchasers tofull amount. At what point, then, will the rise be arrested?the point, whatever it be, which equalizes the demand and the: at the price which cuts off the extra third from the, or brings forward additional sellers sufficient to supply. When, in either of these ways, or by a combination of both,demand becomes equal and no more than equal to the supply,rise of value will stop.

The converse case is equally simple. instead of a demandthe supply, let us suppose a supply exceeding the demand.competition will now be on the side of the sellers: the extracan only find a market by calling forth an additionalequal to itself. This is accomplished by means of; the value falls, and brings the article within theof more numerous customers, or induces those who wereconsumers to make increased purchases. The fall of valueto re-establish equality, is different in different. The kinds of things in which it is commonly greatest arethe two extremities of the scale; absolute necessaries, orpeculiar luxuries, the taste for which is confined to aclass. In the case of food, as those who have alreadydo not require more on account of its cheapness, butexpend in other things what they save in food, theconsumption occasioned by cheapness, carries off, asshows, only a small part of the extra supply caused byabundant harvest;(4*) and the fall is practically arrestedwhen the farmers withdraw their corn, and hold it back inof a higher price; or by the operations of speculators whocorn when it is cheap, and store it up to be brought out whenurgently wanted. Whether the demand and supply are equalizedan increased demand, the result of cheapness, or bya part of the supply, equalized they are in either.

Thus we see that the idea of a ratio, as between demand and, is out of place, and has no concern in the matter: themathematical analogy is that of an equation. Demand and, the quantity demanded and the quantity supplied, will beequal. if unequal at any moment, competition equalizes them,the manner in which this is done is by an adjustment of the. If the demand increases, the value rises; if the demand, the value falls: again, if the supply falls off, therises; and falls if the supply is increased. The rise orfall continues until the demand and supply are again equal toanother.. and the value which a commodity will bring in any, is no other than the value which, in that market, gives ajust sufficient to carry off the existing or expected.

This, then, is the Law of Value, with respect to allnot susceptible of being multiplied at pleasure. Such, no doubt, are exceptions. There is another law formuch larger class of things, which admit of indefinite. But it is not the less necessary to conceiveand grasp firmly the theory of this exceptional case.the first place, it will be found to be of great assistance inthe more common case intelligible. And in the next, the principle of the exception stretches wider, andmore cases, than might at first be supposed.

5. There are but few commodities which are naturally andlimited in supply. But any commodity whatever may beso. Any commodity may be the subject of a monopoly:tea, in this country, up to 1834; tobacco in France, opiumBritish India, at

present. The price of a monopolizedis commonly supposed to be arbitrary; depending on theof the monopolist, and limited only (as in Mr. De Quincey'sof the musical box in the wilds of America) by the buyer'sestimate of its worth to himself. This is in one sense, but forms no exception, nevertheless, to the dependence ofvalue on supply and demand. The monopolist can fix the valuehigh as he pleases, short of what the consumer either couldor would not pay'. but he can only do so by limiting the. The Dutch East India Company obtained a monopoly pricethe produce of the Spice Islands, but to do so they were, in good seasons, to destroy a portion of the crop. Hadpersisted in selling all that they produced, they must havea market by reducing the price, so low, perhaps, that theyhave received for the larger quantity a less total returnfor the smaller: at least they showed that such was theirby destroying the surplus. Even on Lake Superior, Mr. De's huckster could not have sold his box for sixty guineas,he had possessed two musical boxes and desired to sell them. Supposing the cost price of each to be six guineas, hehave taken seventy for the two in preference to sixty for; that is, although his monopoly was the closest possible, hehave sold the boxes at thirty-five guineas each,that sixty was not beyond the buyer's estimate ofarticle for his purposes. Monopoly value, therefore, does noton any peculiar principle, but is a mere variety of thecase of demand and supply.

Again, though there are few commodities which are at alland for ever unsusceptible of increase of supply, anywhatever may be temporarily so; and with somethis is habitually the case. Agricultural produce,example, cannot be increased in quantity before the next; the quantity of corn already existing in the world, isthat can be had for sometimes a year to come. During that, corn is practically assimilated to things Of which thecannot be increased. In the case of most commodities, ita certain time to increase their quantity; and if theincreases, then until a corresponding supply can heforward, that is, until the supply can accommodate itselfthe demand, the value will so rise as to accommodate theto the supply.

There is another case, the exact converse of this. There arearticles of which the supply may be indefinitely increased,cannot be rapidly diminished. There are things so durablethe quantity in existence is at all times very great inwith the annual produce. Gold, and the more durable, are things of this sort; and also houses. The supply ofthings might be at once diminished by destroying them; butdo this could only be the interest of the possessor if he hadmonopoly of the article, and could repay himself for theof a part by the increased value of the remainder.value, therefore, of such things may continue for a long timelow, either from excess of supply or falling off in the, as to put a complete stop to further production; theof supply by wearing out being so slow a process, thatlong time is requisite, even under a total suspension of, to restore the original value. During that intervalvalue will be regulated solely by supply and demand, and willvery gradually as the existing stock wears out, until thereagain a remunerating value, and production resumes its course.

Finally, there are commodities of which, though capable ofincreased or diminished to a great, and even an unlimited, the value never depends upon anything but demand and. This is the case, in particular, with the commodity; of the value of which we have treated copiously in theBook: and there are many cases besides, in which wefind it necessary to call in this principle to solvequestions of exchange value. This will be particularlywhen we

treat of International Values; that is, ofterms of interchange between things produced in different, or, to speak more generally, in distant places. Butthese questions we cannot enter, until we shall havethe case of commodities which can be increased inindefinitely and at pleasure; and shall have determinedwhat law, other than that of Demand and Supply, the permanentaverage values of such commodities are regulated. This wedo in the next chapter. :. Logic of Political Economy, p. 13.. Adam Smith, who introduced the expression "effectual demand",it to denote the demand of those who are willing andto give for the commodity what he calls its natural price,is, the price which will enable it to be permanentlyand brought to market. — See his chapter on Natural andPrice (book i. ch. 7). "The price of corn in this country has risen from 100 to 200cent and upwards, when the utmost computed deficiency of thehas not been more than between one-sixth and one-thirdan average, and when that deficiency has been relieved bysupplies. If there should be a deficiency of the cropsto one-third, without any surplus from a former year,without any chance of relief by importation, the price mightfive, six, or even tenfold." — Tooke's History of Prices,. i. pp. 13-5.. See Tooke, and the Report of the Agricultural Committee of.

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3: Distribution

3Cost of Production in Its Relation to Value

1. When the production of a commodity is the effect of labourexpenditure, whether the commodity is susceptible ofmultiplication or not, there is a minimum value whichthe essential condition of its being permanently produced. Theat any particular time is the result of supply and demand;is always that which is necessary to create a market for thesupply. But unless that value is sufficient to repay theof Production, and to afford, besides, the ordinaryof profit, the commodity will not continue to be. Capitalists will not go on permanently producing at a. They will not even go on producing at a profit less thancan live on. Persons whose capital is already embarked, andbe easily extricated, will persevere for a considerablewithout profit, and have been known to persevere even at a, in hope of better times. But they will not do so, or when there is nothing to indicate that times areto improve. No new capital will be invested in an, unless there be an expectation not only of some, but of a profit as great (regard being had to the degreeeligibility of the employment in other respects) as can befor in any other occupation at that time and place. Whenprofit is evidently not to be had, if people do not actuallytheir capital, they at least abstain from replacing itconsumed. The cost of production, together with the ordinary, may therefore be called the necessary price, or value, ofthings made by labour and capital. Nobody willingly producesthe prospect of loss. Whoever does so, does it under a, which he corrects as fast as he is able.

When a commodity is not only made by labour and capital, butbe made by them in indefinite quantity, this Necessary Value,minimum with which the producers will be content, is also, ifis free and active, the maximum which they can. If the value of a commodity is such that it repays theof production not only with the customary, but with a higherof profit, capital rushes to share in this extra gain, andincreasing the supply of the article, reduces its value. Thisnot a mere supposition or surmise, but a fact familiar toconversant with commercial operations. Whenever a new linebusiness presents itself, offering a hope of unusual profits,whenever any established trade or manufacture is believed toyielding a greater profit than customary, there is sure to bea short time so large a production or importation of the, as not only destroys the extra profit, but generallybeyond the mark, and sinks the value as much too low as itbefore been raised too high; until the oversupply isby a total or partial suspension of further production.already intimated,(1*) these variations in the quantitydo not presuppose or require that any person shouldhis employment. Those whose business is thriving, increaseproduce by availing themselves more largely of their, while those who are not making the ordinary profit,their operations, and (in manufacturing phrase) worktime. In this mode is surely and speedily effected the, not of profits perhaps, but of the expectations of, in different occupations.

As a general rule, then, things tend to exchange for oneat such values as will enable each producer to be repaidcost of production with the ordinary profit; in other words,as will give to all producers the same rate of profit onoutlay. But in order that the profit may be equal where the, that is, the cost of production, is equal, things must

onaverage exchange for one another in the ratio of their costproduction: things of which the cost of production is the, must be of the same value. For only thus will an equalyield an equal return. If a farmer with a capital equal to000 quarters of corn, can produce 1 200 quarters, yielding himprofit of 20 per cent; whatever else can be produced in thetime by a capital of 1000 quarters, must be worth, that is,exchange for, 1200 quarters, otherwise the producer wouldeither more or less than 20 per cent.

Adam Smith and Ricardo have called that value of a thingis proportional to its cost of production, its Natural(or its Natural Price). They meant by this, the point aboutthe value oscillates, and to which it always tends to; the centre value, towards which, as Adam Smith expresses, the market value of a thing is constantly gravitating; anddeviation from which is but a temporary irregularity, which,moment it exists, sets forces in motion tending to correct. On an average of years sufficient to enable the oscillationsone side of the central line to be compensated by those on the, the market value agrees with the natural value; but itseldom coincides exactly with it at any particular time. Theeverywhere tends to a level; but it never is at an exact; its surface is always ruffled by waves, and often agitatedstorms. It is enough that no point, at least in the open sea,permanently higher than another. Each place is alternatelyand depressed; but the ocean preserves its level.

2. The latent influence by which the values of things areto conform in the long run to the cost of production, is thethat would otherwise take place in the supply of the. The supply would be increased if the thing continuedsell above the ratio of its cost of production, and would beif it fell below that ratio. But we must not thereforeit to be necessary that the supply should actually bediminished or increased. Suppose that the cost ofof a thing is cheapened by some mechanical invention,increased by a tax. The value of the thing would in a little, if not immediately, fall in the one case, and rise in the; and it would do so, because if it did not, the supplyin the one case be increased, until the price fell, in thediminished, until it rose. For this reason, and from thenotion that value depends on the proportion between theand the supply, many persons suppose that this proportionbe altered whenever there is any change in the value of the; that the value cannot fall through a diminution of theof production, unless the supply is permanently increased;rise, unless the supply is permanently diminished. But thisnot the fact: there is no need that there should be any actualof supply; and when there is, the alteration, if, is not the cause, but the consequence of thein value. If, indeed, the supply could not be, no diminution in the cost of production would lowervalue: but there is by no means any necessity that it should.mere possibility often suffices; the dealers are aware ofwould happen, and their mutual competition makes themthe result by lowering the price. Whether there willa greater permanent supply of the commodity after itshas been cheapened, depends on quite another question,, on whether a greater quantity is wanted at the reduced. Most commonly a greater quantity is wanted, but not. "A man," says Mr De Quincey, (2*) "buys an articleinstant applicability to his own purposes the more readily andmore largely as it happens to be cheaper. Silk handkerchiefsfallen to half-price, he will buy, perhaps, in threefold; but he does not buy more steam-engines because theis lowered. His demand for steam-engines is almost alwaysby the circumstances of his situation. So far as hethe cost at all, it is much more the cost of workingengine than the cost upon its

purchase. But there are manyfor which the market is absolutely and merely limited bypre-existing system, to which those articles are attached asparts or members. How could we force the dials orof timepieces by artificial cheapness to sell morethan the inner works or movements of such timepieces?the sale of wine-vaults be increased without increasing theof wine? Or the tools of shipwrights find an enlarged marketshipbuilding was stationary?.... Offer to a town of 3000a stock of hearses, no cheapness will tempt that townbuying more than one. Offer a stock of yachts, the chieflies in manning, victualling, repairing; no diminution uponmere price to a purchaser will tempt into the market any manhabits and propensities had not already disposed him toa purchase. So of professional costume for bishops, lawyers,at Oxford." Nobody doubts, however, that the price andof all these things would be eventually lowered by anyof their cost of production; and lowered through theentertained of new competitors, and an increased,. though the great hazard to which a new competitor wouldhimself, in an article not susceptible of any considerableof its market, would enable the established dealers totheir original prices much longer than they could do inarticle offering more encouragement to competition.

Again, reverse the case, and suppose the cost of production, as for example by laying a tax on the commodity. Thewould rise; and that, probably, immediately. Would thebe diminished? Only if the increase of value diminisheddemand. Whether this effect followed, would soon appear, andit did, the value would recede somewhat, from excess of, until the production was reduced, and would then rise. There are many articles for which it requires a veryrise of price, materially to reduce the demand; in, articles of necessity, such as the habitual food ofpeople; in England, wheaten bread: of which there is probablyas much consumed, at the present cost price, as therebe with the present population at a price considerably. Yet it is especially in such things that dearness or highis popularly confounded with scarcity. Food may be dearscarcity, as after a bad harvest; but the dearness (for) which is the effect of taxation, or of corn laws, haswhatever to do with insufficient supply: such causes domuch diminish the quantity of food in a country. it is otherrather than food that are diminished in quantity by them,, those who pay more for food not having so much to expend, the production of other things contracts itself to theof a smaller demand.

It is, therefore, strictly correct to say, that the value ofwhich can be increased in quantity at pleasure, does not(except accidentally, and during the time necessary forto adjust itself,) upon demand and supply; on the, demand and supply depend upon it. There is a demand forcertain quantity of the commodity at its natural or cost value,to that the supply in the long run endeavours to conform.at any time it fails of so conforming, it is either from, or from a change in some of the elements of the: either in the natural value, that is, in the cost of; or in the demand, from an alteration in public tastein the number or wealth of the consumers. These causes ofare very liable to occur, and when any one of themoccur, the market value of the article ceases to agree withnatural value. The real law of demand and supply, thebetween them, still holds good: if a value differentthe natural value be necessary to make the demand equal tosupply, the market value will deviate from the natural value;only for a time; for the permanent tendency of supply is toitself to the demand which is found by experience tofor the commodity when selling at its natural value. If theis either more or less than this, it is so accidentally,affords either more or less

than the ordinary rate of profit;, under free and active competition, cannot long continue tothe case.

To recapitulate: demand and supply govern the value of allwhich cannot be indefinitely increased; except that eventhem, when produced by industry, there is a minimum value,by the cost of production. But in all things whichof indefinite multiplication, demand and supply onlythe perturbations of value, during a period whichexceed the length of time necessary for altering the. While thus ruling the oscillations of value, theyobey a superior force, which makes value gravitateCost of Production, and which would settle it and keep it, if fresh disturbing influences were not continuity arisingmake it again deviate. To pursue the same strain of metaphor,and supply always rush to an equilibrium, but theof stable equilibrium is when things exchange for eachaccording to their cost of production, or, in thewe have used, when things are at their Natural Value. :. Supra, p. 407.. Logic of Political Economy, pp. 230-1.

The Principles of Political Economy

John Stuart Mill

3: Distribution

4Analysis of Cost of Production

1. The component elements of Cost of Production have been setin the First Part of this enquiry.(1*) The principal of, and so much the principal as to be nearly the sole, weto be Labour. What the production of a thing costs to its, or its series of producers, is the labour expended init. If we consider as the producer the capitalist whothe advances, the word Labour may be replaced by the word: what the produce costs to him, is the wages which he hasto pay. At the first glance indeed this seems to be only aof his outlay, since he has not only paid wages to, but has likewise provided them with tools, materials,perhaps buildings. These tools, materials, and buildings,, were produced by labour and capital; and their value,that of the article to the production of which they are, depends on cost of production, which again isinto labour. The cost of production of broadcloth doeswholly consist in the wages of weavers; which alone arepaid by the cloth manufacturer. It consists also of theof spinners and woolcombers, and, it may be added, of, all of which the clothier has paid for in the price of. It consists too of the wages of builders and brickmakers,he has reimbursed in the contract price of erecting his. It partly consists of the wages of machine-makers,founders, and miners. And to these must be added the wagesthe carriers who transported any of the means and appliancesthe production to the place where they were to be used, andproduct itself to the place where it is to be sold.

The value of commodities, therefore, depends principally (wepresently see whether it depends solely) on the quantity ofrequired for their production; including in the idea of, that of conveyance to the market. "In estimating,"Ricardo,(2*) "the exchangeable value of stockings, for, we shall find that their value, comparatively with other, depends on the total quantity of labour necessary tothem and bring them to market. First, there is thenecessary to cultivate the land on which the raw cotton is; secondly, the labour of conveying the cotton to thewhere the stockings are to be manufactured, whicha portion of the labour bestowed in building the ship init is conveyed, and which is charged in the freight of the; thirdly, the labour of the spinner and weaver; fourthly, aof the labour of the engineer, smith, and carpenter, whothe buildings and machinery by the help of which they are; fifthly, the labour of the retail dealer and of many, whom it is unnecessary further to particularize. Thesum of these various kinds of labour, determines theof other things for which these stockings will exchange,the same consideration of the various quantities of labourhave been bestowed on those other things, will equallythe portion of them which will be given for the stockings.

"To convince ourselves that this is the real foundation ofvalue, let us suppose any improvement to be made inmeans of abridging labour in any one of the various processeswhich the raw cotton must pass before the manufacturedcome to the market to be exchanged for other things;observe the effects which will follow. If fewer men wereto cultivate the raw cotton, or if fewer sailors werein navigating, or shipwrights in constructing, the shipwhich it was conveyed to us; if fewer hands were employed inthe buildings and machinery, or if these, when raised,rendered more efficient; the stockings

would inevitably fallvalue, and command less of other things. They would fall,a less quantity of labour was necessary to their, and would therefore exchange for a smaller quantitythose things in which no such abridgement of labour had been.

"Economy in the use of labour never fails to reduce thevalue of a commodity, whether the saving be in thenecessary to the manufacture of the commodity itself, orthat necessary to the formation of the capital, by the aid ofit is produced. In either case the price of stockings would, whether there were fewer men employed as bleachers,, and weavers, persons immediately necessary to their; or as sailors, carriers, engineers, and smiths,more indirectly concerned. In the one case, the wholeof labour would fall on the stockings, because thatof labour was wholly confined to the stockings; in the, a portion only would fall on the stockings, the remainderapplied to all those other commodities, to the productionwhich the buildings, machinery, and carriage, were."

2. It will have been observed that Ricardo expresses himselfif the quantity of labour which it costs to produce aand bring it to market, were the only thing on whichvalue depended. But since the cost of production to theis not labour but wages, and since wages may be eitheror less, the quantity of labour being the same; it wouldthat the value of the product cannot be determined solely byquantity of labour, but by the quantity together with the; and that values must partly depend on wages.

In order to decide this point, it must be considered, thatis a relative term: that the value of a commodity is not afor an inherent and substantive quality of the thing itself,means the quantity of other things which can be obtained infor it. The value of one thing, must always berelatively to some other thing, or to things in. Now the relation of one thing to another cannot beby any cause which affects them both alike. A rise orof general wages is a fact which affects all commodities insame manner, and therefore affords no reason why they shouldfor each other in one rather than in another proportion.suppose that high wages make high values, is to suppose thatcan be such a thing as general high values. But this is ain terms : the high value of some things iswith the low value of others. The mistake arises fromattending to values, but only to prices. Though there is nothing as a general rise of values, there is such a thing asgeneral rise of prices. As soon as we form distinctly the ideavalues, we see that high or low wages can have nothing to dothem; but that high wages make high prices, is a popular andspread opinion. The whole amount of error involved in thiscan only be seen thoroughly when we come to theof money; at present we need only say that if it be true,can be no such thing as a real rise of wages; for if wagesnot rise without a proportional rise of the price of, they could not, for any substantial purpose, rise at. This surely is a sufficient reductio ad absurdum, and showsamazing folly of the propositions which may and do become,long remain, accredited doctrines of popular political. It must be remembered too that general high prices, eventhem to exist, can be of no use to a producer or, considered as such; for if they increase his money, they increase in the same degree all his expenses. Thereno mode in which capitalists can compensate themselves for acost of labour, through any action on values or prices. Itbe prevented from taking its effect on low profits. If thereally get more, that is, get the produce of more, a smaller percentage must remain for profit. From thisof Distribution, resting as it does on a law of arithmetic,is no escape. The mechanism of Exchange and Price may hidefrom us, but is quite powerless to alter it.

3. Although, however, general wages, whether high or low, doaffect values, yet if wages are higher in one employment than, or if they rise and fall permanently in one employmentdoing so in others, these inequalities do really operatevalues. The causes which make wages vary from one employmentanother, have been considered in a former chapter. When theof an employment permanently exceed the average rate, theof the thing produced will, in the same degree, exceed thedetermined by mere quantity of labour. Things, for, which are made by skilled labour, exchange for theof a much greater quantity of unskilled labour; for nobut because the labour is more highly paid. If, throughextension of education, the labourers competent to skilledwere so increased in number as to diminish thebetween their wages and those of common labour, allproduced by labour of the superior kind would fall in, compared with things produced by common labour, and thesebe said therefore to rise in value. We have before remarkedthe difficulty of passing from one class of employments to agreatly superior, has hitherto caused the wages of allclasses of labourers who are separated from one another byvery marked barrier, to depend more than might be supposedthe increase of the population of each class considered; and that the inequalities in the remuneration ofare much greater than could exist if the competition oflabouring people generally could be brought practically toon each particular employment. It follows from this thatin different employments do not rise or fall, but are, for short and sometimes even for long, nearly independent of one another. All such disparitiesalter the relative costs of production of different, and will therefore be completely represented innatural or average value.

It thus appears that the maxim laid down by some of the besteconomists, that wages do not enter into value, iswith greater latitude than the truth warrants, or thanwith their own meaning. Wages do enter into value. Thewages of the labour necessary for producing different, affect their value just as much as the relativeof labour. It is true, the absolute wages paid have noupon values; but neither has the absolute quantity of. If that were to vary simultaneously and equally in all, values would not be affected. If, for instance, theefficiency of all labour were increased, so that allwithout exception could be produced in the same quantitybefore with a smaller amount of labour, no trace of thisdiminution of cost of production would show itself in theof commodities. Any change which might take place in themonly represent the unequal degrees in which the improvementdifferent things; and would consist in cheapening thosewhich the saving of labour had been the greatest, while thosewhich there had been some, but a less saving of labour, wouldrise in value. In strictness, therefore, wages of labouras much to do with value as quantity of labour: and neithernor any one else has denied the fact. In considering,, the causes of variations in value, quantity of labour isthing of chief importance; for when that varies, it isin one or a few commodities at a time, but theof wages (except passing fluctuations) are usually, and have no considerable effect on value.

4. Thus far of labour, or wages, as an element in cost of. But in our analysis, in the First Book, of theof production, we found that there is anotherelement in it besides labour. There is also capital;this being the result of abstinence, the produce, or its, must be sufficient to remunerate, not only all the labour, but the abstinence of all the persons by whom theof the different classes of labourers was advanced.return for abstinence is Profit. And profit, we have also, is not exclusively the surplus remaining to the capitalisthe has

been compensated for his outlay, but forms, in most, no unimportant part of the outlay itself. Thespinner, part of whose expenses consists of the purchase ofand of machinery, has had to pay, in their price, not onlywages of the labour by which the flax was grown and themade, but the profits of the grower, the flax-dresser,miner, the ironfounder, and the machine-maker. All these, together with those of the spinner himself, were againby the weaver, in the price of his material, linen yarn:along with them the profit of a fresh set of machine-makers,of the miners and iron-workers who supplied them with theirmaterial. All these advances form part of the cost ofof linen. Profits, therefore, as well as wages, enterthe cost of production which determines the value of the.

Value, however, being purely relative, cannot depend uponprofits, no more than upon absolute wages, but uponprofits only. High general profits cannot, any more thangeneral wages, be a cause of high values, because highvalues are an absurdity and a contradiction. In so far asenter into the cost of production of all things, theyaffect the value of any. It is only by entering in adegree into the cost of production of some things than of, that they can have any influence on value.

For example, we have seen that there are causes whicha permanently higher rate of profit in certainthan in others. There must be a compensation forrisk, trouble, and disagreeableness. This can only beby selling the commodity at a value above that which isto the quantity of labour necessary for its production. Ifexchanged for other things in no higher ratio than thatthe labour required from first to last for producing it, nowould set up a powder-mill. Butchers are certainly a moreclass than bakers, and do not seem to be exposed torisks, since it is not remarked that they are oftener. They seem, therefore, to obtain higher profits, whichonly arise from the more limited competition caused by the, and to a certain degree, the unpopularity, oftrade. But this higher profit implies that they sell theirat a higher value than that due to their labour and. All inequalities of profit which are necessary and, are represented in the relative values of the.

5. Profits, however, may enter more largely into theof production of one commodity than of another, eventhere be no difference in the rate of profit between theemployments. The one commodity may be called upon to yieldduring a longer period of time than the other. The examplewhich this case is usually illustrated is that of wine.a quantity of wine, and a quantity of cloth, made byamounts of labour, and that labour paid at the same rate.cloth does not improve by keeping; the wine does. Suppose, to attain the desired quality, the wine requires to be keptyears. The producer or dealer will not keep it, unless atend of five years he can sell it for as much more than the, as amounts to five years' profit, accumulated at compound. The wine and the cloth were made by the same original. Here then is a case in which the natural values,to one another, of two commodities, do not conform tocost of production alone, but to their cost of productionsomething else. Unless, indeed, for the sake of generalitythe expression, we include the profit which the wine-merchantduring the five years, in the cost of production of the: looking upon it as a kind of additional outlay, over andhis other advances, for which outlay he must be indemnifiedlast.

All commodities made by machinery are assimilated, at least, to the wine in the preceding example. Inwith things made wholly by immediate labour, profitsmore largely into their cost of production. Suppose two, A and B, each requiring a year for its

production,means of a capital which we will on this occasion denote by, and suppose to be 1000l. A is made wholly by immediate, the whole 1000l. being expended directly in wages. B isby means of labour which costs 500l. and a machine which500l., and the machine is worn out by one year's use. Thecommodities will be exactly of the same value; which, ifin money, and if profits are 20 per cent per annum, will1200l. But of this 1200l., in the case of A, only 200l., orsixth, is profit: while in the case of B there is not only200l., but as much of 500l. (the price of the machine) asof the profits of the machine-maker; which, if wethe machine also to have taken a year for its production,again one-sixth. So that in the case of A only one-sixth ofentire return is profit, whilst in B the element of profitnot only a sixth of the whole, but an additional sixtha large part.

The greater the proportion of the whole capital whichof machinery, or buildings, or material, or anythingwhich must be provided before the immediate labour can, the more largely will profits enter into the cost of. It is equally true, though not so obvious at first, that greater durability in the portion of capital whichof machinery or buildings, has precisely the same effecta greater amount of it. As we just supposed one extreme case,a machine entirely worn out by a year's use, let us nowthe opposite and still more extreme case of a machinelasts for ever, and requires no repairs. In this case,is as well suited for the purposed of illustration as if ita possible one, it will be unnecessary that the manufacturerever be repaid the 500l. which he gave for the machine,he has always the machine itself, worth 500l.; but he mustpaid, as before, a profit on it. The commodity B, therefore,in the case previously supposed was sold for 1200l. ofsum 1000l. were to replace the capital and 200l. were, can now be sold for 700l., being 500l. to replace wages,200l. profit on the entire capital. Profit, therefore, entersthe value of B in the ratio of 200l. out of 700l., beingsevenths of the whole, or 28 4/7 per cent, while in the caseA, as before, it enters only in the ratio of one-sixth, or 16/3 per cent. The case is of course purely ideal, since noor other fixed capital lasts for ever; but the moreit is, the nearer it approaches to this ideal case, andmore largely does profit enter into the return. If, for, a machine worth 500l. loses one-fifth of its value byyear's use, l00l. must be added to the return to make uploss, and the price of the commodity will be 8OOl. Profitwill enter into it in the ratio of 200l. to 800l., orfourth, which is still a much higher proportion thansixth, or 200l. in 1200l., as in case A. From the unequalin which, in different employments, profits enter intoadvances of the capitalist, and therefore into the returnsby him, two consequences follow in regard to value. One, that commodities do not exchange in the ratio simply of theof labour required to produce them; not even if wefor the unequal rates at which different kinds of labourpermanently remunerated. We have already illustrated this byexample of wine : we shall now further exemplify it by theof commodities made by machinery. Suppose, as before, anA made by a thousand pounds' worth of immediate labour.instead of B, made by 500l. worth of immediate labour and aworth 500l., let us suppose C, made by 500l. worth oflabour with the aid of a machine which has beenby another 500l. worth of immediate labour: the machinea year for making, and worn out by a year's use;being as before 20 per cent. A and C are made by equalof labour, paid at the same rate: A costs 1000l. worthdirect labour; C, only 500l. worth, which however is made up1000l. by the labour expended in the construction of the. If labour, or its remuneration, were the sole ingredientcost of production, these two things would exchange for one. But will they do so? Certainly not. The machine havingmade in a year by an outlay of 500l.,

and profits being 20cent, the natural price of the machine is 600l.: making an100l. which must be advanced, over and above his other, by the manufacturer of C, and repaid to him with aof 20 per cent. While, therefore, the commodity A is sold1200l., C cannot be permanently sold for less than 1320l.

A second consequence is, that every rise or fall of generalwill have an effect on values. Not indeed by raising orthem generally, (which, as we have so often said, is aand an impossibility): but by altering thein which the values of things are affected by thelengths of time for which profit is due. When two things,made by equal labour, are of unequal value because the onecalled upon to yield profit for a greater number of years orthan the other; this difference of value will be greaterprofits are greater, and less when they are less. The winehas to yield five years' profit more than the cloth, willit in value much more if profits are 40 per cent, than ifare only 20. The commodities A and C, which, though made byquantities of labour, were sold for 1200l. and 1320l., aof 10 per cent, would, if profits had been only halfmuch, have been sold for 1100l. and 1155l., a difference of5 per cent.

It follows from this, that even a general rise of wages, wheninvolves a real increase in the cost of labour, does in someinfluence values. It does not affect them in the mannersupposed, by raising them universally. But an increasethe cost of labour, lowers profits; and therefore lowers invalue the things into which profits enter in a greaterthan the average, and raises those into which theyin a less proportion than the average. All commodities inproduction of which machinery bears a large part, especiallythe machinery is very durable, are lowered in their relativewhen profits fall; or, what is equivalent, other things arein value relatively to them. This truth is sometimesin a phraseology more plausible than sound, by sayinga rise of wages raises the value of things made by labour,comparison with those made by machinery. But things made by, just as much as any other things, are made by labour,, the labour which made the machinery itself: the onlybeing that profits enter somewhat more largely intoproduction of things for which machinery is used, though theitem of the outlay is still labour. It is better,, to associate the effect with fall of profits than withof wages; especially as this last expression is extremely, suggesting the idea of an increase of the labourer'sremuneration, rather than of what is alone to the purpose, namely, the cost of labour to its employer.

6. Besides the natural and necessary elements in cost oflabour and profits-there are others which areand casual, as for instance a tax. The tax on malt ismuch a part of the cost of production of that article as theof the labourers. The expenses which the law imposes, asas those which the nature of things imposes, must bewith the ordinary profit from the value of the, or the things will not continue to be produced. But theof taxation on value is subject to the same conditionsthe influence of wages and of profits. It is not general, but differential taxation, that produces the effect. Ifproductions were taxed so as to take an equal percentage fromprofits, relative values would be in no way disturbed. Ifa few commodities were taxed, their value would rise: and ifa few were left untaxed, their value would fall. If halftaxed and the remainder untaxed, the first half would risethe last would fall relatively to each other. This would bein order to equalize the expectation of profit in all, without which the taxed employments would, if not immediately, be

abandoned. But general, when equally imposed, and not disturbing the relationsdifferent productions to one another, cannot produce anyon values.

We have thus far supposed that all the means and appliancesenter into the cost of production of commodities, arewhose own value depends on their cost of production. Somethem, however, may belong to the class of things which cannotincreased ad libitum in quantity, and which therefore, if thegoes beyond a certain amount, command a scarcity value.materials of many of the ornamental articles manufactured inare the substances called rosso, giallo, and verde antico,, whether truly or falsely I know not, are asserted to bederived from the destruction of ancient columns and otherstructures; the quarries from which the stone wascut being exhausted, or their locality forgotten.(3*)material of such a nature, if in much demand, must be at avalue; and this value enters into the cost of, and consequently into the value, of the finished. The time seems to be approaching when the more valuablewill come under the influence of a scarcity value of the. Hitherto the diminishing number of the animals whichthem, in the wildernesses of Siberia, and on the coaststhe Esquimaux Sea, has operated on the value only through thelabour which has become necessary for securing any givenof the article, since, without doubt, by employingenough, it might still be obtained in much greaterfor some time longer.

But the case in which scarcity value chiefly operates into cost of production, is the case of natural agents., when unappropriated, and to be had for the taking, do notinto cost of production, save to the extent of the labourmay be necessary to fit them for use. Even when, they do not (as we have already seen) bear a valuethe mere fact of the appropriation, but only from scarcity,is, from limitation of supply. But it is equally certainthey often do bear a scarcity value. Suppose a fall of, in a place where there are more mills wanted than there ispower to supply them, the use of the fall of water willa scarcity value, sufficient either to bring the demand downthe supply, or to pay for the creation of an artificial power,steam or otherwise, equal in efficiency to the water-power.

A natural agent being a possession in perpetuity, and beingserviceable by the products resulting from its continued, the ordinary mode of deriving benefit from itsis by an annual equivalent, paid by the person who uses, from the proceeds of its use. This equivalent always might, and generally is, termed rent. The question, therefore,the influence which the appropriation of naturalproduces on values, is often stated in this form: Doesenter into Cost of Production? and the answer of the besteconomists is in the negative. The temptation is strongthe adoption of these sweeping expressions, even by those whoaware of the restrictions with which they must be taken; foris no denying that they stamp a general principle moreon the mind, than if it were hedged round in theory withits practical limitations. But they also puzzle and mislead,create an impression unfavourable to political economy, as ifdisregarded the evidence of facts. No one can deny that rententers into cost of production. If I buy or rent aof ground, and build a cloth manufactory on it, therent forms legitimately a part of my expenses of, which must be repaid by the product. And since allare built on ground, and most of them in places whereis peculiarly valuable, the rent paid for it must, on the, be compensated in the values of all things made in. In what sense it is true that rent does not enter intocost of production or affect the value of agricultural, will be shown in the succeeding chapter. :.

Supra, pp. 31-2.. Principles of Political Economy and Taxation, ch. 1,sect.3.. Some of these quarries, I believe, have been rediscovered, andagain worked.

The Principles of Political Economy

John Stuart Mill

3: Distribution

5Rent, in Its Relation to Value

1. We have investigated the laws which determine the value ofclasses of commodities: the small class which, being limiteda definite quantity, have their value entirely determined byand supply, save that their cost of production (if theyany) constitutes a minimum below which they cannotfall; and the large class, which can be multiplied adby labour and capital, and of which the cost offixes the maximum as well as the minimum at which theypermanently exchange. But there is still a third kind ofto be considered: those which have, not one, butcosts of production: which can always be increased inby labour and capital, but not by the same amount ofand capital; of which so much may be produced at a given, but a further quantity not without a greater cost. Theseform an intermediate class, partaking of theof both the others. The principal of them isproduce. We have already made abundant reference tofundamental truth, that in agriculture, the state of the artgiven, doubling the labour does not double the produce;if an increased quantity of produce is required, thesupply is obtained at a greater cost than the first.a hundred quarters of corn are all that is at presentfrom the lands of a given village, if the growth ofmade it necessary to raise a hundred more, either byup worse land now uncultivated, or by a more elaborateof the land already under the plough, the additional, or some part of them at least, might cost double oras much per quarter as the former supply.

If the first hundred quarters were all raised at the same(only the best land being cultivated); and if thatwould be remunerated with the ordinary profit by a price20s. the quarter; the natural price of wheat, so long as nothan that quantity was required, would be 20s.; and it couldrise above, or fall below that price, from vicissitudes of, or other casual variations in supply. But if theof the district advanced, a time would arrive whenthan a hundred quarters would be necessary to feed it. Wesuppose that there is no access to any foreign supply. Byhypothesis, no more than a hundred quarters can be producedthe district, unless by either bringing worse land into, or altering the system of culture to a moreone. Neither of these things will be done without ain price. ThiS rise of price will gradually be brought aboutthe increasing demand. So long as the price has risen, but notenough to repay with the ordinary profit the cost ofan additional quantity, the increased value of thesupply partakes of the nature of a scarcity value.that it will not answer to cultivate the second best, or land of the second degree of remoteness, for a lessthan 25s. the quarter; and that this price is alsoto remunerate the expensive operations by which anproduce might be raised from land of the first quality.so, the price will rise, through the increased demand, untilreaches 25s. That will now be the natural price; being thewithout which the quantity, for which society has a demandthat price, will not be produced. At that price, however,can go on for some time longer; could go on perhaps for, if population did not increase. The price, having attainedpoint, will not again permanently recede (though it may fallfrom accidental abundance); nor will it advance, so long as society can obtain the supply it requiresa second increase of the cost of production.

I have made use of Price in this reasoning, as a convenientof Value, from the greater familiarity of the idea; and Icontinue to do so as far as may appears to be necessary.

In the case supposed, different portions of the supply ofhave different costs of production. Though the 20, or 50, orquarters additional have been produced at a cost proportional25s., the original hundred quarters per annum are stillat a cost only proportional to 20s. This isevident, if the original and the additional supply areon different qualities of land. It is equally true ifare produced on the same land. Suppose that land of the best, which produced 100 quarters at 20s., has been made to150 by an expensive process, which it would not answer towithout a price of 25s. The cost which requires 25s. isfor the sake of 50 quarters alone: the first hundredhave continued for ever to be produced at the original, and with the benefit, on that quantity, of the whole riseprice caused by the increased demand: no one, therefore, willthe additional expense for the sake of the additional, unless they alone will pay for the whole of it. The fifty,, will be produced at their natural price, proportionedthe cost of their production; while the other hundred will nowin 5s. a quarter more than their natural price-than thecorresponding to, and sufficing to remunerate, their lowerof production.

If the production of any, even the smallest, portion of the, requires as a necessary condition a certain price, thatwill be obtained for all the rest. We are not able to buyloaf cheaper than another because the corn from which it was, being grown on a richer soil, has cost less to the grower.value, therefore, of an article (meaning its natural, whichthe same with its average value) is determined by the cost ofportion of the supply which is produced and brought toat the greatest expense. This is the Law of Value of theof the three classes into which all commodities are.

2. If the portion of produce raised in the most unfavourable, obtains a value proportioned to its cost of; all the portions raised in more favorable, selling as they must do at the same value, obtainvalue more than proportioned to their cost of production. Theiris not, correctly speaking, a scarcity value, for it isby the circumstances of the production of the, and not by the degree of dearness necessary fordown the demand to the level of a limited supply. The, however, of those portions of the produce enjoy a; they obtain a value which yields them more than theprofit. If this advantage depends upon any special, such as being free from a tax, or upon any personal, physical or mental, Or any peculiar process onlyto themselves, or upon the possession of a greater capitalother people, or upon various other things which might be, they retain it to themselves as an extra gain, overabove the general profits of capital, of the nature, in some, of a monopoly profit. But when, as in the case which we areparticularly considering, the advantage depends on theof a natural agent of peculiar quality, as forof more fertile land than that which determines thevalue of the commodity; and when this natural agent isowned by themselves; the person who does own it, is able tofrom them, in the form of rent, the whole extra gainfrom its use. We are thus brought by another road to theof Rent, investigated in the concluding chapter of the Second. Rent, we again see, is the difference between the unequalto different parts of the capital employed on the soil.surplus any portion of agricultural capital produces,what is produced by the same amount of capital on thesoil, or under the most expensive mode of cultivation,the existing demands of society

compel a recourse to; thatwill naturally be paid as rent from that capital, to theof the land on which it is employed.

It was long thought by political economists, among the restby Adam Smith, that the produce of land is always at avalue, because (they said) in addition to the ordinaryof profit, it always yields something further for rent. Thisnow see to be erroneous. A thing cannot be at a monopoly, when its supply can be increased to an indefinite extentwe are only willing to incur the cost. If no more corn thanexisting quantity is grown, it is because the value has nothigh enough to remunerate any one for growing it. Any land(not reserved for other uses, or for pleasure) which at theprice, and by the existing processes, will yield theprofit, is tolerably certain, unless some artificialintervenes, to be cultivated, although nothing may befor rent. As long as there is any land fit for cultivation,at the existing price cannot be profitably cultivated at, there must be some land a little better, which will yieldordinary profit, but allow nothing for rent: and that land,within the boundary of a farm, will be cultivated by the; if not so, probably by the proprietor, or by some otheron sufferance. Some such land at least, under cultivation,can scarcely fail to be.

Rent, therefore, forms no part of the cost of productiondetermines the value of agricultural produce. Circumstancesdoubt may be conceived in which it might do so, and verytoo. We can imagine a country so fully peopled, and withits cultivable soil so completely occupied, that to produceadditional quantity would require more labour than thewould feed: and if we suppose this to be the condition ofwhole world, or of a country debarred from foreign supply,, if population continued increasing, both the land and itswould really rise to a monopoly or scarcity price. Butstate of things never can have really existed anywhere,possibly in some small island cut off from the rest of the; nor is there any danger whatever that it should exist. Itexists in no known region at present. Monopoly, we have, can take effect on value, only through limitation of. In all countries of any extent there is more cultivablethan is yet cultivated; and while there is any such surplus,is the same thing, so far as that quality of land is, as if there were an infinite quantity. What islimited in supply is only the better qualities; andfor those, so much rent cannot be demanded as would bring incompetition of the lands not yet in cultivation; the rent ofpiece of land must be somewhat less than the whole excess ofproductiveness over that of the best land which it is not yetto cultivate; that is, it must be about equal to theabove the worst land which it is profitable to cultivate.land or the capital most unfavourably circumstanced amongactually employed, pays no rent; and that land or capitalthe cost of production which regulates the value ofwhole produce. Thus rent is, as we have already seen, noof value, but the price of the privilege which theof the returns to different portions of agriculturalconfers on all except the least favoured portions.

Rent, in short, merely equalizes the profits of differentcapitals, by enabling the landlord to appropriate allgains occasioned by superiority of natural advantages. Iflandlords were unanimously to forego their rent, they wouldtransfer it to the farmers, without benefiting the consumer;the existing price of corn would still be an indispensableof the production of part of the existing supply, anda part obtained that price the whole would obtain it. Rent,, unless artificially increased by restrictive laws, isburthen on the consumer: it does not raise the price of corn,is no otherwise a detriment to the

public, than inasmuch asthe state had retained it, or imposed an equivalent in theof a land-tax, it would then have been a fund applicable toinstead of private advantage.

3. Agricultural productions are not the only commoditieshave several different costs of production at once, and, in consequence of that difference, and in proportion to, afford a rent. Mines are also an instance. Almost all kindsraw material extracted from the interior of the earthmetal,, precious stones, &c., are obtained from mines differingin fertility, that is, yielding very differentof the product to the same quantity of labour and. This being the case, it is an obvious question, why arethe most fertile mines so worked as to supply the whole? No such question can arise as to land; it beingevident, that the most fertile lands could not possibly beto supply the whole demand of a fully-peopled country; andof what they do yield, a part is extorted from them by aand outlay as great as that required to grow the sameon worse land. But it is not so with mines; at least, not. There are, perhaps, cases in which it is impossibleextract from a particular vein, in a given time, more than aquantity of ore, because there is only a limited surfacethe vein exposed, on which more than a certain number ofcannot be simultaneously employed. But this is not trueall mines. In collieries, for example, some other cause ofmust be sought for. In some instances the owners limitquantity raised, in order not too rapidly to exhaust the.. in others there are said to be combinations of owners, toup a monopoly price by limiting the production. Whatever becauses, it is a fact that mines of different degrees ofare in operation, and since the value of the producebe proportional to the cost of production at the worst mine(fertility and situation taken together), it is more thanto that of the best. All mines superior in producethe worst actually worked, will yield, therefore, a rent equalthe excess. They may yield more; and the worst mine may itselfa rent. Mines being comparatively few, their qualities dograduate gently into one another, as the qualities of land; and the demand may be such as to keep the value of theconsiderably above the cost of production at the worstnow worked, without being sufficient to bring into operationstill worse. During the interval, the produce is really at avalue.

Fisheries are another example. Fisheries in the open sea areappropriated, but fisheries in lakes or rivers almost alwaysso, and likewise oyster-beds or other particular fishingon coasts. We may take salmon fisheries as an example ofwhole class. Some rivers are far more productive in salmonothers. None, however, without being exhausted, can supplythan a very limited demand. The demand of a country likecan only be supplied by taking salmon from many differentof unequal productiveness, and the value must beto repay the cost of obtaining the fish from the leastof these. All others, therefore, will if appropriateda rent equal to the value of their superiority. Muchthan this it cannot be, if there are salmon riverswhich from distance or inferior productiveness haveyet contributed to supply the market. If there are not, the, doubtless, may rise to a scarcity rate, and the worstin use may then yield a considerable rent.

Both in the case of mines and of fisheries, the natural orderevents is liable to be interrupted by the opening of a new, or a new fishery, of superior quality to some of thosein use. The first effect of such an incident is anof the supply; which of course lowers the value to callan increased demand. This reduced value may be no longerto remunerate the worst of the existing mines or, and these may consequently be abandoned. If themines or fisheries, with the addition of the one newly, produce as much of the commodity as is

required at thevalue corresponding to their lower cost of production, theof value will be permanent, and there will be afall in the rents of those mines or fisheries whichnot abandoned. In this case, when things have permanentlythemselves, the result will be, that the scale ofwhich supply the market will have been cut short at theend, while a new insertion will have been made in the scalesome point higher up; and the worst mine or fishery in use —one which regulates the rents of the superior qualities andvalue of the commodity — will be a mine or fishery of betterthan that by which they were previously regulated.

Land is used for other purposes than agriculture, especiallyresidence; and when so used, yields a rent, determined bysimilar to those already laid down. The ground rent ofbuilding, and the rent of a garden or park attached to it, willbe less than the rent which the same land would afford in: but may be greater than this to an indefinite; the surplus being either in consideration of beauty or of, the convenience often consisting in superiorfor pecuniary gain. Sites of remarkable beauty arelimited in supply, and therefore, if in great demand,at a scarcity value. Sites superior only in convenience areas to their value by the ordinary principles of rent.ground rent of a house in a small village is but littlethan the rent of a similar patch of ground in the open: but that of a shop in Cheapside will exceed these, by theamount at which people estimate the superior facilities ofmaking in the more crowded place. The rents of wharfage,and harbour room, waterpower, and many other privileges, mayanalysed on similar principles.

4. Cases of extra profit analogous to rent, are more frequentthe transactions of industry than is sometimes supposed. Takecase, for example, of a patent, or exclusive privilege foruse of a process by which cost of production is lessened. Ifvalue of the product continues to be regulated by what itto those who are obliged to persist in the old process, thewill make an extra profit equal to the advantage whichprocess possesses over theirs. This extra profit issimilar to rent, and sometimes even assumes the formit; the patentee allowing to other producers the use of his, in consideration of an annual payment. So long as he,those whom he associates in the privilege, do not produceto supply the whole market, so long the original cost of, being the necessary condition of producing a part,regulate the value of the whole; and the patentee will beto keep up his rent to a full equivalent for thewhich his process gives him. In the commencement indeedwill probably forego a part of this advantage for the sake ofothers: the increased supply which he brings forwardlower the value, and make the trade a bad one for those whonot share in the privilege: many of whom therefore willretire, or restrict their operations, or enter intowith the patentee: as his supply increases theirsdiminish, the value meanwhile continuing slightly depressed.if he stops short in his operations before the market issupplied by the new process, things will again adjustto what was the natural value before the invention was, and the benefit of the improvement will accrue solely topatentee.

The extra gains which any producer or dealer obtains throughtalents for business, or superior business arrangements,very much of a similar kind. If all his competitors had theadvantages, and used them, the benefit would be transferredtheir customers, through the diminished value of the article:only retains it for himself because he is able to bring histo market at a lower cost, while its value isby a higher. All advantages, in fact, which onehas over another, whether natural or acquired, whetheror the result of social

arrangements, bring the, so far, into the Third Class, and assimilate theof the advantage to a receiver of rent. Wages andrepresent the universal elements in production, whilemay be taken to represent the differential and peculiar: anyin favour of certain producers, or in favour ofin certain circumstances, being the source of a gain,, though not called rent unless paid periodically by oneto another, is governed by laws entirely the same with it.price paid for a differential advantage in producing a, cannot enter into the general cost of production ofcommodity.

A commodity may no doubt, in some contingencies, yield a rentunder the most disadvantageous circumstances of its: but only when it is, for the time, in the conditionthose commodities which are absolutely limited in supply, andtherefore selling at a scarcity value; which never is, nor has, nor can be, a permanent condition of any of the greatyielding commodities: unless through their approaching, if they are mineral products (coal for example), oran increase of population, continuing after a furtherof production becomes impossible: a contingency, whichalmost inevitable progress of human culture and improvementthe long interval which has first to elapse, forbids us toas probable.

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John Stuart Mill

3: Distribution

6 of the Theory of Value

1. We have now attained a favourable point for looking back,taking a simultaneous view of the space which we havesince the commencement of the present Book. Theare the principles of the theory of Value, so far as weyet ascertained them.

I. Value is a relative term. The value of a thing means theof some other thing, or of things in general, which itfor. The values of all things can never, therefore,or fall simultaneously. There is no such thing as a generalor a general fall of values. Every rise of value supposes a, and every fall a rise.

II. The temporary or market value of a thing, depends on theand supply; rising as the demand rises, and falling as therises. The demand, however, varies with the value, beinggreater when the thing is cheap than when it is dear;the value always adjusts itself in such a manner, that theis equal to the supply.

III. Besides their temporary value, things have also a, or as it may be called, a Natural Value, to which thevalue, after every variation, always tends to return; andoscillations compensate for one another, so that, on the, commodities exchange at about their natural value.

IV. The natural value of some things is a scarcity value; butthings naturally exchange for one another in the ratio ofcost of production, or at what may be termed their Cost.

V. The things which are naturally and permanently at avalue, are those of which the supply cannot be increasedall, or not sufficiently to satisfy the whole of the demandwould exist for them at their cost value.

VI. A monopoly value means a scarcity value. Monopoly cannota value to anything except through a limitation of the.

VII. Every commodity of which the supply can be indefinitelyby labour and capital, exchanges for other thingsto the cost necessary for producing and bringingmarket the most costly portion of the supply required. Thevalue is synonymous with the Cost Value, and the costof a thing, means the cost value of the most costly portionit.

VIII. Cost of Production consists of several elements, somewhich are constant and universal, others occasional. Theelements of cost of production are, the wages of the, and the profits of the capital. The occasional elementstaxes, and any extra cost occasioned by a scarcity value ofof the requisites.

IX. Rent is not an element in the cost of production of thewhich yields it; except in the cases (ratherthan actually existing) in which it results from, and, a scarcity value. But when land capable of yieldingin agriculture is applied to some other purpose, the rentit would have yielded is an element in the cost ofof the commodity which it is employed to produce.

X. Omitting the occasional elements; things which admit ofincrease, naturally and permanently exchange for eachaccording to the comparative amount of wages which must befor producing them, and the comparative amount of profitsmust be obtained by the capitalists who pay those wages.

XI. The comparative amount of wages does not depend on whatare in themselves. High wages do not make high values, norwages low values. The comparative amount of wages dependson the comparative quantities of labour required, andon the comparative rates of its remuneration.

XII. So, the comparative rate of profits does not depend onprofits are in themselves; nor do high or low profits makeor low values. It depends partly on the comparative lengthstime during which the capital is employed, and partly on therate of profits in different employments.

XIII. If two things are made by the same quantity of labour,that labour paid at the same rate, and if the wages of thehave to be advanced for the same space of time, and theof the employment does not require that there be adifference in their rate of profit; then, whether wagesprofits be high or low, and whether the quantity of labourbe much or little, these two things will, on the, exchange for one another.

XIV. If one of two things commands, on the average, a greaterthan the other, the cause must be that it requires for itseither a greater quantity of labour, or a kind ofpermanently paid at a higher rate; or that the capital, orof the capital, which suPports that labour, must be advanceda longer period; or lastly, that the production is attendedsome circumstance which requires to be compensated by ahigher rate of profit.

XV. Of these elements, the quantity of labour required forproduction is the most important: the effect of the others is, though none of them are insignificant.

XVI. The lower profits are, the less important become theelements of cost of production, and the less do commoditiesfrom a value proportioned to the quantity and quality oflabour required for their production.

XVII. But every fall of profits lowers, in some degree, thevalue of things made with much or durable machinery, andthat of things made by hand; and every rise of profitsthe reverse.

2. Such is the general theory of Exchange Value. It is, however, to remark that this theory contemplates aof production carried on by capitalists for profit, andby labourers for subsistence. In proportion as we admit thissupposition — and in most counties we must admit it, atin respect of agricultural produce, to a very greatsuch of the preceding theorems as relate to the dependencevalue on cost of production will require modification. Thoseare all grounded on the supposition, that the producer'sand aim is to derive a profit from his capital. This, it follows that he must sell his commodity at the pricewill afford the ordinary rate of profit, that is to say, itexchange for other commodities at its cost value. But theproprietor, the metayer, and even the peasant-farmer orholder — the labourer, under whatever name, producinghis own account-is seeking, not an investment for his little, but an advantageous employment for his time and labour.disbursements, beyond his own maintenance and that of his, are so small, that

nearly the whole proceeds of the salethe produce are wages of labour. When he and his family havefed from the produce of the farm (and perhaps clothed withgrown thereon, and manufactured in the family) he may,respect of the supplementary remuneration derived from theof the surplus produce, be compared to those labourers who,their subsistence from an independent source, can affordsell their labour at any price which is to their minds worthexertion. A peasant, who supports himself and his family withportion of his produce, will often sell the reminder verybelow what would be its cost value to the capitalist.

There is, however, even in this case, a minimum, or inferior, of value. The produce which he carries to market, mustin to him the value of all necessaries which he isto purchase; and it must enable him to pay his rent., under peasant cultivation, is not governed by theset forth in the chapters immediately preceding, buteither determined by custom, as in the case of metayers, or,fixed by competition, depends on the ratio of population to. Rent, therefore, in this case, is an element of cost of. The peasant must work until he has cleared his rentthe price of all purchased necessaries. After this, he willon working only if he can sell the produce for such a price asovercome his aversion to labour.

The minimum just mentioned is what the peasant must obtain infor the whole of his surplus produce. But inasmuch assurplus is not a fixed quantity, but may be either greaterless according to the degree of his industry, a minimum valuethe whole of it does not give any minimum value for aquantity of the commodity. In this state of things,, it can hardly be sid, that the value depends at all onof production. It depends entirely on demand and supply,is, on the proportion between the quantity of surplus foodthe peasants choose to produce, and the numbers of theagricultural, or rather of the non-peasant population. If theclass were numerous and the growing class lazy, food mightpermanently at a scarcity price. I am not aware that this caseanywhere a real existence. If the growing class is energeticindustrious, and the buyers few, food will be extremely. This also is a rare case, though some parts of Franceapproximate to it. The common cases are, either that, asIreland until lately, the peasant class is indolent and thefew, or the peasants industrious and the town populationand opulent, as in Belgium, the north of Italy, andof Germany. The price of the produce will adjust itself tovarieties of circumstances, unless modified, as in manyit is, by the competition of producers who are not, or by the prices of foreign markets.

3. Another anomalous case is that of slave-grown produce:presents, however, by no means the same degree of. The slave-owner is a capitalist, and his inducementproduction consists in a profit on his capital. This profitamount to the ordinary rate. In respect to his expenses, hein the same position as if his slaves were free labourerswith their present efficiency, and were hired with wagesto their present cost. If the cost is less in proportion towork done, than the wages of free labour would be, so muchgreater are his profits: but if all other producers in thepossess the same advantage, the values of commoditiesnot be at all affected by it. The only case in which theybe affected, is when the privilege of cheap labour isto particular branches of production, free labourers athigher wages being employed in the remainder. Incase, as in all cases of permanent inequality between theof different employments, prices and values receive theof the inequality. Slave-grown will exchange forslave-grown commodities in a less ratio than

that of theof labour required for their production; the value offormer will be less, of the latter greater, than if slaverynot exist.

The further adaptation of the theory of value to theof existing or possible industrial systems may be leftgreat advantage to the intelligent reader. It is well saidMontesquieu, "Il ne faut pas toujours tellement epuiser un, qu'on ne laisse rien a faire au lecteur. Il ne s'agit pasfaire lire, mais de faire penser." (1*):. Esprit des Lois, xi, ad finem.

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3: Distribution

7Money

1. Having proceeded thus far in ascertaining the general lawsValue, without introducing the idea of Money (exceptfor illustration,) it is time that we should nowthat idea, and consider in what manner the principles ofmutual interchange of commodities are affected by the use ofis termed a Medium of Exchange.

In order to understand the manifold functions of aMedium, there is no better way than to consider whatthe principal inconveniences which we should experience if wenot such a medium. The first and most obvious would be theof a common measure for values of different sorts. If ahad only coats, and wanted to buy bread or a horse, itbe very troublesome to ascertain how much bread he ought tofor a coat, or how many coats he should give for a horse.calculation must be recommenced on different data, every timebartered his coats for a different kind of article; and therebe no current price, or regular quotations of value.now each thing has a current price in money, and he getsall difficulties by reckoning his coat at 4l. or 5l., and apound loaf at 6d. or 7d. As it is much easier to comparelengths by expressing them in a common language of feetinches, so it is much easier to compare values by means of alanguage of pounds, shillings, and pence. In no other wayvalues be arranged one above another in a scale; in no othera person conveniently calculate the sum of his possessions;it is easier to ascertain and remember the relations of manyto one thing, than their innumerable cross relations withanother. This advantage of having a common language in whichmay be expressed, is, even by itself, so important, thatsuch mode of expressing and computing them would probably beeven if a pound or a shilling did not express any real, but a mere unit of calculation. It is said that there aretribes in which this somewhat artificial contrivanceprevails. They calculate the value of things in a sortmoney of account, called macutes. They say, one thing is worthmacutes, another fifteen, another twenty.(1*) There is nothing called a macute: it is a conventional unit, for theconvenient comparison of things with one another.

This advantage, however, forms but an inconsiderable part ofeconomical benefits derived from the use of money. Theof barter are so great, that without some moremeans of effecting exchanges, the division ofcould hardly have been carried to any considerable. A tailor, who had nothing but coats, might starve beforecould find any person having bread to sell who wanted a coat:, he would not want as much bread at a time as would bea coat, and the coat could not be divided. Every person,, would at all times hasten to dispose of his commodityexchange for anything which, though it might not be fitted toown immediate wants, was in great and general demand, anddivisible, so that he might be sure of being able towith it whatever was offered for sale. The primaryof life possess these properties in a high degree.is extremely divisible, and an object of universal desire., this is not the sort of thing required : for, of food,in expectation of a scarcity, no one wishes to possessat once, than is wanted for immediate consumption; so that ais never sure of finding an immediate purchaser forof food; and unless soon disposed of, most of them. The thing which people would select to keep by them forpurchases, must be one which,

besides being divisible anddesired, does not deteriorate by keeping. This reduceschoice to a small number of articles.

2. By a tacit concurrence, almost all nations, at a veryperiod, fixed upon certain metals, and especially gold and, to serve this purpose. No other substances unite thequalities in so great a degree, with so manyadvantages. Next to food and clothing, and in someeven before clothing, the strongest inclination in astate of society is for personal ornament, and for the kinddistinction which is obtained by rarity or costliness in such. After the immediate necessities of life were, every one was eager to accumulate as great a store asof things at once costly and ornamental; which weregold, silver, and jewels. These were the things which itpleased every one to possess, and which there was mostof finding others willing to receive in exchange forkind of produce. They were among the most imperishable of all. They were also portable, and containing great valuesmall bulk, were easily hid; a consideration of muchin an age of insecurity. Jewels are inferior to goldsilver in the quality of divisibility; and are of veryqualities, not to be accurately discriminated withouttrouble. Gold and silver are eminently divisible, and when, always of the same quality; and their purity may beand certified by a public authority. Accordingly,furs have been employed as money in some countries, cattleothers, in Chinese Tartary cubes of tea closely pressed, the shell called cowries on the coast of Western, and in Abyssinia at this day blocks of rock salt; thoughof metals, the less costly have sometimes been chosen, asin Lacedaemon from an ascetic policy, copper in the earlyrepublic from the poverty of the people; gold and silverbeen generally preferred by nations which were able tothem, either by industry, commerce, or conquest. To thewhich originally recommended them, another came to be, the importance of which only unfolded itself by degrees.all commodities, they are among the least influenced by any ofcauses which produce fluctuations of value. No commodity isfree from such fluctuations. Gold and silver have, since the beginning of history, one great permanentof value, from the discovery of the American mines;some temporary variations, such as that which, in the lastwar, was produced by the absorption of the metals in, and in the military chests of the immense armiesin the field. In the present age the opening of newof supply, so abundant as the Ural mountains, California,Australia, may be the commencement of another period of, on the limits of which it would be useless at present to. But on the whole, no commodities are so little exposedcauses of variation. They fluctuate less than almost any otherin their cost of production. And from their durability,total quantity in existence is at all times so great into the annual supply, that the effect on value even ofchange in the cost of production is not sudden: a very longbeing required to diminish materially the quantity in, and even to increase it very greatly not being a rapid. Gold and silver, therefore, are more fit than any otherto be the subject of engagements for receiving ora given quantity at some distant period. If the engagementmade in corn, a failure of crops might increase the burthenthe payment in one year to fourfold what was intended, or anharvest sink it in another to one-fourth. If stipulatedcloth, some manufacturing invention might permanently reducepayment to a tenth of its original value. Such things haveeven in the case of payments stipulated in gold and; but the great fall of their value after the discovery of, is, as yet, the only authenticated instance; and in thisthe change was extremely gradual, being spread over a periodmany years.

When gold and silver had become virtually a medium of, by becoming the things for which people generally sold,with which they generally bought, whatever they had to sellto buy; the contrivance of coining obviously suggested itself.this process the metal was divided into convenient portions,any degree of smallness, and bearing a recognised proportionone another; and the trouble was saved of weighing andat every change of possessors, an inconvenience which onoccasion of small purchases would soon have become. Governments found it their interest to take theinto their own hands, and to interdict all coining bypersons; indeed, their guarantee was often the only onewould have been relied on, a reliance however which veryit ill deserved; profligate governments having until a veryperiod seldom scrupled, for the sake of robbing their, to confer on all other debtors a licence to rob, by the shallow and impudent artifice of lowering the; that least covert of all modes of knavery, whichin calling a shilling a pound, that a debt of onepounds may be cancelled by the payment of a hundred. It would have been as simple a plan, and would havethe purpose as well, to have enacted that "a hundred"always be interpreted to mean five, which would havethe same reduction in all pecuniary contracts, and wouldhave been at all more shameless. Such strokes of policy havewholly ceased to be recommended, but they have ceased to be; except occasionally through the medium of paper money,which case the character of the transaction, from the greaterof the subject, is a little less barefaced.

3. Money, when its use has grown habitual, is the mediumwhich the incomes of the different members of theare distributed to them, and the measure by which theytheir possessions. As it is always by means of moneypeople provide for their different necessities, there growsin their minds a powerful association leading them to regardas wealth in a more peculiar sense than any other article;even those who pass their lives in the production of the mostobjects, acquire the habit of regarding those objects asimportant by their capacity of being exchanged for money.person who parts with money to obtain commodities, unless heto sell them, appears to the imagination to be making abargain than a person who parts with commodities to get; the one seems to be spending his means, the other addingthem. Illusions which, though now in some measure dispelled,long powerful enough to overmaster the mind of every, both speculative and practical, in Europe.

It must be evident, however, that the mere introduction of amode of exchanging things for one another, by firsta thing for money, and then exchanging the money forelse, makes no difference in the essential character of. It is not with money that things are really. Nobody's income (except that of the gold or silver) is derived from the precious metals. The pounds orwhich a person receives weekly or yearly, are not whathis income; they are a sort of tickets or ordershe can present for payment at any shop he pleases, andentitle him to receive a certain value of any commodityhe makes choice of. The farmer pays his labourers and hisin these tickets, as the most convenient plan forand them; but their real income is their share of his, cattle, and hay, and it makes no essential differencehe distributes it to them directly, or sells it for themgives them the price; but as they would have to sell it forif he did not, and as he is a seller at any rate, it bestthe purposes of all, that he should sell their share alonghis own, and leave the labourers more leisure for work andlandlord for being idle. The capitalists, except those whoproducers of the precious metals, derive no part of theirfrom those metals, since they only get them by

buying themtheir own produce : while all other persons have theirpaid to them by the capitalists, or by those who havepayment from the capitalists, and as the capitalistsnothing, from the first, except their produce, it is thatnothing else which supplies all incomes furnished by them.cannot, in short, be intrinsically a more insignificant, in the economy of society, than money; except in theof a contrivance for sparing time and labour. It is afor doing quickly and commodiously, what would be done,less quickly and commodiously, without it: and like manykinds of machinery, it only exerts a distinct andinfluence of its own when it gets out of order.

The introduction of money does not interfere with theof any of the Laws of Value laid down in the preceding. The reasons which make the temporary or market value ofdepend on the demand and supply, and their average andvalues upon their cost of production, are as applicablea money system as to a system of barter. Things which bywould exchange for one another, will, if sold for money,for an equal amount of it, and so will exchange for onestill, though the process of exchanging them will consisttwo operations instead of only one. The relations ofto one another remain unaltered by money: the onlyrelation introduced, is their relation to money itself; howor how little money they will exchange for; in other words,the Exchange Value of money itself is determined. And this isa question of any difficulty, when the illusion is dispelled,caused money to be looked upon as a peculiar thing, notby the same laws as other things. Money is a commodity,its value is determined like that of other commodities,by demand and supply, permanently and on the averagecost of production. The illustration of these principles,in their application to money, must be given in some, on account of the confusion which, in minds notinstructed on the subject, envelopes the whole; partly from a lingering remnant of the old misleading, and partly from the mass of vapoury and baselesswith which this, more than any other topic ofeconomy, has in latter times become surrounded. I shalltreat of the Value of Money in a chapter apart. :. Montesquieu, Esprit des Lois, liv. xxii, ch. 8.

The Principles of Political Economy

John Stuart Mill3:

Distribution8the Value of Money, as Dependent on Demand and Supply

1. It is unfortunate that in the very outset of the subjecthave to clear from our path a formidable ambiguity of. The Value of Money is to appearance an expression as, as free from possibility of misunderstanding, as any in. The value of a thing, is what it will exchange for: theof money, is what money will exchange for; the purchasingof money. If prices are low, money will buy much of other, and is of high value; if prices are high, it will buyof other things, and is of low value. The value of moneyinversely as general prices: falling as they rise, and risingthey fall.

But unhappily the same phrase is also employed, in thelanguage of commerce, in a very different sense. Money,is so commonly understood as the synonyme of wealth, isespecially the term in use to denote it when it is theof borrowing. When one person lends to another, as wellwhen he pays wages or rent to another, what he transfers isthe mere money, but a right to a certain value of the producethe country, to be selected at pleasure; the lender havingbought this right, by giving for it a portion of his. What he really lends is so much capital; the money ismere instrument of transfer. But the capital usually passesthe lender to the receiver through the means either of, or of an order to receive money, and at any rate it is inthat the capital is computed and estimated. Hence,capital is universally called borrowing money; the loanis called the money market: those who have their capitalfor investment on loan are called the monied class:the equivalent given for the use of capital, or in other, interest, is not only called the interest of money, but,a grosser perversion of terms, the value of money. Thisof language, assisted by some fallaciouswhich we shall notice and clear up hereafter,(1*) hasa general notion among persons in business, that theof Money, meaning the rate of interest, has an intimatewith the Value of Money in its proper sense, the valuepurchasing power of the circulating medium. We shall return tosubject before long: at present it is enough to say, that byI shall always mean Exchange Value, and by money the mediumexchange, not the capital which is passed from hand to handthat medium.

2. The value or purchasing power of money depends, in theinstance, on demand and supply. But demand and supply, into money, present themselves in a somewhat differentfrom the demand and supply of other things.

The supply of a commodity means the quantity offered for. But it is not usual to speak of offering money for sale.are not usually said to buy or sell money. This, however,merely an accident of language. In point of fact, money isand sold like other things, whenever other things areand sold for money. Whoever sells corn, or tallow, or, buys money. Whoever buys bread, or wine, or clothes,money to the dealer in those articles. The money with whichare offering to buy, is money offered for sale. The supplymoney, then, is the quantity of it which people are wanting toout; that is, all the money they have in their possession,what they are hoarding, or at least keeping by them as afor future contingencies. The supply of money, in short,all the money in circulation at the time.

The demand for money, again, consists of all the goodsfor sale. Every seller of goods is a buyer of money, andgoods he brings with him constitute his demand. The demandmoney differs from the demand for other things in this, thatis limited only by the means of the purchaser. The demand forthings is for so much and no more; but there is always afor as much money as can be got. Persons may indeed refusesell, and withdraw their goods from the market, if they cannotfor them what they consider a sufficient price. But this iswhen they think that the price will rise, and that theyget more money by waiting. If they thought the low priceto be permanent, they would take what they could get. Italways a sine qua non with a dealer to dispose of his goods.

As the whole of the goods in the market compose the demandmoney, so the whole of the money constitutes the demand for. The money and the goods are seeking each other for theof being exchanged. They are reciprocally supply andto one another. It is indifferent whether, inthe phenomena, we speak of the demand and supplygoods, or the supply and the demand of money. They areexpressions.

We shall proceed to illustrate this proposition more fully.in doing this, the reader will remark a great differencethe class of questions which now occupy us, and thosewe previously had under discussion respecting Values. InValue, we were only concerned with causes which actedparticular commodities apart from the rest. Causes whichall commodities alike, do not act upon values. But inthe relation between goods and money, it is with thethat operate upon all goods whatever, that we areconcerned. We are comparing goods of all sorts on one, with money on the other side, as things to be exchangedeach other.

Suppose, everything else being the same, that there is anin the quantity of money, say by the arrival of ain a place, with a treasure of gold and silver. When heexpending it (for this question it matters not whetheror unproductively), he adds to the supply of money,by the same act, to the demand for goods. Doubtless he adds,the first instance, to the demand only for certain kinds of, namely, those which he selects for purchase; he willraise the price of those, and so far as he isconcerned, of those only. If he spends his funds inentertainments, he will raise the prices of food and wine.he expends them in establishing a manufactory, he will raiseprices of labour and materials. But at the higher prices,money will pass into the hands of the sellers of thesearticles; and they, whether labourers or dealers,more money to lay out, will create an increased demand forthe things which they are accustomed to purchase: thesewill rise in price, and so on until the rise haseverything. I say everything, though it is of coursethat the influx of money might take place through theof some new class of consumers, or in such a manner as tothe proportions of different classes of consumers to one, so that a greater share of the national income thanwould thenceforth be expended in some articles, and ain others; exactly as if a change had taken place in theand wants of the community. If this were the case, thenproduction had accommodated itself to this change in thedemand for different things, there would be a realin values, and some things would rise in price moreothers, while some perhaps would not rise at all. These, however, would evidently proceed, not from the mereof money, but from accessory circumstances attending it.are now only called upon to consider what would be the effectan increase of money, considered by itself. Supposing thein the hands of individuals to be increased, the wants andof the community

collectively in respect toremaining exactly the same; the increase of demandreach all things equally, and there would be an universalof prices. We might suppose, with Hume, that some morning,person in the nation should wake and find a gold coin inpocket: this example, however, would involve an alteration ofproportions in the demand for different commodities; theof the poor would, in the first instance be raised in, in a much greater degree than other things. Let us rather, therefore, that to every pound, or shilling, or penny,the possession of any one, another pound, shilling, or penny,suddenly added. There would be an increased money demand,consequently an increased money value, or price, for thingsall sorts. This increased value would do no good to any one;make no difference, except that of having to reckon pounds,, and pence, in higher numbers. It would be an increasevalues only as estimated in money, a thing only wanted to buythings with; and would not enable any one to buy more ofthan before. Prices would have risen in a certain ratio, andvalue of money would have fallen in the same ratio.

It is to be remarked that this ratio would be precisely thatwhich the quantity of money had been increased. If the wholein circulation was doubled, prices would be doubled. If itonly increased one-fourth, prices would rise one-fourth.would be one-fourth more money, all of which would be usedpurchase goods of some description. When there had been timethe increased supply of money to reach all markets, or(according to the conventional metaphor) to permeate all theof circulation, all prices would have risen one-fourth.the general rise of price is independent of this diffusingequalizing process. Even if some prices were raised more, andless, the average rise would be one-fourth. This is aconsequence of the fact, that a fourth more money wouldbeen given for only the same quantity of goods. General, therefore, would in any case be a fourth higher.

The very same effect would be produced on prices if wethe goods diminished, instead of the money increased: andcontrary effect if the goods were increased or the money. If there were less money in the hands of the, and the same amount of goods to be sold, less moneywould be given for them, and they would be sold atprices; lower, too, in the precise ratio in which the moneydiminished. So that the value of money, other things beingsame, varies inversely as its quantity; every increase oflowering the value, and every diminution raising it, inratio exactly equivalent.

This, it must be observed, is a property peculiar to money.did not find it to be true of commodities generally, thatdiminution of supply raised the value exactly in proportionthe deficiency, or that every increase lowered it in theratio of the excess. Some things are usually affected ingreater ratio than that of the excess or deficiency, othersin a less: because, in ordinary cases of demand, the, being for the thing itself, may be stronger or weaker:the amount of what people are willing to expend on it, beingany case a limited quantity, may be affected in very unequalby difficulty or facility of attainment. But in the casemoney, which is desired as the means of universal purchase,demand consists of everything which people have to sell; andonly limit to what they are willing to give, is the limit settheir having nothing more to offer. The whole of the goodsin any case exchanged for the whole of the money whichinto the market to be laid out, they will sell for less orof it, exactly according as less or more is brought.

3. From what precedes, it might for a moment be supposed,all the goods on sale in a country at any one time, arefor all the money existing and in circulation at thattime: or

in other words, that there is always in circulationa country, a quantity of money equal in value to the whole ofgoods then and there on sale. But this would be a complete. The money laid out is equal in value to theit purchases; but the quantity of money laid out is not thething with the quantity in circulation. As the money passeshand to hand, the same piece of money is laid out many, before all the things on sale at one time are purchasedfinally removed from the market: and each pound or dollarbe counted for as many pounds or dollars, as the number ofit changes hands in order to effect this object. Thepart of the goods must also be counted more than once,only because most things pass through the hands of severalof manufacturers and dealers before they assume the form inthey are finally consumed, but because in times of(and all times are so, more or less) the same goodsoften bought repeatedly, to be resold for a profit, beforeare bought for the purpose of consumption at all.

If we assume the quantity of goods on sale, and the number ofthose goods are resold, to be fixed quantities, the valuemoney will depend upon its quantity, together with the averageof times that each piece changes hands in the process. Theof the goods sold (counting each resale of the same goodsso much added to the goods) have been exchanged for the wholethe money, multiplied by the number of purchases made on theby each piece. Consequently, the amount of goods and ofbeing the same, the value of money is inversely asquantity multiplied by what is called the rapidity of. And the quantity of money in circulation, is equalthe money value of all the goods sold, divided by the numberexpresses the rapidity of circulation.

The phrase, rapidity of circulation, requires some comment.must not be understood to mean, the number of purchases madeeach piece of money in a given time. Time is not the thing toconsidered. The state of society may he such, that each piecemoney hardly performs more than one purchase in a year; but ifarises from the small number of transactions-from the smallof business done, the want of activity in traffic, orwhat traffic there is, mostly takes place by barter — itno reason why prices should be lower, or the value ofhigher. The essential point is, not how often the samechanges hands in a given time, but how often it changesin order to perform a given amount of traffic. We mustthe number of purchases made by the money in a given, not with the time itself, but with the goods sold in thattime. If each piece of money changes hands on an average tenwhile goods are sold to the value of a million sterling, itevident that the money required to circulate those goods is,000l. And conversely, if the money in circulation is,000l., and each piece changes hands by the purchase of goodstimes in a month, the sales of goods for money which takeevery month must amount on the average to 1,000,000l.

Rapidity of circulation being a phrase so ill adapted tothe only thing which it is of any importance to expressit, and having a tendency to confuse the subject by suggestingmeaning extremely different from the one intended, it would begood thing if the phrase could be got rid of, and another, more directly significant of the idea meant to be. Some such expression as "the efficiency of money,"not unexceptionable, would do better; as it would pointto the quantity of work done, without suggesting theof estimating it by time. Until an appropriate term can be, we must be content when ambiguity is to be apprehended,express the idea by the circumlocution which alone conveys it, namely, the average number of purchases made by eachin order to effect a given pecuniary amount of.

4. The proposition which we have laid down respecting theof general prices upon the quantity of money in, must be understood as applying only to a state ofin which money, that is, gold or silver, is the exclusiveof exchange, and actually passes from hand to hand atpurchase, credit in any of its shapes being unknown. Whencomes into play as a means of purchasing, distinct fromin hand, we shall hereafter find that the connexion betweenand the amount of the circulating medium is much lessand intimate, and that such connexion as does exist, noadmits of so simple a mode of expression. But on a subjectfull of complexity as that of currency and prices, it isto lay the foundation of our theory in a thoroughof the most simple cases, which we shall alwayslying as a groundwork or substratum under those which arisepractice. That an increase of the quantity of money raises, and a diminution lowers them, is the most elementaryin the theory of currency, and without it we shouldno key to any of the others. In any state of things,, except the simple and primitive one which we have, the proposition is only true other things being the: and what those other things are, which must be the same, wenot yet ready to pronounce. We can, however, point out, even, one or two of the cautions with which the principle must bein attempting to make use of it for the practicalof phenomena; cautions the more indispensable, as the, though a scientific truth, has of late years been theof a greater mass of false theory, and erroneousof facts, than any other proposition relating to. From the time of the resumption of cash payments byAct of 1819, and especially since the commercial crisis of, the favourite explanation of every rise or fall of pricesbeen "the currency;" and like most popular theories, thehas been applied with little regard to the conditionsfor making it correct.

For example, it is habitually assumed that whenever there isgreater amount of money in the country, or in existence, a riseprices must necessity follow. But this is by no means anconsequence. In no commodity is it the quantity in, but the quantity offered for sale, that determines the. Whatever may be the quantity of money in the country, onlypart of it will affect prices, which goes into the market of, and is there actually exchanged against goods.increases the amount of this portion of the money in the, tends to raise prices. But money hoarded does not act on. Money kept in reserve by individuals to meetwhich do not occur, does not act on prices. Thein the coffers of the Bank, or retained as a reserve bybankers, does not act on prices until drawn out, nor evenunless drawn out to be expended in commodities.

It frequently happens that money, to a considerable amount,brought into the country, is there actually invested as, and again flows out, without having ever once acted uponmarkets of commodities, but only upon the market of, or, as it is commonly though improperly called, themarket. Let us return to the case already put for, that of a foreigner landing in the country with a. We supposed him to employ his treasure in the purchasegoods for his own use, or in setting up a manufactory andlabourers; and in either case he would, caeteris, raise prices. But instead of doing either of these, he might very probably prefer to invest his fortune at; which we shall suppose him to do in the most obvious, by becoming a competitor for a portion of the stock,bills, railway debentures, mercantile bills, mortgages,&c., which are at all times in the hands of the public. By doinghe would raise the prices of those different securities, orother words would lower the rate of interest; and since thisdisturb the relation previously existing between the

rateinterest on capital in the country itself, and that in foreign, it would probably induce some of those who hadcapital seeking employment, to send it abroad forinvestment rather than buy securities at home at theprice. As much money might thus go out as had previouslyin, while the prices of commodities would have shown noof its temporary presence. This is a case highly deservingattention: and it is a fact now beginning to be recognised,the passage of the precious metals from country to countrydetermined much more than was formerly supposed, by the statethe loan market in different countries, and much less by theof prices.

Another point must be adverted to, in order to avoid seriousin the interpretation of mercantile phenomena. If there be,any time, an increase in the number of money transactions, acontinually liable to happen from differences in theof speculation, and even in the time of year (sincekinds of business are transacted only at particular); an increase of the currency which is only proportionalthis increase of transactions, and is of no longer duration,no tendency to raise prices. At the quarterly periods whenpublic dividends are paid at the Bank, a sudden increaseplace of the money in the hands of the public; an increaseat from a fifth to two-fifths of the whole issues ofBank of England. Yet this never has any effect on prices; anda very few weeks, the currency has again shrunk into its usual, by a mere reduction in the demands of the public(after so copious a supply of ready money) for accommodation fromBank in the way of discount or loan. In like manner theof the agricultural districts fluctuates in amount atseasons of the year. It is always lowest in August: "itgenerally towards Christmas, and obtains its greatestabout Lady-day, when the farmer commonly lays in his, and has to pay his rent and summer taxes," and when hemakes his principal applications to country bankers for. "Those variations occur with the same regularity as the, and with just as little disturbance of the markets as thefluctuations of the notes of the Bank of England. Asas the extra payments have been completed, the superfluous", which is estimated at half a million, "as certainly andis reabsorbed and disappears." (2*)

If extra currency were not forthcoming to make these extra, one of three things must happen. Either the paymentsbe made without money, by a resort to some of thoseby which its use is dispensed with; or there must beincrease in the rapidity of circulation, the same sum of moneymade to perform more payments; or if neither of thesetook place, money to make the extra payments must befrom the market for commodities, and prices,, must fall. An increase of the circulating medium,in extent and duration to the temporary stress of, does not raise prices, but merely prevents this fall.

The sequel of our investigation will point out many otherwith which the proposition must be received, thatvalue of the circulating medium depends on the demand and, and is in the inverse ratio of the quantity;which, under a complex system of credit like thatin England, render the proposition an extremelyexpression of the fact. :. Infra, chap. xxiii.. Fullarton on the Regulation of Currencies, 2nd edit., pp.-9.

The Principles of Political Economy

John Stuart Mill3:

Distribution

9

the Value of Money, as Dependent on Cost of Production

1. But money, no more than commodities in general, has itsdefinitively determined by demand and supply. The ultimateof its value is Cost of Production.

We are supposing, of course, that things are left to. Governments have not always left things to. They have undertaken to prevent the quantity of moneyadjusting itself according to spontaneous laws, and haveto regulate it at their pleasure; generally with aof keeping a greater quantity of money in the country, thanotherwise have remained there. It was, until lately, theof all governments to interdict the exportation and theof money; while, by encouraging the exportation andthe importation of other things, they endeavoured toa stream of money constantly flowing in. By this course theytwo prejudices; they drew, or thought that they drew,money into the country, which they believed to be tantamountmore wealth; and they gave, or thought that they gave, to alland dealers, high prices, which, though no real, people are always inclined to suppose to be one.

In this attempt to regulate the value of money artificiallymeans of the supply, governments have never succeeded in the, or even in the manner, which they intended. Theiragainst exporting or melting the coin have nevereffectual. A commodity of such small bulk in proportion tovalue is so easily smuggled, and still more easily melted,it has been impossible by the most stringent measures tothese operations. All the risk which it was in the powergovernments to attach to them, was outweighed by a veryprofit.(1*) In the more indirect mode of aiming at thepurpose, by throwing difficulties in the way of making thefor exported goods in any other commodity than money,have not been quite so unsuccessful. They have not, indeed,in making money flow continuously into the country; buthave to a certain extent been able to keep it at a higherits natural level; and have, thus far, removed the value offrom exclusive dependence on the causes which fix the valuethings not artificially interfered with.

We are, however, to suppose a state, not of artificial, but of freedom. In that state, and assuming no chargebe made for coinage, the value of money will conform to theof the bullion of which it is made. A pound weight of goldsilver in coin, and the same weight in an ingot, willexchange for one another. On the supposition of, the metal cannot be worth more in the state of bullionof coin; for as it can be melted without any loss of time,with hardly any expense, this would of course be done untilquantity in circulation was so much diminished as to equalizevalue with that of the same weight in bullion. It may behowever that the coin, though it cannot be of less, may, and being a manufactured article will naturally be, ofvalue than the bullion contained in it, on the sameon which linen cloth is of more value than an equalof linen yarn. This would be true, were it not that, in this country, and in some others, coins moneyfor any one who furnishes the metal. The labour andof coinage, when not charged to the possessor, do notthe value of the article. If Government opened an office, on delivery of a given weight of yarn, it returned theweight of cloth to

any one who asked for it, cloth would beno more in the market than the yarn it contained. As sooncoin is worth a fraction more than the value of the bullion,becomes the interest of the holders of bullion to send it tocoined. If Government, however, throws the expense of coinage,is reasonable, upon the holder, by making a charge to coverexpense (which is done by giving back rather less in coinhas been received in bullion, and is called levying a), the coin will rise, to the extent of the seignorage,the value of the bullion. If the Mint kept back one per, to pay the expense of coinage, it would be against theof the holders of bullion to have it coined, until thewas more valuable than the bullion by at least that. The coin, therefore, would be kept one per cent highervalue, which could only be by keeping it one per cent less in, than if its coinage were gratuitous.

The Government might attempt to obtain a profit by the, and might lay on a seignorage calculated for that; but whatever they took for coinage beyond its expenses,be so much profit on private coining. Coining, though noteasy an operation as melting, is far from a difficult one,, when the coin produced is of full weight and standard, is very difficult to detect. If, therefore, a profitbe made by coining good money, it would certainly be done:the attempt to make seignorage a source of revenue would be. Any attempt to keep the value of the coin at anelevation, not by a seignorage, but by refusing to, would be frustrated in the same manner.(2*)

2. The value of money, then, conforms, permanently, and, in aof freedom, almost immediately, to the value of the metalwhich it is made; with the addition, or not, of the expensescoinage, according as those expenses are borne by theor by the state. This simplifies extremely thewhich we have here to consider: since gold and silverare commodities like any others, and their value depends,that of other things, on their cost of production.

To the majority of civilized countries, gold and silver areproducts: and the circumstances which govern the valuesforeign products, present some questions which we are not yetto examine. For the present, therefore, we must suppose thewhich is the subject of our inquiries, to be suppliedgold and silver by its own mines, reserving for futurehow far our conclusions require modification tothem to the more usual case.

Of the three classes into which commodities are divided —absolutely limited in supply, those which may be had inquantity at a given cost of production, and those whichbe had in unlimited quantity, but at an increasing cost of— the precious metals, being the produce of mines,to the third class. Their natural value, therefore, is inlong run proportional to their cost of production in the mostexisting circumstances, that is, at the worst mineit is necessary to work in order to obtain the required. A pound weight of gold will, in the gold-producing, ultimately tend to exchange for as much of every other, as is produced at a cost equal to its own; meaning byown cost the cost in labour and expense, at the leastsources of supply which the then existing demand makesnecessary to work. The average value of gold is made toto its natural value, in the same manner as the values ofthings are made to conform to their natural value. Supposeit were selling above its natural value; that is, above thewhich is an equivalent for the labour and expense of, and for the risks attending a branch of industry in whichout of ten experiments have usually been failures. A part ofmass of floating capital which is on the look out for, would take the direction of mining enterprise; thewould thus be increased, and the value would fall. If,

oncontrary, it were selling below its natural value, minersnot be obtaining the ordinary profit; they would slackenworks; if the depreciation was great, some of the inferiorwould perhaps stop working altogether: and a falling off inannual supply, preventing the annual wear and tear from beingcompensated, would by degrees reduce the quantity, andthe value.

When examined more closely, the following are the details ofprocess. If gold is above its natural or cost value — the, as we have seen, conforming in its value to themoney will be of high value, and the prices of all, labour included, will be low. These low prices will lowerexpenses of all producers; but as their returns will also be, no advantage will be obtained by any producer, exceptproducer of gold: whose returns from his mine, not dependingprice, will be the same as before, and his expenses being, he will obtain extra profits, and will be stimulated tohis production. E converso if the metal is below itsvalue: since this is as much as to say that prices are, and the money expenses of all producers unusually great:this, however, all other producers will be compensated bymoney returns: the miner alone will extract from hisno more metal than before, while his expenses will be: his profits therefore being diminished or annihilated,will diminish his production, if not abandon his employment.

In this manner it is that the value of money is made toto the cost of production of the metal of which it is. It may be well, however, to repeat (what has been said) that the adjustment takes a long time to effect, in theof a commodity so generally desired and at the same time soas the precious metals. Being so largely used not only asbut for plate and ornament, there is at all times a veryquantity of these metals in existence: while they are soworn out, that a comparatively small annual production isto keep up the supply, and to make any addition to itmay be required by the increase of goods to be circulated,by the increased demand for gold and silver articles byconsumers. Even if this small annual supply were stopt, it would require many years to reduce the quantity soas to make any very material difference in prices. Themay be increased, much more rapidly than it can be; but the increase must be very great before it canitself much felt over such a mass of the precious metals asin the whole commercial world. And hence the effects ofchanges in the conditions of production of the preciousare at first, and continue to be for many years, questionsquantity only, with little reference to cost of production.especially is this the case when, as at the present time,new sources of supply have been simultaneously opened, mostthem practicable by labour alone, without any capital inbeyond a pickaxe and a week's food; and when theare as yet wholly experimental, the comparativeproductiveness of the different sources being entirely.

3. Since, however, the value of money really conforms, likeof other things, though more slowly, to its cost of, some political economists have objected altogether tostatement that the value of money depends on its quantitywith the rapidity of circulation; which, they think, isa law for money that does not exist for any other, when the truth is that it is governed by the very same. To this we may answer, in the first place, that thein question assumes no peculiar law. It is simply theof demand and supply, which is acknowledged to be applicableall commodities, and which, in the case of money as of mostthings, is controlled, but not set aside, by the law ofof production, since cost of production would have no effectvalue if it could have none on supply. But, secondly, thereis, in one respect,

a closer connexion between the valuemoney and its quantity, than between the values of otherand their quantity. The value of other things conforms tochanges in the cost of production, without requiring, as a, that there should be any actual alteration of the: the potential alteration is sufficient; and if there evenan actual alteration, it is but a temporary one, except in soas the altered value may make a difference in the demand, andrequire an increase or diminution of supply, as a consequence,a cause, of the alteration in value. Now this is also true ofand silver, considered as articles of expenditure forand luxury; but it is not true of money. If thecost of production of gold were reduced one-fourth, ithappen that there would not be more of it bought for plate,, or jewellery, than before; and if so, though the valuefall, the quantity extracted from the mines for thesewould be no greater than previously. Not so with theused as money; that portion could not fall in valuefourth, unless actually increased one-fourth; for, at pricesfourth higher, one-fourth more money would be required tothe accustomed purchases; and if this were not forthcoming,of the commodities would be without purchasers, and pricesnot be kept up. Alterations, therefore, in the cost ofof the precious metals, do not act upon the value ofexcept just in proportion as they increase or diminish its; which cannot be said of any other commodity. It would, I conceive, be an error both scientifically and, to discard the proposition which asserts a connexionthe value of money and its quantity.

It is evident, however, that the cost of production, in therun, regulates the quantity; and that every country(temporary fluctuations excepted) will possess, and have in, just that quantity of money, which will perform allexchanges required of it, consistently with maintaining aconformable to its cost of production. The prices of things, on the average, be such that money will exchange for itscost in all other goods: and, precisely because the quantitybe prevented from affecting the value, the quantity itself(by a sort of self-acting machinery) be kept at the amountwith that standard of prices-at the amount necessaryperforming, at those prices, all the business required of it.

"The quantity wanted will depend partly on the cost ofgold, and partly on the rapidity of its circulation.rapidity of circulation being given, it would depend on theof production: and the cost of production being given, theof money would depend on the rapidity of its."(3*) After what has been already said, I hope thatof these propositions stands in need of any further.

Money, then, like commodities in general, having a valueon, and proportional to, its cost of production; theof money is, by the admission of this principle, stript ofgreat part of the mystery which apparently surrounded it. Wenot forget, however, that this doctrine only applies to thein which the precious metals are actually produced; andwe have yet to enquire whether the law of the dependence ofon cost of production applies to the exchange of thingsat distant places. But however this may be, ourwith respect to value will require no other, where money is an imported commodity, than that offor the cost of its production, the cost ofit in the country. Every foreign commodity is bought byfor it some domestic production; and the labour andwhich a foreign commodity costs to us, is the labour andexpended in producing the quantity of our own goods whichgive in exchange for it. What this quantity depends upon, —determines the proportions of interchange between theof one country and those of another, — is indeed aof somewhat greater complexity than those we haveconsidered. But this at least is indisputable, thatthe

country itself the value of imported commodities isby the value, and consequently by the cost of, of the equivalent given for them; and money, where itan imported commodity, is subject to the same law. NOTES:. The effect of the prohibition cannot, however, have been soinsignificant as it has been supposed to be by writersthe subject. The facts adduced by Mr Fullerton, in the note to7 of his work on the Regulation of Currencies, show that ita greater percentage of difference in value between coinbullion that has commonly been imagined, to bring the coin tomelting pot.. In England, though there is no seignorage on gold coin, (thereturning in coin the same weight of pure metal which itin bullion) there is a delay of a few weeks after theis deposited, before the coin can be obtained,a loss of interest, which, to the holder, isto a trifling seignorage. From this cause, the valuecoin is in general slightly above that of the bullion it. An ounce of gold, according to the quantity of metal insovereign, should be worth 3l. 17s. 10 1/2d.; but it wasquoted at 3l. 17s. 6d., until the Bank Charter Act ofmade it imperative on the Bank to give its notes for alloffered to it at the rate of 3l. 17s. 9d. . From some printed, but not published, Lectures of Mr Senior:which the great differences in the business done by money, asas in the rapidity of its circulation, in different statessociety and civilization, are interestingly illustrated.

The Principles of Political Economy

John Stuart Mill

3: Distribution

10a Double Standard, and Subsidiary Coins

1. Though the qualities necessary to fit any commodity forused as money are rarely united in any considerable, there are two commodities which possess them in an, and nearly an equal degree; the two precious metals, asare called; gold and silver. Some nations have accordinglyto compose their circulating medium of these two metals. There is an obvious convenience in making usethe more costly metal for larger payments, and the cheaper onesmaller; and the only question relates to the mode in whichcan best be done. The mode most frequently adopted has beenestablish between the two metals a fixed proportion; to, for example, that a gold coin called a sovereign shouldequivalent to twenty of the silver coins called shillings:the one and the other being called, in the ordinary money ofof the country, by the same denomination, a pound: and itleft free to every one who has a pound to pay, either toit in the one metal or in the other.

At the time when the valuation of the two metals relativelyeach other, say twenty shillings to the sovereign, orone shillings to the guinea, was first made, theprobably corresponded, as nearly as it could be madedo, with the ordinary relative values of the two metalson their cost of production: and if those natural orvalues always continued to bear the same ratio to one, the arrangement would be unobjectionable. This, however,far from being the fact. Gold and silver, though the leastin value of all commodities, are not invariable, and doalways vary simultaneously. Silver, for example, was loweredpermanent value more than gold, by the discovery of themines; and those smal1 variations of value which takeoccasionally, do not affect both metals alike. Suppose suchvariation to take place: the value of the two metals relativelyone another no longer agreeing with their rated proportion,or other of them will now be rated below its bullion value,there will be a profit to be made by melting it.

Suppose, for example, that gold rises in value relatively to, so that the quantity of gold in a sovereign is now worththan the quantity of silver in twenty shillings. Twowill ensue. No debtor will any longer find it histo pay in gold. He will always pay in silver, becauseshillings are a legal tender for a debt of one pound, andcan procure silver convertible into twenty shillings for lessthan that contained in a sovereign. The other consequencebe, that unless a sovereign can be sold for more than twenty, all the sovereigns will be melted, since as bullionwill purchase a greater number of shillings than theyfor as coin. The converse of all this would happen if, instead of gold, were the metal which had risen invalue. A sovereign would not now be worth so much asshillings, and whoever had a pound to pay would preferit by a sovereign; while the silver coins would befor the purpose of being melted, and sold as bulliongold at their real value, that is, above the legal valuation.money of the community, therefore, would never really consistboth metals, but of the one only which, at the particular, best suited the interest of debtors; and the standard ofcurrency would be constantly liable to change from the oneto the other, at a loss, on each change, of the expense ofon the metal which fell out of use.

It appears, therefore, that the value of money is liable tofrequent fluctuations when both metals are a legal tender atfixed valuation, than when the exclusive standard of theis either gold or silver. Instead of being only affectedvariations in the cost of production of one metal, it isto derangement from those of two. The particular kind ofto which a currency is rendered more liable by havinglegal standards, is a fall of value, or what is commonlya depreciation; since practically that one of the twowill always be the standard, of which the real has fallenthe rated value. If the tendency of the metals be to risevalue, all payments will be made in the one which has risen; and if to fall, then in that which has fallen most.

2. The plan of a double standard is still occasionallyforward by here and there a writer or orator as a greatin currency. It is probable that, with most of its, its chief merit is its tendency to a sort of, there being at all times abundance of supportersany mode, either open or covert, of lowering the standard., however, are influenced by an exaggerated estimate of anwhich to a certain extent is real, that of being ablehave recourse, for replenishing the circulation, to the unitedof gold and silver in the commercial world, instead ofconfined to one of them, which, from accidental absorption,not be obtainable with sufficient rapidity. The advantagethe disadvantages of a double standard, seems to be bestby those nations with whom one only of the two metals islegal tender, but the other also is coined, and allowed to passwhatever value the market assigns to it.

When this plan is adopted, it is naturally the more costlywhich is left to be bought and sold as an article of. But nations which, like England, adopt the more costlythe two as their standard, resort to a different expedient forthem both in circulation, namely, to make silver atender, but only for small payments. In England, no one cancompelled to receive silver in payment for a larger amountforty shillings. With this regulation there is necessarilyanother, namely, that silver coin should be rated, inwith gold, somewhat above its intrinsic value; thatshould not be, in twenty shillings, as much silver as isa sovereign: for if there were, a very slight turn of thein its favour would make it worth more than a sovereign,it would be profitable to melt the silver coin. Thevaluation of the silver coin creates an inducement to buyand send it to the Mint to be coined, since it is givenat a higher value than properly belongs to it: this,, has been guarded against, by limiting the quantity ofsilver coinage, which is not left, like that of gold, to theof individuals, but is determined by the government,restricted to the amount supposed to be required for small. The only precaution necessary is, not to put so high aupon the silver, as to hold out a strong temptation tocoining.

The Principles of Political Economy

John Stuart Mill

3: Distribution

11 Credit, as a Substitute for Money

1. The functions of credit have been a subject of as muchand as much confusion of ideas, as any singlein Political Economy. This is not owing to any peculiarin the theory of the subject, but to the complexof some of the mercantile phenomena arising from the formswhich credit clothes itself; by which attention is divertedthe properties of credit in general, to the peculiarities ofparticular forms.

As a specimen of the confused notions entertained respectingnature of credit, we may advert to the exaggerated languageoften used respecting its national importance. Credit has a, but not, as many people seem to suppose, a magical power;cannot make something out of nothing. How often is anof credit talked of as equivalent to a creation of, or as if credit actually were capital. It seems strangethere should be any need to point out, that credit beingpermission to use the capital of another person, the meansproduction cannot be increased by it, but only transferred. Ifborrower's means of production and of employing labour areby the credit given him, the lender's are as much. The same sum cannot be used as capital both by theand also by the person to whom it is lent: it cannot supplyentire value in wages, tools, and materials, to two sets ofat once. It is true that the capital which A hasfrom B, and makes use of in his business, still formsof the wealth of B for other purposes: he can enter intoin reliance on it, and can borrow, when needful, ansum on the security of it; so that to a superficialit might seem as if both B and A had the use of it at once.the smallest consideration will show that when B has partedhis capital to A, the use of it as capital rests with A, and that B has no other service from it than in so far asultimate claim upon it serves him to obtain the use ofcapital from a third person C. All capital (not his own)which any person has really the use, is, and must be, so muchfrom the capital of some one else.(1*)

2. But though credit is but a transfer of capital from handhand, it is generally, and naturally, a transfer to hands moreto employ the capital efficiently in production. Ifwere no such thing as credit, or if, from generaland want of confidence, it were scantily practised,persons who possess more or less of capital, but who, fromoccupations, or for want of the necessary skill and, cannot personally superintend its employment, wouldno benefit from it: their funds would either lie idle, orbe, perhaps, wasted and annihilated in unskilful attemptsmake them yield a profit. All this capital is now lent at, and made available for production. Capital thusforms a large portion of the productive resourcesany commercial country; and is naturally attracted to thoseor traders who, being in the greatest business, havemeans of employing it to most advantage; because such arethe most desirous to obtain it, and able to give the best. Although, therefore, the productive funds of theare not increased by credit, they are called into a morestate of productive activity. As the confidence on whichis grounded extends itself, means are developed by whichthe smallest portions of capital, the sums which each personby him to meet contingencies, are made available foruses. The principal instruments for this purpose areof deposit. Where these do not exist, a prudent person musta sufficient sum unemployed in his own

possession, to meetdemand which he has even a slight reason for thinkingliable to. When the practice, however, has grown up ofthis reserve not in his own custody but with a banker,small sums, previously lying idle, become aggregated in the's hands; and the banker, being taught by experience whatof the amount is likely to be wanted in a given time,knowing that if one depositor happens to require more thanaverage, another will require less, is able to lend the, that is, the far greater part, to producers and: thereby adding the amount, not indeed to the capital in, but to that in employment, and making a correspondingto the aggregate production of the community.

While credit is thus indispensable for rendering the wholeof the country productive, it is also a means by whichindustrial talent of the country is turned to better accountpurposes of production. Many a person who has either noof his own, or very little, but who has qualificationsbusiness which are known and appreciated by some possessorscapital, is enabled to obtain either advances in money, orfrequently goods on credit, by which his industrialare made instrumental to the increase of the public; and this benefit will be reaped far more largely,, through better laws and better education, the communityhave made such progress in integrity, that personalcan be accepted as a sufficient guarantee not onlydishonestly appropriating, but against dishonestly, what belongs to another.

Such are, in the most general point of view, the uses ofto the productive resources of the world. But theseonly apply to the credit given to the industriousto producers and dealers. Credit given by dealers toconsumers is never an addition, but always a, to the sources of public wealth. It makes over inuse, not the capital of the unproductive classes to the, but that of the productive to the unproductive. If A,dealer, supplies goods to B, a landowner or annuitant, to befor at the end of five years, as much of the capital of A asequal to the value of these goods, remains for five years. Wring such a period, if payment had been made at, the sum might have been several times expended and, and goods to the amount might have been several times, consumed, and reproduced: consequently B's withholdingl. for five years, even if he pays at last, has cost to theclasses of the community during that period an absoluteof probably several times that amount. A, individually, is, by putting a higher price upon his goods, which ispaid by B: but there is no compensation made to theclasses, the chief sufferers by every diversion of, whether permanently or temporarily, to unproductive. The country has had 100l. less of capital during those five, B having taken that amount from A's capital, and spent it, in anticipation of his own means, and having onlyfive years set apart a sum from his income and converted itcapital for the purpose of indemnifying A.

3. Thus far of the general functions of Credit in production.is not a productive power in itself, though, without it, thepowers already existing could not be brought intoemployment. But a more intricate portion of the theoryCredit is its influence on prices; the chief cause of most ofmercantile phenomena which perplex observers. In a state ofin which much credit is habitually given, general pricesany moment depend much more upon the state of credit than uponquantity of money. For credit, though it is not productive, is purchasing power; and a person who, having credit,himself of it in the purchase of goods, creates just asdemand for the goods, and tends quite as much to raise their, as if he made an equal amount of purchases with ready.

The credit which we are now called upon to consider, as apurchasing power, independent of money, is of course notin its simplest form, that of money lent by one person to, and paid directly into his hands; for when the borrowerthis in purchases, he makes the purchases with money, not, and exerts no purchasing power over and above thatby the money. The forms of credit which createpower, are those in which no money passes at the time,very often none passes at all, the transaction being includeda mass of other transactions in an account, and nothing paida balance. This takes place in a variety of ways, which weproceed to examine, beginning, as is our custom, with the.

First: Suppose A and B to be two dealers, who havewith each other both as buyers and as sellers. Afrom B on credit. B does the like with respect to A. At theof the year, the sum of A's debts to B is set against the sumB's debts to A, and it is ascertained to which side a balancedue. This balance, which may be less than the amount of manythe transactions singly, and is necessarily less than the sumthe transactions, is all that is paid in money. and perhapsthis is not paid, but carried over in an account current tonext year. A single payment of a hundred pounds may in thissuffice to liquidate a long series of transactions, somethem to the value of thousands.

But secondly. The debts of A to B may be paid without theof money, even though there be no reciprocal debtsB to A. A may satisfy B by making over to him a debt due tofrom a third person, C. This is conveniently done byof a written instrument, called a bill of exchange, which, in fact, a transferable order by a creditor upon his debtor,when accepted by the debtor, that is authenticated by his, becomes an acknowledgment of debt.

4. Bills of exchange were first introduced to save theand risk of transporting the precious metals from placeplace. "Let it be supposed," says Mr Henry Thornton,(2*) "thatare in London ten manufacturers who sell their article toshopkeepers in York, by whom it is retailed; and that therein York ten manufacturers of another commodity, who sell itten shopkeepers in London. There would be no occasion for theshopkeepers in London to send yearly to York guineas for theof the York manufacturers, and for the ten Yorkto send yearly as many guineas to London. It wouldbe necessary for the York manufacturers to receive from eachthe shopkeepers at their own door the money in question,in return letters which should acknowledge the receipt of; and which should also direct the money, lying ready in theof their debtors in London, to be paid to the London, so as to cancel the debt in London in the sameas that at York. The expense and the risk of allof money would thus he saved. Letters ordering theof the debt are termed, in the language of the present, bills of exchange. They are bills by which the debt of oneis exchanged for the debt of another; and the debt,, which is due in one place, for the debt due in another."

Bills of exchange having been found convenient as means ofdebts at distant places without the expense ofthe precious metals, their use was afterwardsextended from another motive. It is usual in every tradegive a certain length of credit for goods bought: three, six months, a year, even two years, according to theor custom of the particular trade. A dealer who hasgoods, for which he is to be paid in six months, but whoto receive payment sooner, draws a bill on his debtorin six months, and gets the bill discounted by a bankerother money-lender, that is, transfers the bill to him,the amount, minus interest for the time it has still to. It has become one of the chief functions of bills ofto serve as a

means by which a debt due from one personthus be made available for obtaining credit from another. Theof the expedient has led to the frequent creation ofof exchange not grounded on any debt previously due to theof the bill by the person on whom it is drawn. These areaccommodation bills; and sometimes, with a tinge of, fictitious bills. Their nature is so clearly, and with such judicious remarks, by the author whom Ijust quoted, that I shall transcribe the entire passage.(3*)

"A, being in want of 100l., requests B to accept a note ordrawn at two months, which B, therefore, on the face of it,bound to pay; it is understood, however, that A will take careto discharge the bill himself, or to furnish B with theof paying it. A obtains ready money for the bill on thecredit of the two parties. A fulfils his promise of payingwhen due, and thus concludes the transaction. This serviceby B to A is, however, not unlikely to be requited, at aor less distant period, by a similar acceptance of a bill on, drawn and discounted for B's convenience.

"Let us now compare such a bill with a real bill. Let usin what points they differ, or seem to differ. and inthey agree.

"They agree, inasmuch as each is a discountable article; eachalso been created for the purpose of being discounted; andis, perhaps, discounted in fact. Each, therefore, servesto supply means of speculation to the merchant. So far,, as bills and notes constitute what is called themedium, or paper currency of the country, and preventuse of guineas, the fictitious and the real bill are upon an. and if the price of commodities be raised in proportionthe quantity of paper currency, the one contributes to thatexactly in the same manner as the other.

"Before we come to the points in which they differ, let usto one point in which they are commonly supposed to be; but in which they cannot be said always or necessarily to.

"Real notes (it is sometimes said) represent actual property.are actual goods in existence, which are the counterpart toreal note. Notes which are not drawn in consequence of aof goods, are a species of false wealth, by which a nationdeceived. These supply only an imaginary capital; the othersone that is real.

"In answer to this statement it may be observed, first, thatnotes given in consequence of a real sale of goods cannot beas on that account certainly representing any actual. Suppose that A sells 100l. worth of goods to B at six' credit, and takes a bill at six months for it; and that, within a month after, sells the same goods, at a like credit,C, taking a like bill; and again, that C, after another month,them to D, taking a like bill, and so on. There may then,the end of six months, be six bills of 100l. each, existing atsame time; and every one of these may possibly have been. Of all these bills, then, only one represents anyproperty.

"In order to justify the supposition that a real bill (as itcalled) represents actual property, there ought to be somein the bill-holder to prevent the property which the bill, from being turned to other purposes than that ofthe bill in question. No such power exists; neither thewho holds the real bill, nor the man who discounts it, hasproperty in the specific goods for which it was given : he astrusts to the general ability to pay of the giver of the,

as the holder of any fictitious bill does. The fictitiousmay, in many cases, be a bill given by a person having aand known capital, a part of which the fictitious bill maysaid in that case to represent. The supposition that realrepresent property, and that fictitious bills do not,, therefore, to be one by which more than justice is done toof these species of bills, and something less than justice toother.

"We come next to some point in which they differ.

"First, the fictitious note, or note of accommodation, isto the objection that it professes to be what it is not.objection, however, lies only against those fictitious billsare passed as real. In many cases it is sufficientlywhat they are. Secondly, the fictitious bill is, in, less likely to be punctually paid than the real one.is a general presumption, that the dealer in fictitiousis a man who is a more adventurous speculator than he whoabstains from them. It follows, thirdly, thatbills, besides being less safe, are less subject toas to their quantity. The extent of a man's actualforms some limit to the amount of his real notes; and as ithighly desirable in commerce that credit should be dealt outall persons in some sort of regular and due proportion, theof a man's actual sales, certified by the appearance ofbills drawn in virtue of those sales, is some rule in the, though a very imperfect one in many respects.

"A fictitious bill, or bill of accommodation, is evidently inthe same as any common promissory note; and even betterthis respect, that there is but one security to the promissory, whereas in the case of the bill of accommodation, there are. So much jealousy subsists lest traders should push theirof raising money too far, that paper, the same in itsnature with that which is given, being the only papercan be given, by men out of business, is deemed somewhatwhen coming from a merchant. And because such, when in the merchant's hand, necessarily imitates the, which passes on the occasion of a sale of goods, thefictitious has been cast upon it; an epithet which haSto countenance the confused and mistaken notion, thatis something altogether false and delusive in the nature ofcertain part both of the paper and of the apparent wealth ofcountry."

A bill of exchange, when merely discounted, and kept in theof the discounter until it falls due, does not performfunctions or supply the place of money, but is itself boughtsold for money. It is no more currency than the public funds,any other securities. But when a bill drawn upon one person isto another (or even to the same person) in discharge of aor a pecuniary claim, it does something for which, if thedid not exist, money would be required: it performs theof currency. This is a use to which bills of exchangeoften applied. "They not only," continues Mr. Thornton,(4*)"spare the use of ready money; they also occupy its place in many. Let us imagine a farmer in the country to discharge a debt10l. to his neighbouring grocer, by giving him a bill for that, drawn on his corn-factor in London for grain sold in the; and the grocer to transit the bill, he havingindorsed it to a neighbouring sugar-baker, inof a like debt; and the sugar-baker to send it, whenindorsed, to a West India merchant in an outport, and theIndia merchant to deliver it to his country banker, who alsoit, and sends it into further circulation. The bill incase will have effected five payments, exactly as if it were10l. note payable to a bearer on demand. A multitude of billsbetween trader and trader in the country, in the mannerhas been described; and they evidently form, in thesense, a part of the circulating medium of the."

Many bills, both domestic and foreign, are at least presentedpayment quite covered with indorsements, each of whicheither a fresh discounting, or a pecuniary transactionwhich the bill has performed the functions of money. Withinpresent generation, the circulating medium of Lancashire forabove five pounds, was almost entirely composed of such.

5. A third form in which credit is employed as a substitutecurrency, is that of promissory notes. A bill drawn upon anyand accepted by him, and a note of hand by him promising tothe same sum, are, as far as he is concerned, exactly, except that the former commonly bears interest andlatter generally does not'. and that the former is commonlyonly after a certain lapse of time, and the latterat sight. But it is chiefly in the latter form that itbecome in commercial countries, an express occupation tosuch substitutes for money. Dealers in money (as lenders byare improperly called) desire, like other dealers, totheir operations beyond what can be carried on by theirmeans: they wish to lend, not their capital merely, but their, and not only such portion of their credit as consists ofactually deposited with them, but their power of obtainingfrom the public generally, so far as they think they canemploy it. This is done in a very convenient manner bytheir own promissory notes payable to bearer on demand:borrower being willing to accept these as so much money,the credit of the lender makes other people willinglythem on the same footing, in purchases or other payments.notes, therefore, perform all the functions of currency,render an equivalent amount of money which was previously in, unnecessary. As, however, being payable on demand,may be at any time returned on the issuer, and moneyfor them, he must, on pain of bankruptcy, keep by him asmoney as will enable him to meet any claims of that sortcan be expected to occur within the time necessary forhimself with more: and prudence also requires that henot attempt to issue notes beyond the amount whichshows can remain in circulation without beingfor payment.

The convenience of this mode of (as it were) coining credit,once been discovered, governments have availed themselvesthe same expedient, and have issued their own promissory notespayment of their expenses; a resource the more useful, becauseis the only mode in which they are able to borrow moneypaying interest, their promises to pay on demand being,the estimation of the holders, equivalent to money in hand.practical differences between such government notes and theof private bankers, and the further diversities of whichclass of substitutes for money are susceptible, will bepresently.

6. A fourth mode of making credit answer the purposes of, by which, when carried far enough, money may be verysuperseded, consists in making payments by cheques.custom of keeping the spare cash reserved for immediate useagainst contingent demands, in the hands of a banker, andall payments, except small ones, by orders on bankers, isthis country spreading to a continually larger portion of the. If the person making the payment, and the personit, keep their money with the same banker, the paymentplace without any intervention of money, by the mereof its amount in the banker's books from the credit ofpayer to that of the receiver. If all persons in London keptcash at the same banker's and made all their payments byof cheques, no money would be required or used for anybeginning and terminating in London. This idealis almost attained in fact, so far as regards transactionsdealers. It is chiefly in the retail transactions betweenand consumers, and in the payment of wages, that money ornotes now pass, and then only

when the amounts are small. In, even shopkeepers of any amount of capital or extent ofhave generally an account with a banker; which, besidessafety and convenience of the practice, is to their advantageanother respect, by giving them an understood claim to havebills discounted in cases when they could not otherwiseit. As for the merchants and larger dealers, theymake all payments in the course of their business by. They do not, however, all deal with the same banker, andA gives a cheque to B, B usually pays it not into the sameinto some other bank. But the convenience of business hasbirth to an arrangement which makes all the banking housesthe City of London, for certain purposes, virtually one. A banker does not send the cheques which are paidhis banking house, to the banks on which they are drawn, andmoney for them. There is a building called thehouse, to which every City banker sends, each afternoon,the cheques on other bankers which he has received during the, and they are there exchanged for the cheques on him whichcome into the hands of other bankers, the balances onlypaid in money; or even these not in money, but in chequesthe Bank of England. By this contrivance, all the businessof the City of London during that day, amountingto millions of pounds, and a vast amount besides of country, represented by bills which country bankers haveupon their London correspondents, are liquidated bynot exceeding on the average 200,000l. (5*)

By means of the various instruments of credit which have nowexplained, the immense business of a country like Greatis transacted with an amount of the precious metalssmall; many times smaller, in proportion to thevalue of the commodities bought and sold, than is foundin France, or any other country in which, the habit anddisposition to give credit not being so generally diffused,"economizing expedients," as they have been called, are notto the same extent. What becomes of the money thusin its functions, and by what process it is made tofrom circulation, are questions the discussion of whichbe for a short time postponed. :. To make the proposition in the text strictly true, a, though a very slight one, requires to be made. Themedium existing in a country at a given time, isemployed in purchases for productive, and partly forconsumption. According as a larger proportion of itemployed in the one way or in the other, the real capital ofcountry is greater or less. If, then, an addition were madethe circulating medium in the hands of unproductive consumers, a larger portion of the existing stock ofwould be bought for unproductive consumption, and afor productive, which state of things, while it lasted,be equivalent to a diminution of capital; and on the, if the addition made be to the portion of themedium which is in the hands of producers, andfor their business, a greater portion of the commoditiesthe country will for the present be employed as capital, and aportion unproductively. Now an effect of this latternaturally attends some extensions of credit, especiallytaking place in the form of bank notes, or other instrumentsexchange. The additional bank notes are, in ordinary course,issued to producers or dealers, to be employed as capital:though the stock of commodities in the country is no greaterbefore, yet as a greater share of that stock now comes byinto the hands of producers and dealers, to that extentwould have been unproductively consumed is applied to, and there is a real increase of capital. The effect, and a counter-process takes place, when the additionalis stopped, and the notes called in. . Enquiry into the Nature and Effects of the Paper Credit ofBritain, p. 24. This work, published in 1802, is even nowclearest exposition that I am acquainted with, in the English, of the modes in which credit is given and taken in acommunity.. Pp. 29-33.. P. 40.. According to Mr. Tooke (Inquiry into the Currency

Principle,. 27) the adjustments at the clearing-house "in the year 1839to 954,401,600l., making an average amount of paymentsupwards of 3,000,000l. of bills of exchange and cheques dailythrough the medium of little more than 200,0001. of bank." At present a very much greater amount of transactions isliquidated, without bank notes at all, cheques on the BankEngland supplying their place.

The Principles of Political Economy

John Stuart Mill

3: Distribution

12of Credit on Money

1. Having now formed a general idea of the modes in whichis made available as a substitute for money, we have toin what manner the use of these substitutes affects theof money, or, what is equivalent, the prices of. It is hardly necessary to say that the permanentof money — the natural and average prices of commodities- are not in question here. These are determined by the cost ofor of obtaining the precious metals. An ounce of goldsilver will in the long run exchange for as much of everycommodity, as can be produced or imported at the same costitself. And an order, or note of hand, or bill payable at, for an ounce of gold, while the credit of the giver is, is worth neither more nor less than the gold itself.

It is not, however, with ultimate or average, but withand temporary prices, that we are now concerned. These,we have seen, may deviate very widely from the standard ofof production. Among other causes of fluctuation, one wefound to be, the quantity of money in circulation. Otherbeing the same, an increase of the money in circulationprices, a diminution lowers them. If more money is throwncirculation than the quantity which can circulate at a valueto its cost of production, the value of money, soas the excess lasts, will remain below the standard of costproduction, and general prices will be sustained above therate.

But we have now found that there are other things, such asnotes, bills of exchange, and cheques, which circulate as, and perform all the functions of it: and the question, Do these various substitutes operate on prices in themanner as money itself? Does an increase in the quantity ofpaper tend to raise prices, in the same manner andas an increase in the quantity of money? There has been nomount of discussion on this point among writers on, without any result so conclusive as to have yetgeneral assent.

I apprehend that bank notes, bills, or cheques, as such, doact on prices at all. What does act on prices is Credit, inshape given, and whether it gives rise to anyinstruments capable of passing into circulation, or.

I proceed to explain and substantiate this opinion.

2. Money acts upon prices in no other way than by beingin exchange for commodities. The demand which influencesprices of commodities consists of the money offered for them.the money offered, is not the same thing with the money. It is sometimes less, sometimes very much more. In therun indeed, the money which people lay out will be neithernor less than the money which they have to lay out: but thisfar from being the case at any given time. Sometimes they keepby them for fear of an emergency, or in expectation of aadvantageous opportunity for expending it. In that case theis said not to be in circulation: in plainer language, itnot offered, nor about to he offered, for commodities. Moneyin circulation has no effect on prices. The converse,, is a much commoner case; people make purchases withnot in their possession. An article, for

instance, which isfor by a cheque on a banker, is bought with money which notis not in the payer's possession, but generally not even inbanker's, having been lent by him (all but the usual reserve)other persons. We just now made the imaginary supposition thatpersons dealt with a bank, and all with the same bank,being universally made by cheques. In this ideal case,would be no money anywhere except in the hands of the: who might then safely part with all of it, by selling itbullion, or lending it, to be sent out of the country infor goods or foreign securities. But though there wouldbe no money in possession, or ultimately perhaps even in, money would be offered, and commodities bought with, just as at present. People would continue to reckon theirand their capitals in money, and to make their usualwith orders for the receipt of a thing which would haveceased to exist. There would be in all this nothing toof, so long as the money, in disappearing, left anvalue in other things, applicable when required to theof those to whom the money originally belonged.

In the case however of payment by cheques, the purchases areany rate made, though not with money in the buyer's, yet with money to which he has a right. But he maypurchases with money which he only expects to have, or evenpretends to expect. He may obtain goods in return for hispayable at a future time; or on his note of hand; ora simple book credit, that is, on a mere promise to pay. Allpurchases have exactly the same effect on price, as if theymade with ready money. The amount of purchasing power whichperson can exercise is composed of all the money in hisor due to him, and of all his credit. For exercisingwhole of this power he finds a sufficient motive only undercircumstances; but he always possesses it; and theof it which he at any time does exercise, is the measurethe effect which he produces on price.

Suppose that, in the expectation that some commodity willin price, he determines, not only to invest in it all hismoney, but to take up on credit, from the producers or, as much of it as their opinion of his resources willhim to obtain. Every one must see that by thus acting hea greater effect on price, than if he limited histo the money he has actually in hand. He creates afor the article to the full amount of his money and credittogether, and raises the price proportionally to both. Andeffect is produced, though none of the written instrumentssubstitutes for currency may be called into existence;the transaction may give rise to no bill of exchange, northe issue of a single bank note. The buyer, instead of takingmere book credit, might have given a bill for the amount; orhave paid for the goods with bank notes borrowed for thatfrom a hanker, thus making the purchase not on his ownwith the seller, but on the banker's credit with the, and his own with the banker. Had he done so, he wouldproduced as great an effect on price as by a simple purchasethe same amount on a book credit, but no greater effect. Theitself, not the form and mode in which it is given, is thecause.

3. The inclination of the mercantile public to increase theirfor commodities by making use of all or much of theiras a purchasing power, depends on their expectation of. When there is a general impression that the price of someis likely to rise, from an extra demand, a short crop,to importation, or any other cause, there is aamong dealers to increase their stocks, in order toby the expected rise. This disposition tends in itself tothe effect which it looks forward to, a rise of price:if the rise is considerable and progressive, otherare attracted, who, so long as the price has notto fall, are willing to believe that it will

continue. These, by further purchases, produce a further advance:thus a rise of price for which there were originally somegrounds, is often heightened by merely speculative, until it greatly exceeds what the original groundsjustify. After a time this begins to be perceived; the priceto rise, and the holders, thinking it time to realizegains, are anxious to sell. Then the price begins to: the holders rush into the market to avoid a stillloss, and, few being willing to buy in a falling market,price falls much more suddenly than it rose. Those who haveat a higher price than reasonable calculation justified,who have been overtaken by the revulsion before they had, are losers in proportion to the greatness of the fall,to the quantity of the commodity which they hold, or havethemselves to pay for.

Now all these effects might take place in a community tocredit was unknown: the prices of some commodities mightfrom speculation, to an extravagant height, and then fallback. But if there were no such thing as credit, thishardly happen with respect to commodities generally. If allwere made with ready money, the payment of increasedfor some articles would draw an unusual proportion of theof the community into the markets for those articles, andtherefore draw it away from some other class of commodities,thus lower their prices. The vacuum might, it is true, befilled up by increased rapidity of circulation; and inmanner the money of the community is virtually increased intime of speculative activity, because people keep little of itthem, but hasten to lay it out in some tempting adventure asas possible after they receive it. This resource, however,limited: on the whole, people cannot, while the quantity ofremains. the same, lay out much more of it in some things,laying out less in others. But what they cannot do bymoney, they can do by an extension of credit. When peopleinto the market and purchase with money which they hope tohereafter, they are drawing upon an unlimited, not afund. Speculation, thus supported, may be going on in anyof commodities, without disturbing the regular course ofin others. It might even be going on in all commoditiesonce. We could imagine that in an epidemic fit of the passiongambling, all dealers, instead of giving only their accustomedto the manufacturers or growers of their commodity,buying up all of it which they could procure, as far ascapital and credit would go. All prices would rise, even if there were no increase of money, and no paper, but a mere extension of purchases on book credits. Aftertime those who had bought would wish to sell, and prices would.

This is the ideal extreme case of what is called a commercial. There is said to be a commercial crisis, when a greatof merchants and traders at once, either have, orthat they shall have, a difficulty in meeting their. The most usual cause of this general embarrassment,the recoil of prices after they have been raised by a spiritspeculation, intense in degree, and extending to many. Some accident which excites expectations of rising, such as the opening of a new foreign market, orindications of a short supply of several greatof commerce, sets speculation at work in several leadingat once. The prices rise, and the holders realize, orto have the power of realizing, great gains. In certainof the public mind, such examples of rapid increase ofcall forth numerous imitators, and speculation not onlymuch beyond what is justified by the original grounds forrise of price, but extends itself to articles in whichnever was any such ground: these, however, rise like theas soon as speculation sets in. At periods of this kind, aextension of credit takes place. Not only do all whom thereaches, employ their credit much more freely than; but they really have more credit, because they seem to beunusual gains, and because a generally

reckless andfeeling prevails, which disposes people to give asas take credit more largely than at other times, and give itpersons not entitled to it. In this manner, in the celebratedyear 1825, and at various other periods during thecentury, the prices of many of the principal articles ofrose greatly, without any fall in others, so thatprices might, without incorrectness, be said to have. When, after such a rise, the reaction comes, and pricesto fall, though at first perhaps only through the desire ofholders to realize, speculative purchases cease: but wereall, prices would only fall to the level from which they, or to that which is justified by the state of theand of the supply. They fall, however, much lower;as, when prices were rising, and everybody apparently makingfortune, it was easy to obtain almost any amount of credit, so, when everybody seems to be losing, and many fail entirely,is with difficulty that firms of known solidity can obtainthe credit to which they are accustomed, and which it is theinconvenience to them to be without; because all dealersengagements to fulfil, and nobody feeling sure that theof his means which he has entrusted to others will bein time, no one likes to part with ready money, or tohis claim to it. To these rational considerations theresuperadded, in extreme cases, a panic as unreasoning as theoverconfidence; money is borrowed for short periods atany rate of interest, and sales of goods for immediateare made at almost any sacrifice. Thus general prices,a commercial revulsion, fall as much below the usual, as during the previous period of speculation they haveabove it: the fall, as well as the rise, originating not inaffecting money, but in the state of credit; anextended employment of credit during the earlier, followed by a great diminution, never amounting howeveran entire cessation of it, in the later.

It is not, however, universally true that the contraction of, characteristic of a commercial crisis, must have beenby an extraordinary and irrational extension of it.are other causes; and one of the more recent crises, that1847, is an instance, having been preceded by no particularof credit, and by no speculations; except those inshares, which, though in many cases extravagant enough,being carried on mostly with that portion of means which thecould afford to lose, were not calculated to producewidespread ruin which arises from vicissitudes of price incommodities in which men habitually deal, and in which theof their capital is invested. The crisis of 1847 belonged toclass of mercantile phenomena. There occasionally happensconcurrence of circumstances tending to withdraw from the loana considerable portion of the capital which usuallyit. These circumstances, in the present case, were greatpayments, (occasioned by a high price of cotton and animportation of food,) together with the continualon the circulating capital of the country by railwayand the loan transactions of railway companies, for theof being converted into fixed capital and madefor future lending. These various demands fell, as such demands always do, on the loan market. A, though not the greatest part of the imported food, waspaid for by the proceeds of a government loan. The extrawhich purchasers of corn and cotton, and railway, found themselves obliged to make, were either madetheir own spare cash, or with money raised for the occasion.the first supposition, they were made by withdrawing depositsbankers, and thus cutting off a part of the streams whichthe loan market; on the second supposition, they were made bydrafts on the loan market, either by the sale of, or by taking up money at interest. This combinationa fresh demand for loans, with a curtailment of the capitalfor them, raised the rate of interest, and made itto borrow except on the very best security. Some, therefore, which by an improvident and

unmercantile modeconducting business had allowed their capital to become eitheror permanently unavailable, became unable to commandperpetual renewal of credit which had previously enabledto struggle on. These firms stopped payment: their failuremore or less deeply many other firms which had trusted; and, as usual in such cases, the general distrust, commonlya panic, began to set in, and might have produced aof credit equal to that of 1825, had notwhich may almost be called accidental, given to asimple measure of the government (the suspension of the BankAct of 1844) a fortunate power of allaying panic, to, when considered in itself, it had no sort of claim.(1*)

4. The general operation of credit upon prices being such ashave described, it is evident that if any particular mode orof credit is calculated to have a greater operation onthan others, it can only be by giving greater facility, orencouragement, to the multiplication of creditgenerally. If bank notes, for instance, or bills,a greater effect on prices than book credits, it is not bydifference in the transactions themselves, which arethe same, whether taking place in the one way or inother: it must be that there are likely to be more of them.credit is likely to be more extensively used as a purchasingwhen bank notes or bills are the instruments used, thanthe credit is given by mere entries in an account, to thatand no more there is ground for ascribing to the former apower over the markets than belongs to the latter.

Now it appears that there is some such distinction. As far asthe particular transactions, it makes no difference ineffect on price whether A buys goods of B on simple credit,gives a bill for them, or pays for them with bank notes lenthim by a banker C. The difference is in a subsequent stage. Ifhas bought the goods on a book credit, there is no obvious ormode by which B can make A's debt to him a means ofhis own credit. Whatever credit he has, will be due togeneral opinion entertained of his solvency; he cannotpledge A's debt to a third person, as a security forlent or goods bought. But if A has given him a bill for the, he can get this discounted, which is the same thing asmoney on the joint credit of A and himself: or he mayaway the bill in exchange for goods, which is obtaining goodsthe same joint credit. In either case, here is a second credit, grounded on the first, and which would not haveplace if the first had been transacted without theof a bill. Nor need the transactions end here. Themay be again discounted, or again paid away for goods,times before it is itself presented for payment. Norit be correct to say that these successive holders, if theynot had the bill, might have attained their purpose bygoods on their own credit with the dealers. They mayall of them be persons of credit, or they may already havetheir credit as far as it will go. And at all events,money or goods are more readily obtained on the credit ofpersons than of one. Nobody will pretend that it is as easy afor a merchant to borrow a thousand pounds on his own, as to get a bill discounted to the same amount, when theis of known solvency.

If we now suppose that A, instead of giving a bill, obtains aof bank notes from a banker C, and with them pays B for his, we shall find the difference to be still greater. B is noweven of a discounter: A's bill would have been takenpayment only by those who were acquainted with his reputationsolvency, but a banker is a person who has credit with thegenerally, and whose notes are taken in payment by every, at least in his own neighbourhood: insomuch that, by awhich has grown into law, payment in bank notes is aacquittance to the payer, whereas if he has paid by a, he still remains liable to the debt, if

the person on whombill is drawn fails to pay it when due. B therefore canthe whole of the bank notes without at all involving hiscredit; and whatever power he had before of obtaining goodsbook credit, remains to him unimpaired, in addition to thepower he derives from the possession of the notes. Theremark applies to every person in succession, into whosethe notes may come. It is only A, the first holder, (whohis credit to obtain the notes as a loan from the issuer,)can possibly find the credit he possesses in other quartersby it; and even in his case that result is not probable;though, in reason, and if all his circumstances were known,draft already made upon his credit ought to diminish by sohis power of obtaining more, yet in practice the reversefrequently happens, and his having been trusted by oneis supposed to be evidence that he may safely be trustedothers also.

It appears, therefore, that bank notes are a more powerfulfor raising prices than bills, and bills than book. It does not, indeed, follow that credit will be morebecause it can be. When the state of trade holds out notemptation to make large purchases on credit, dealersuse only a small portion of the credit power, and it willonly on convenience whether the portion which they usebe taken in one form or in another. It is not until theof the markets, and the state of the mercantile, render many persons desirous of stretching their credit tounusual extent, that the distinctive properties of theforms of credit display themselves. Credit alreadyto the utmost in the form of book debts, would beof a great additional extension by means of bills,of a still greater by means of bank notes. The first, becausedealer, in addition to his own credit, would be enabled toa further purchasing power out of the credit which he hadgiven to others: the second, because the banker's creditthe public at large, coined into notes, as bullion is coinedpieces of money to make it portable and divisible, is sopurchasing power superadded, in the hands of everyholder, to that which he may derive from his own. To state the matter otherwise; one single exertion of thepower in the form of book credit, is only the foundationa single purchase: but if a bill is drawn, that same portioncredit may serve for as many purchases as the number of timesbill changes hands: while every bank note issued, renders theof the banker a purchasing power to that amount in theof all the successive holders, without impairing any powermay possess of effecting purchases on their own credit., in short, has exactly the same purchasing power with; and as money tells upon prices not simply in proportion toamount, but to its amount multiplied by the number of timeschanges hands, so also does credit; and credit transferablehand to hand is in that proportion more potent, than creditonly performs one purchase.

5. All this purchasing power, however, is operative upon, only according to the proportion of it which is used; andeffect, therefore, is only felt in a state of circumstancesto lead to an unusually extended use of credit. Ina state of circumstances, that is, in speculative times, it, I think, be denied, that prices are likely to rise higherthe speculative purchases are made with bank notes, than whenare made with bills, and when made by bills than when madebook credits. This, however, is of far less practicalthan might at first be imagined; because, in point of, speculative purchases are not, in the great majority of, made either with bank notes or with bills, but are madeexclusively on book credits. "Applications to the Bank fordiscount," says the highest authority on such,(2*) (and the same thing must be true of applications tobanks) "occur rarely if ever in the origin

or progress ofspeculations in commodities. These are entered into,the most part if not entirely, in the first instance, on, for the length of term usual in the several trades; thuson the parties no immediate necessity for borrowing soas may he wanted for the purpose beyond their own available. This applies particularly to speculative purchases ofon the spot, with a view to resale. But theseform the smaller proportion of engagements on credit.far the largest of those entered into on the prospect of aof prices, are such as have in view importations from. The same remark, too, is applicable to the export of, when a large proportion is on the credit of theor their consignees. As long as circumstances hold outprospect of a favourable result, the credit of the parties issustained. If some of them wish to realize, there arewith capital and credit ready to replace them; and if thefully justify the grounds on which the speculativewere entered into (thus admitting of sales forin time to replace the capital embarked) there is nodemand for borrowed capital to sustain them. It is onlyby the vicissitudes of political events, or of the seasons,other adventitious circumstances, the forthcoming supplies areto exceed the computed rate of consumption, and a fall ofensues, that an increased demand for capital takes place;market rate of interest then rises, and increasedare made to the Bank of England for discount." Sothe multiplication of bank notes and other transferabledoes not, for the most part, accompany and facilitate the; but comes into play chiefly when the tide is, and difficulties begin to be felt.

Of the extraordinary height to which speculative transactionsbe carried upon mere book credits, without the smallestto what is commonly called the currency, very feware at all aware. "The power of purchase," says Mr,(3*) "by persons having capital and credit, is much beyondthat those who are unacquainted practically withmarkets have any idea of.... A person having theof capital enough for his regular business, andgood credit in his trade, if he takes a sanguine view ofprospect of a rise of price of the article in which he deals,is favoured by circumstances in the outset and progress ofspeculation, may effect purchases to an extent perfectly, compared with his capital." Mr Tooke confirms thisby some remarkable instances, exemplifying the immensepower which may be exercised, and rise of price whichbe produced, by credit not represented by either bank notesbills of exchange.

"Amongst the earlier speculators for an advance in the pricetea, in consequence of our dispute with China in 1839, wereretail grocers and tea-dealers. There was a generalamong the trade to get into stock: that is, to lay inonce a quantity which would meet the probable demand fromcustomers for several months to come. Some, however, among, more sanguine and adventurous than the rest, availedof their credit with the importers and wholesale, for purchasing quantities much beyond the estimatedin their own business. As the purchases were made in theinstance ostensibly, and perhaps really, for the legitimateand within the limits of their regular business, thewere enabled to buy without the condition of any deposit;speculators, known to be such, are required to pay 2l.chest, to cover any probable difference of price which mightbefore the expiration of the prompt, which, for this, is three months. Without, therefore, the outlay of afarthing of actual capital or currency in any shape, theypurchases to a considerable extent; and with the profiton the resale of a part of these purchases, they wereto pay the deposit on further quantities when required,was the case when the extent of the purchases attracted. In this way, the speculation went on at advancing(100 per cent and upwards) till nearly the

expiration ofprompt, and if at that time circumstances had been such as tothe apprehension which at one time prevailed, that allsupplies would be cut off, the prices might have stilladvanced, and at any rate not have retrograded. In this, the speculators might have realized, if not all the profithad anticipated, a very handsome sum, upon which they mightbeen enabled to extend their business greatly, or to retireit altogether, with a reputation for great sagacity in thustheir fortune. But instead of this favourable result, ithappened that two or three cargoes of tea which had beenwere admitted, contrary to expectation, to entry onarrival here, and it was found that further indirectwere in progress. Thus the supply was increased beyondcalculation of the speculators: and at the same time, thehad been diminished by the high price. There was,, a violent reaction on the market; the speculatorsunable to sell without such a sacrifice as disabLed themfulfilling their engagements, and several of themfailed. Among these, one was mentioned, whO having anot exceeding 1200l. which was locked up in his business,contrived to buy 4000 chests, value above 80,000l., the losswhich was about 16,000l.

"The other example which I have to give, is that of theon the corn market between 1838 and 1842. There was anof a person who, when he entered on his extensive, was, as it appeared by the subsequent examinationhis affairs, possessed of a capital not exceeding 5000l., butsuccessful in the outset, and favoured by circumstances inprogress of his operations, he contrived to make purchases toan extent, that when he stopped payment his engagements wereto amount to between 500,000l. and 600,000l. Othermight be cited of parties without any capital at all,, by dint of mere credit, were enabled, while the aspect ofmarket favoured their views, to make purchases to a veryextent.

"And be it observed, that these speculations, involvingpurchases on little or no capital, were carried on inand 1840, when the money market was in its most contracted; or when, according to modern phraseology, there was thescarcity of money."

But though the great instrument of speculative purchases iscredits, it cannot be contested that in speculative periodsincrease does take place in the quantity both of bills ofand of bank notes. This increase, indeed, so far as bankare concerned, hardly ever takes place in the earliestof the speculations: advances from bankers (as Mr Tooke) not being applied for in order to purchase, but into hold on without selling when the usual term of creditexpired, and the high price which was calculated on has not. But the tea speculators mentioned by Mr Tooke could notcarried their speculations beyond the three months which areusual term of credit in their trade, unless they had beento obtain advances from bankers, which, if the expectationa rise of price had still continued, they probably could have.

Since, then, credit in the form of bank notes is a moreinstrument for raising prices than book credits, anpower of resorting to this instrument may contributeprolong and heighten the speculative rise of prices, and henceaggravate the subsequent recoil. But in what degree? and whatought we to ascribe to this possibility? It may helpto form some judgment on this point, if we consider thewhich the utmost increase of bank notes in a period of, bears, I do not say to the whole mass of credit incountry, but to the bills of exchange alone. The averageof bills in existence at any one time is supposed greatlyexceed a hundred millions sterling.(4*) The bank noteof Great Britain and Ireland seldom exceeds forty, and the increase in speculative periods at most two or. And even this, as we have

seen, hardly ever comes intountil that advanced period of the speculation at which theshows signs of turning, and the dealers generally are ratherof the means of fulfilling their existing engagements,meditating an extension of them: while the quantity of billsexistence is largely increased from the very commencement ofspeculations.

6. It is well known that of late years, an artificialof the issue of bank notes has been regarded by manyeconomists, and by a great portion of the public, as anof supreme efficacy for preventing, and when it cannot, for moderating, the fever of speculation; and thisreceived the recognition and sanction of the legislaturethe Currency Act of 1844. At the point, however, which ourhave reached, though we have conceded to bank notes apower over prices than is possessed by bills or book, we have not found reason to think that this superiorhas much share in producing the rise of prices whicha period of speculation, nor consequently that anyapplied to this one instrument can be efficacious todegree which is often supposed, in moderating either that, or the recoil which follows it. We shall be still lessto think so, when we consider that there is a fourthof credit transactions, by cheques on bankers, and transfersa banker's books, which is exactly parallel in every respectbank notes, giving equal facilities to an extension of credit,capable of acting on prices quite as powerfully. In the wordsMr. Fullarton,(5*) "there is not a single object at presentthrough the agency of Bank of England notes, which mightbe as effectually accomplished by each individual keeping anwith the bank, and transacting all his payments of fiveand upwards by cheque." A bank, instead of lending itsto a merchant or dealer, might open an account with him,credit the account with the sum it had agreed to advance: onunderstanding that he should not draw out that sum in anymode than by drawing cheques against it in favour of thosewhom he had occasion to make payments. These cheques mighteven pass from hand to hand like bank notes; morehowever the receiver would pay them into the hands ofown banker, and when he wanted the money, would draw a freshagainst it: and hence an objector may urge that as thecheque would very soon be presented for payment, when itbe paid either in notes or in coin, notes or coin to anamount must be provided as the ultimate means of. It is not so, however. The person to whom the chequetransferred, may perhaps deal with the same banker, and themay return to the very bank on which it was drawn: this isoften the case in country districts; if so, no payment willcalled for, but a simple transfer in the banker's books willthe transaction. If the cheque is paid into a different, it will not be presented for payment, but liquidated byoff against other cheques; and in a state of circumstancesto a general extension of banking credits, a bankerhas granted more credit, and has therefore more cheques drawnhim, will also have more cheques on other bankers paid to him,will only have to provide notes or cash for the payment of; for which purpose the ordinary reserve of prudent, one-third of their liabilities, will abundantly suffice., if he had granted the extension of credit by means of anof his own notes, he must equally have retained, in coin orof England notes, the usual reserve: so that he can, as Mr.says, give every facility of credit by what may bea cheque circulation, which he could give by a note.

This extension of credit by entries in a banker's books, hasthat superior efficiency in acting on prices, which weto an extension by means of bank notes. As a bank note20l., paid to any one, gives him 20l. of purchasing-poweron credit, over and above whatever credit he had of his, so does a cheque paid to him do the same: for, although hemake no

purchase with the cheque itself, he deposits it withbanker, and can draw against it. As this act of drawing aagainst another which has been exchanged and cancelled,be repeated as often as a purchase with a bank note, itthe same increase of purchasing power. The original loan,credit, given by the banker to his customer, is potentiallyas a means of purchase, in the hands of the successiveto whom portions of the credit are paid away, just as thepower of a bank note is multiplied by the number ofthrough whose hands it passes before it is returned toissuer.

These considerations abate very much from the importance ofeffect which can be produced in allaying the vicissitudes of, by so superficial a contrivance as the one so muchon of late, the restriction of the issue of bank notes byartificial rule. An examination of all the consequences ofrestriction, and an estimate of the reasons for and against, must be deferred until we have treated of the foreign, and the international movements of bullion. At presentare only concerned with the general theory of prices, of whichdifferent influence of different kinds of credit is anpart.

7. There has been a great amount of discussion and argumentthe question whether several of these forms of credit, and inwhether bank notes, ought to be considered as money.question is so purely verbal as to be scarcely worth raising,one would have some difficulty in comprehending why so muchis attached to it, if there were not some authorities, still adhering to the doctrine of the infancy of society andpolitical economy, that the quantity of money compared withof commodities, determines general prices, think itto prove that bank notes and no other forms of creditmoney, in order to support the inference that bank notes andother forms of credit influence prices. It is obvious,, that prices do not depend on money, but on purchases.left with a banker, and not drawn against, or drawn againstother purposes than buying commodities, has no effect on, any more than credit which is not used. Credit which isto purchase commodities, affects prices in the same mannermoney. Money and credit are thus exactly on a par, in theiron prices; and whether we choose to class bank notes withone or the other, is in this respect entirely immaterial.

Since, however, this question of nomenclature has been, it seems desirable that it should be answered. The reasonfor considering bank notes as money, is, that by law andthey have the property, in common with metallic money, ofclosing the transactions in which they are employed;no other mode of paying one debt by transferring another,that privilege. The first remark which here suggests itself, that on this showing, the notes at least of private banks aremoney; for a creditor cannot be forced to accept them inof a debt. They certainly close the transaction if heaccept them; but so, on the same supposition, would a balecloth, or a pipe of wine; which are not for that reasonas money. It seems to be an essential part of the ideamoney, that it be legal tender. An inconvertible paper whichlegal tender is universally admitted to be money; in thelanguage the phrase papier-monnaie actually means, convertible notes being merely billets a. It is only in the case of Bank of England notes underlaw of convertibility, that any difficulty arises; thosenot being a legal tender from the Bank itself, though atender from all other persons. Bank of England notesdo close transactions, so far as respects the buyer.he has once paid in Bank of England notes, he can in no caserequired to pay over again. But I confess I cannot see how thecan be deemed complete as regards the seller, when heonly be found to

have received the price of his commoditythe Bank keeps its promise to pay. An instrument whichbe deprived of all value by the insolvency of a, cannot be money in any sense in which money isto credit. It either is not money, or it is money andtoo. It may be most suitably described as coined credit.other forms of credit may be distinguished from it as creditingots.

8. Some high authorities have claimed for bank notes, aswith other modes of credit, a greater distinction into influence on price, than we have seen reason to allow;difference, not in degree, but in kind. They ground thison the fact, that all bills and cheques, as well asbook-debts, are from the first intended to be, and actually, ultimately liquidated either in coin or in notes. The bankin circulation, jointly with the coin, are therefore,to these authorities, the basis on which all the otherof credit rest; and in proportion to the basis will besuperstructure; insomuch that the quantity of bank notesthat of all the other forms of credit. If bank notesmultiplied, there will, they seem to think, be more bills,payments by cheque, and I presume, more book credits; and byand limiting the issue of bank notes, they think thatother forms of credit are, by an indirect consequence,under a similar limitation. I believe I have stated theof these authorities correctly, though I have nowherethe grounds of it set forth with such distinctness as tome feel quite certain that I understand them. It may be, that according as there are more or fewer bank notes, therealso in general (though not invariably), more or less of otherof credit; for the same state of affairs which leadsan increase of credit in one shape, leads to an increase of itother shapes. But I see no reason for believing that the onethe cause of the other. If indeed we begin by assuming, as Iis tacitly done, that prices are regulated by coin andnotes, the proposition maintained will certainly follow;, according as prices are higher or lower, the same purchasesgive rise to bills, cheques, and book credits of a larger orsmaller amount. But the premise in this reasoning is the veryto be proved. Setting this assumption aside, I knowhow the conclusion can be substantiated. The credit given toone by those with whom he deals, does not depend on theof bank notes or coin in circulation at the time, but onopinion of his solvency: if any consideration of a morecharacter enters into their calculation, it is only in aof pressure on the loan market, when they are not certain ofthemselves able to obtain the credit on which they haveaccustomed to rely; and even then, what they look to is thestate of the loan market, and not (preconceived theory) the amount of bank notes. So far, as to the willingness tocredit. And the willingness of a dealer to use his credit,on his expectations of gain, that is, on his opinion ofprobable future price of his commodity; an opinion groundedon the rise or fall already going on, or on hisjudgment respecting the supply and the rate of. When a dealer extends his purchases beyond hismeans of payment, engaging to pay at a specified time,does so in the expectation either that the transaction willterminated favourably before that time arrives, or that hethen be in possession of sufficient funds from the proceedshis other transactions. The fulfilment of these expectationsupon prices, but not especially upon the amount of bank. He may, doubtless, also ask himself, in case he should bein these expectations, to what quarter he can looka temporary advance, to enable him, at the worst, to keep his. But in the first place, this prospective rejectionthe somewhat more or less of difficulty which he may have inover his embarrassments, seems too slender an inducementbe much of a restraint in a period supposed to be one of rash, and upon persons so confident of success as to involvebeyond their certain means of extrication. And, I apprehend that their

confidence of being helped out inevent of ill-fortune, will mainly depend on their opinion ofown individual credit, with, perhaps, some consideration,of the quantity of the currency, but of the general state ofloan market. They are aware that, in case of a commercial, they shall have difficulty in obtaining advances. But ifthought it likely that a commercial crisis would occurthey had realized, they would not speculate. If no greatof general credit occurs, they will feel no doubt ofany advances which they absolutely require, providedstate of their own affairs at the time affords in theof lenders a sufficient prospect that those advancesbe repaid. :. The commercial difficulties, not however amounting to acrisis, of 1864, had essentially the same origin.payments for cotton imported at high prices, and largein banking and other joint stock projects, combinedthe loan operations of foreign governments, made such largeupon the loan market as to raise the rate of discount onbills as high as nine per cent.. Tooke's History of Prices, vol. iv, pp. 125-6.. Inquiry into the Currency Principle, pp. 79 and 136-8.. The most approved estimate is that of Mr Leatham, grounded onofficial returns of bill stamps issued. The following are the: —

Bills created in

Great Britain

Average amount in Year

and Ireland,

circulation at one

founded on

time in each year

returns of

Bill Stamps

issued from the

Stamp Office

£356,153,409

£89,038,352

383,659,585

95,914,896

379,155,052

94,788,763

405,403,051

101,350,762

485,943,473

121,485,868

455,084,445

113,771,111

465,504,041

116,376,010

528,493,842

132,123.460

"Mr. Leatham," says Mr. Tooke, "gives the process by which,the data furnished by the returns of stamps, he arrives atresults; and I am disposed to think that they are as nearapproximation to the truth as the nature of the materialsof arriving at." — Inquiry into the Currency Principle,. 26. Mr. Newmarch (Appendix No. 39 to Report of the Committeethe Bank Acts in 1857, and History of Prices, vol. vi. p. 587)grounds for the opinion that the total bill circulation inwas not much less than 180 millions sterling, and that itrises to 200 millions. . On the Regulation of Currencies, p. 41.

The Principles of Political Economy

John Stuart Mill

3: Distribution

13an Inconvertible Paper Currency

1. After experience had shown that pieces of paper, of novalue, by merely bearing upon them the writtenof being equivalent to a certain number of francs,, or pounds, could be made to circulate as such, and toall the benefit to the issuers which could have beenby the coins which they purported to represent;began to think that it would be a happy device ifcould appropriate to themselves this benefit, free from theto which individuals issuing such paper substitutes forwere subject, of giving, when required, for the sign, thesignified. They determined to try whether they could notthemselves from this unpleasant obligation, and make aof paper issued by them pass for a pound, by merely callinga pound, and consenting to receive it in payment of the taxes.such is the influence of almost all established governments,they have generally succeeded in attaining this object: II might say they have always succeeded for a time, andpower has only been lost to them after they had compromisedby the most flagrant abuse.

In the case supposed, theof money are performed by a thing which derives itsfor performing them solely from convention: but conventionquite sufficient to confer the power; since nothing more isto make a person accept anything as money, and even atarbitrary value, than the persuasion that it will be takenhim on the same terms by others. The only question is, whatthe value of such a currency; since it cannot be, asthe case of gold and silver (or paper exchangeable for them at), the cost of production.

We have seen, however, that even in the case of a metallic, the immediate agency in determining its value is its. If the quantity, instead of depending on the ordinarymotives of profit and loss, could be arbitrarily fixedauthority, the value would depend on the fiat of that, not on cost of production. The quantity of a papernot convertible into the metals at the option of the, can be arbitrarily fixed; especially if the issuer is thepower of the state. The value, therefore, of such a, is entirely arbitrary.

Suppose that, in a country of which the currency is wholly, a paper currency is suddenly issued, to the amount ofthe metallic circulation; not by a banking establishment, orthe form of loans, but by the government, in payment ofand purchase of commodities. The currency being suddenlyby one-half, all prices will rise, and among the rest,prices of all things made of gold and silver. An ounce ofgold will become more valuable than an ounce of gold, by more than that customary difference which compensatesthe value of the workmanship; and it will be profitable tothe coin for the purpose of being manufactured, until ashas been taken from the currency by the subtraction of gold,had been added to it by the issue of paper. Then prices willto what they were at first, and there will be nothingexcept that a paper currency has been substituted forof the metallic currency which existed before. Suppose, now,second emission of paper; the same series of effects will be; and so on, until the whole of the metallic money has: that is, if paper be issued of as low a denominationthe lowest coin; if not, as much will remain, as conveniencefor the smaller payments. The addition made to theof gold and silver disposable for ornamental

purposes,somewhat reduce, for a time, the value of the article; andlong as this is the case, even though paper has been issued tooriginal amount of the metallic circulation, as much coinremain in circulation along with it, as will keep the valuethe currency down to the reduced value of the metallic; but the value having fallen below the cost of, a stoppage or diminution of the supply from the minesenable the surplus to be carried off by the ordinary agentsdestruction, after which, the metals and the currency willtheir natural value. We are here supposing, as we havethroughout, that the country has mines of its own, andcommercial intercourse with other countries; or, in a countryforeign trade, the coin which is rendered superfluous byissue of paper is carried off by a much prompter method.

Up to this point, the effects of a paper currency arethe same, whether it is convertible into specie or. It is when the metals have been completely superseded andfrom circulation, that the difference between convertibleinconvertible paper begins to be operative. When the gold orhas all gone from circulation, and an equal quantity ofhas taken its place, suppose that a still further issue is. The same series of phenomena recommences: prices, among the rest the prices of gold and silver articles, andbecomes an object as before to procure coin in order toit into bullion. There is no longer any coin in; but if the paper currency is convertible, coin maybe obtained from the issuers, in exchange for notes. Allnotes, therefore, which are attempted to be forcedcirculation after the metals have been completely, will return upon the issuers in exchange for coin;they will not be able to maintain in circulation such aof convertible paper, as to sink its value below thewhich it represents. It is not so, however, with ancurrency. To the increase of that (if permitted by) there is no check. The issuers may add to it indefinitely,its value and raising prices in proportion; they may, inwords, depreciate the currency without limit.

Such a power, in whomsoever vested, is an intolerable evil.variations in the value of the circulating medium are: they disturb existing contracts and expectations,the liability to such changes renders every pecuniaryof long date entirely precarious. The person who buyshimself, or gives to another, an annuity of 100l., does notwhether it will be equivalent to 200l. or to 50l. a fewhence. Great as this evil would be if it depended only on, it is still greater when placed at the arbitraryof an individual or a body of individuals; who may havekind or degree of interest to be served by an artificialin fortunes; and who have at any rate a strongin issuing as much as possible, each issue being ina source of profit. Not to add, that the issuers may have,in the case of a government paper, always have, a directin lowering the value of the currency, because it is thein which their own debts are computed.

2. In order that the value of the currency may be secure fromaltered by design, and may be as little as possible liablefluctuation from accident, the articles least liable of allcommodities to vary in their value, the precious metals,been made in all civilized countries the standard of valuethe circulating medium; and no paper currency ought to existwhich the value cannot be made to conform to theirs. Nor hasfundamental maxim ever been entirely lost sight of, even bygovernments which have most abused the power of creatingpaper. If they have not (as they generally have)an intention of paying in specie at some indefinitetime, they have at least, by giving to their paper issuesnames of their coins, made a virtual, though generally a, profession of intending to keep them at a valueto that of the coins. This is not impracticable,with an inconvertible paper. There is not indeed

theacting check which convertibility brings with it. But therea clear and unequivocal indication by which to judge whethercurrency is depreciated, and to what extent. That indication, the price of the precious metals. When holders of paperdemand coin to be converted into bullion, and when therenone left in circulation, bullion rises and falls in priceother things; and if it is above the Mint price, if an ouncegold, which would be coined into the equivalent of 3l. 17s./2d., is sold for 4l. or 5l. in paper, the value of thehas sunk just that much below what the value of acurrency would he. If, therefore, the issue ofpaper were subjected to strict rules, one rulethat whenever bullion rose above the Mint price, the issueshe contracted until the market price of bullion and theprice were again in accordance, such a currency would not beto any of the evils usually deemed inherent in anpaper.

But also such a system of currency would have no advantagesto recommend it to adoption. An inconvertible, regulated by the price of bullion, would conform, in all its variations, to a convertible one; and theadvantage gained, would be that of exemption from theof keeping any reserve of the precious metals; which isa very important consideration, especially as a government,long as its good faith is not suspected, needs not keep soa reserve as private issuers, being not so liable to greatsudden demands, since there never can be any real doubt ofsolvency. Against this small advantage is to be set, in theplace, the possibility of fraudulent tampering with theof bullion for the sake of acting on the currency; in theof the fictitious sales of corn, to influence the, so much and so justly complained of while the corn lawsin force. But a still stronger consideration is theof adhering to a simple principle, intelligible to theuntaught capacity. Everybody can understand convertibility;one sees that what can be at any moment exchanged for five, is worth five pounds. Regulation by the price of bulliona more complex idea, and does not recommend itself through thefamiliar associations. There would be nothing like the same, by the public generally, in an inconvertible currencyregulated, as in a convertible one: and the most instructedmight reasonably doubt whether such a rule would be asto be inflexibly adhered to. The grounds of the rule notso well understood by the public, opinion would probablyenforce it with as much rigidity, and, in any circumstancesdifficulty, would be likely to turn against it; while to theitself a suspension of convertibility would appear astronger and more extreme measure, than a relaxation of whatpossibly be considered a somewhat artificial rule. There isa great preponderance of reasons in favour of a, in preference to even the best regulatedcurrency. The temptation to over-issue, in certainemergencies, is so strong, that nothing is admissiblecan tend, in however slight a degree, to weaken thethat restrain it.

3. Although no doctrine in political economy rests on moregrounds than the mischief of a paper currency notat the same value with a metallic, either by, or by some principal of limitation equivalent to; and although, accordingly, this doctrine has, though not tillthe discussions of many years, been tolerably effectuallyinto the public mind; yet dissentients are still, and projectors every now and then start up, with planscuring all the economical evils of society by means of anissue of inconvertible paper. There is, in truth, acharm in the idea. To be able to pay off the national debt,the expenses of government without taxation, and in fine,make the fortunes of the whole community, is a brilliant,

when once a man is capable of believing that printing acharacters on bits of paper will do it. The philosopher'scould not be expected to do more.

As these projects, however often slain, always resuscitate,is not superfluous to examine one or two of the fallacies bythe schemers impose upon themselves. One of the commonest, that a paper currency cannot be issued in excess so long aSnote issued represents property, or has a foundation ofproperty to rest on. These phrases, of representing and, seldom convey any distinct or well-defined idea: whendo, their meaning is no more than this — that the issuersthe paper must have property, either of their own, orto them, to the value of all the notes they issue:for what purpose does not very clearly appear; for if thecannot be claimed in exchange for the notes, it isto divine in what manner its mere existence can serveuphold their value. I presume, however, it is intended as athat the holders would be finally reimbursed, in caseuntoward event should cause the whole concern to be wound up.this theory there have been many schemes for "coining theland of the country into money" and the like.

In so far as this notion has any connexion at all with, it seems to originate in confounding two entirelyevils, to which a paper currency is liable. One is, theof the issuers; which, if the paper is grounded oncredit — if it makes any promise of payment in cash,on demand or at any future time — of course deprives theof any vaLue which it derives from the promise. To thispaper credit is equally liable, however moderately used; andit, a proviso that all issues should be "founded on," as for instance that notes should only be issued onsecurity of some valuable thing expressly pledged for their, would really be efficacious as a precaution. But thetakes no account of another evil, which is incident to theof the most solvent firm, company, or government; that ofdepreciated in value from being issued in excessive. The assignats, during the French Revolution were anof a currency grounded on these principles. The assignats"represented" an immense amount of highly valuable property,the lands of the crown, the church, the monasteries, andemigrants; amounting possibly to half the territory of. They were, in fact, orders or assignments on this mass of. The revolutionary government had the idea of "coining"lands into money; but, to do them justice, they did notcontemplate the immense multiplication of issues tothey were eventually driven by the failure of all otherresources. They imagined that the assignats would comeback to the issuers in exchange for land, and that theybe able to reissue them continually until the lands weredisposed of, without having at any time more than a veryquantity in circulation. Their hope was frustrated: thedid not sell so quickly as they expected; buyers were notto invest their money in possessions which were likelybe resumed without compensation if the Revolution succumbed:bits of paper which represented land, becoming prodigiously, could no more keep up their value than the landwould have done if it had all been brought to market at; and the result was that it at last required an assignat ofhundred francs to pay for a pound of butter.

The example of the assignats has been said not to be, because an assignat only represented land in general,not a definite quantity of land. To have prevented their, the proper course, it is affirmed, would have beenhave made a valuation of all the confiscated property at itsvalue, and to have issued assignats up to, but not, that limit; giving to the holders a right to demand anyof land, at its registered valuation, in exchange forto the same amount. There can be no question about theof this plan over the one actually

adopted. Had thisbeen followed, the assignats could never have beento the inordinate degree they were; for — as theyhave retained all their purchasing power in relation to, however much they might have fallen in respect to other— before they had lost very much of their market value,would probably have been brought in to be exchanged for. It must be remembered, however, that their not beingwould presuppose that no greater number of themin circulation than would have circulated if they hadconvertible into cash. However convenient, therefore, in aof revolution, this currency convertible into land on demandhave been, as a contrivance for selling rapidly a greatof land with the least possible sacrifice; it isto see what advantage it would have, as the permanentof a country, over a currency convertible into coin: whileis not at all difficult to see what would be its; since land is far more variable in value than goldsilver; and besides, land, to most persons, being rather anthan a desirable possession, except to be convertedmoney, people would submit to a much greater depreciationdemanding land, than they will before demanding gold or.(1*)

4 Another of the fallacies from which the advocates of ancurrency derive support, is the notion that anof the currency quickens industry. This idea was setby Hume, in his Essay on Money, and has had many devotedsince; witness the Birmingham currency school, of whom. Attwood was at one time the most conspicuous representative.. Attwood maintained that a rise of prices produced by anof paper currency, stimulates every producer to hisexertions, and brings all the capital and labour of theinto complete employment; and that this has invariablyin all periods of rising prices, when the rise was on agreat scale. I presume, however, that the inducement, according to Mr Attwood, excited this unusual ardour inpersons engaged in production, must have been the expectationgetting more commodities generally, more real wealth, infor the produce of their labour, and not merely moreof paper. This expectation, however, must have been, byvery terms of the supposition, disappointed, since, allbeing supposed to rise equally, no one was really betterfor his goods than before. Those who agree with Mr. Attwoodonly succeed in winning people on to these unwonted, by a prolongation of what would in fact be a delusion;matters so, that by a progressive rise of money, every producer shall always seem to be in the very act ofan increased remuneration which he never, in reality,obtain. It is unnecessary to advert to any other of theto this plan, than that of its total impracticability.calculates on finding the whole world persisting for ever inbelief that more pieces of paper are more riches, and neverthat, with all their paper, they cannot buy more ofthat they could before. No such mistake was made duringof the periods of high prices, on the experience of whichschool lays so much stress. At the periods which Mr. Attwoodfor times of prosperity, and which were simply (as allof high prices, under a convertible currency, must be)of speculation, the speculators did not think they wererich because the high prices would last, but because theynot last, and because whoever contrived to realize whiledid last, would find himself, after the recoil, inof a greater number of pounds sterling, without theirbecome of less value. If, at the close of the speculation,issue of paper had been made, sufficient to keep prices up topoint which they attained when at the highest, no one wouldbeen more disappointed than the speculators; since the gainthey thought to have reaped by realizing in time (at theof their competitors, who bought when they sold, and hadsell after the revulsion) would have faded away in their, and instead of it they would have got nothing except a fewpaper tickets to count by.

Hume's version of the doctrine differed in a slight degreeMr. Attwood's. He thought that all commodities would notin price simultaneously, and that some persons thereforeobtain a real gain, by getting more money for what they hadsell, while the things which they wished to buy might not yetrisen. And those who would reap this gain would always be(he seems to think) the first comers. It seems obvious, however,for every person who thus gains more than usual, there issome other person who gains less. The loser, iftook place as Hume supposes, would be the seller of thewhich are slowest to rise; who, by the supposition,with his goods at the old prices, to purchasers who havebenefited by the new. This seller has obtained for hisonly the accustomed quantity of money, while there aresome things of which that money will no longer purchasemuch as before. If, therefore, he knows what is going on, heraise his price, and then the buyer will not have the gain,is supposed to stimulate his industry. But if, on the, the seller does not know the state of the case, anddiscovers it when he finds, in laying his money out, that itnot go so far, he then obtains less than the ordinaryfor his labour and capital; and if the other's industry is encouraged, it should seem that his must,the opposite cause, be impaired.

5. There is no way in which a general and permanent rise of, or in other words, depreciation of money, can benefit, except at the expense of somebody else. The substitutionpaper for metallic currency is a national gain: any furtherof paper beyond this is but a form of robbery.

An issue of notes is a manifest gain to the issuers, who,the notes are returned for payment, obtain the use of themif they were a real capital: and so long as the notes are noaddition to the currency, but merely supersede gold orto the same amount, the gain of the issuer is a loss to no; it is obtained by saving to the community the expense of thecostly material. But if there is no gold or silver to be— if the notes are added to the currency, instead ofsubstituted for the metallic part of it — all holders oflose, by the depreciation of its value, the exactof what the issuer gains. A tax is virtually levied onfor his benefit. It will be objected by some, that gains aremade by the producers and dealers who, by means of theissue, are accommodated with loans. Theirs, however, isan additional gain, but a portion of that which is reaped byissuer at the expense of all possessors of money. The profitsfrom the contribution levied upon the public, he does notto himself, but divides with his customers. But besides thereaped by the issuers, or by others through them, at theof the public generally, there is another unjust gainby a larger class, namely by those who are under fixedobligations. All such persons are freed, by aof the currency, from a portion of the burthen ofdebts or other engagements: in other words, part of theof their creditors is gratuitously transferred to them.a superficial view it may be imagined that this is anto industry'. since the productive classes are great, and generally owe larger debts to the unproductive (ifinclude among the latter all persons not actually in business)the unproductive classes owe to them; especially if thedebt be included. It is only thus that a general rise ofcan be a source of benefit to producers and dealers; bythe pressure of their fixed burthens. And this mightaccounted an advantage, if integrity and good faith were of noto the world, and to industry and commerce in. Not many, however, have been found to say that theought to be depreciated on the simple ground of itsdesirable to rob the national creditor and privateof a part of what is in their bond. The schemes whichtended that way

have almost always had some appearance ofand circumstantial justification, such as the necessitycompensating for a prior injustice committed in the contrary.

6. Thus in England, for many years subsequent to 1819, it wascontended, that a large portion of the national, and a multitude of private debts still in existence, werebetween 1797 and 1819, when the Bank of England wasfrom giving cash for its notes; and that it is grosslyto borrowers, (that is, in the case of the national debt,all tax-payers) that they should be paying interest on thenominal sums in a currency of full value, which werein a depreciated one. The depreciation, according to theand objects of the particular writer, was represented toaveraged thirty, fifty, or even more than fifty per cent:the conclusion was, that either we ought to return to thiscurrency, or to strike off from the national debt,from mortgages or other private debts of old standing, acorresponding to the estimated amount of the.

To this doctrine, the following was the answer usually made.that, by returning to cash payments without lowering the, an injustice was done to debtors, in holding themfor the same amount of a currency enhanced in value, whichhad borrowed while it was depreciated; it is now too late toreparation for this injury. The debtors and creditors ofday are not the debtors and creditors of 1819: the lapse ofhas entirely altered the pecuniary relations of the., and it being impossible now to ascertain thepersons who were either benefited or injured, toto retrace our steps would not be redressing a wrong, buta second act of wide-spread injustice to the onecommitted. This argument is certainly conclusive on thequestion; but it places the honest conclusion on tooand too low a ground. It concedes that the measure of, called Peel's Bill, by which cash payments were resumed atoriginal standard of 3l. 17s. 10 1/2d., was really theit was said to be. This is an admission wholly opposedthe truth. Parliament had no alternative; it was absolutelyto adhere to the acknowledged standard; as may be shown ondistinct grounds, two of fact, and one of principle.

The reasons of fact are these. In the first place it is notthat the debts, private or public, incurred during the Bank, were contracted in a currency of lower value thanin which the interest is now paid. It is indeed true thatsuspension of the obligation to pay in specie, did put it inpower of the Bank to depreciate the currency. It is true alsothe Bank really exercised that power, though to a far lessthan is often pretended; since the difference between theprice of gold and the Mint valuation, during the greaterof the interval, was very trifling, and when it was, during the last five years of the war, did not muchthirty per cent. To the extent of that difference, thewas depreciated, that is, its value was below that ofstandard to which it professed to adhere. But the state ofat that time was such — there was so unusual anof the precious metals, by hoarding, and in thechests of the vast armies which then desolated the, that the value of the standard itself was veryraised: and the best authorities, among whom it isto name Mr Tooke, have, after an elaborate, satisfied themselves that the difference betweenand bullion was not greater than the enhancement in valuegold itself, and that the paper, though depreciated relativelythe then value of gold, did not sink below the ordinary value,other times, either of gold or of a convertible paper. If thistrue (and the evidences of the fact are conclusively stated in. Tooke's History of Prices) the foundation of the whole casethe fundholder and other creditors on the ground ofis subverted.

But, secondly, even if the currency had really been loweredvalue at each period of the Bank restriction, in the samein which it was depreciated in relation to its standard,must remember that a part only of the national debt, or ofpermanent engagements, was incurred during the Bank. A large part had been contracted before 1797; alarger during the early years of the restriction, when thebetween paper and gold was yet small. To the holdersthe former part, an injury was done, by paying the interesttwenty-two years in a depreciated currency: those of the, suffered an injury during the years in which the interestpaid in a currency more depreciated than that in which thewere contracted. To have resumed cash payments at a lowerwould have been to perpetuate the injury to these twoof creditors, in order to avoid giving an undue benefita third class, who had lent their money during the few yearsgreatest depreciation. As it is, there was an underpayment toset of persons, and an overpayment to another. The late Mr.took the trouble to make an arithmetical comparisonthe two amounts. He ascertained by calculation, that ifaccount had been made out in 1819, of what the fundholders hadand lost by the variation of the paper currency from its, they would have been found as a body to have been; so that if any compensation was due on the ground of, it would not be from the fundholders collectively,to them.

Thus it is with the facts of the case. But these reasons ofare not the strongest. There is a reason of principle, stillpowerful. Suppose that, not a part of the debt merely, butwhole, had been contracted in a depreciated currency,not only in comparison with its standard, but withown value before and after; and that we were now paying theof this debt in a currency fifty or even a hundred permore valuable than that in which it was contracted. Whatwould this make in the obligation of paying it, if thethat it should be so paid was part of the original? Now this is not only truth, but less than the truth. Thestipulated better terms for the fundholder than he has. During the whole continuance of the Bank restriction,was a parliamentary pledge, by which the legislature was asbound as any legislature is capable of binding itself, thatpayments should be resumed on the original footing, atin six months after the conclusion of a general peace.was therefore an actual condition of every loan; and theof the loan were more favourable in consideration of it.some such stipulation, the Government could not haveto borrow, unless on the terms on which loans are madethe native princes of India. If it had been understood andthat, after borrowing the money, the standard at which itcommuted might be permanently lowered, to any extent which to"collective wisdom" of a legislature of borrowers might seem— who can say what rate of interest would have been ainducement to persons of common sense to risk theirin such an adventure? However much the fundholders hadby the resumption of cash payments, the terms of theinsured their giving ample value for it. They gave valuemore than they received; since cash payments were not resumedsix months, but in as many years, after the peace. So thatall our arguments except the last, and conceding all theasserted on the other side of the question, the, instead of being unduly benefited, are the injured; and would have a claim to compensation, if such claimsnot very properly barred by the impossibility of, and by the salutary general maxim of law and, "quod interest reipublicae ut sit finis litium." :. Among the schemes of currency to which, strange to say,writers have been found to give their sanction, oneas follows: that the state should receive in pledge or, any kind or amount of property, such as land, stock,&c., and should advance to the owners inconvertible paper moneythe estimated value. Such a currency would not even have theof the imaginary assignats supposed in the text:those

into whose hands the notes were paid by the personsreceived them, could not return them to the Government, andin exchange land or stock which was only pledged, not. There would be no reflux of such assignats as these,their depreciation would be indefinite.

The Principles of Political Economy

John Stuart Mill

3: Distribution

14Excess of Supply

1. After the elementary exposition of the theory of moneyin the last few chapters, we shall return to a questionthe general theory of Value, which could not be satisfactorilyuntil the nature and operations of Money were in someunderstood, because the errors against which we have tomainly originate in a misunderstanding of those.

We have seen that the value of everything gravitates towardscertain medium point (which has been called the Natural Value),, that at which it exchanges for every other thing in theof their cost of production. We have seen, too, that theor market value coincides, or nearly so, with the natural, only on an average of years; and is continually eitherabove, or falling below it, from alterations in the, or casual fluctuations in the supply: but that thesecorrect themselves, through the tendency of the supplyaccommodate itself to the demand which exists for theat its natural value. A general convergence thusfrom the balance of opposite divergences. Dearth, or, on the one hand, and over-supply, or in mercantile, glut, on the other, are incident to all commodities. Infirst case, the commodity affords to the producers or, while the deficiency lasts, an unusually high rate of: in the second, the supply being in excess of that fora demand exists at such a value as will afford the ordinary, the sellers must be content with less, and must , incases, submit to a loss.

Because this phenomenon of over-supply, and consequentor loss to the producer or dealer, may exist in theof any one commodity whatever, many persons, including somepolitical economists, have thought that it maywith regard to all commodities; that there may be a generalproduction of wealth; a supply of commodities in the, surpassing the demand; and a consequent depressedof all classes of producers. Against this doctrine, ofMr. Malthus and Dr. Chalmers in this country, and M. deon the Continent, were the chief apostles, I havecontended in the First Book;(1*) but it was not possible,that stage of our inquiry, to enter into a completeof an error (as I conceive) essentially grounded on aof the phenomena of Value and Price. Theappears to me to involve so much inconsistency in itsconception, that I feel considerable difficulty in givingstatement of it which shall be at once clear, andto its supporters. They agree in maintaining thatmay be, and sometimes is, an excess of productions inbeyond the demand for them; that when this happens,cannot be found at prices which will repay the cost ofwith a profit; that there ensues a general depressionprices or values (they are seldom accurate in discriminatingthe two), so that producers, the more they produce, findthe poorer, instead of richer; and Dr Chalmersinculcates on capitalists the practice of a moralin reference to the pursuit of gain; while Sismondimachinery, and the various inventions which increasepower. They both maintain that accumulation of capitalproceed too fast, not merely for the moral, but for theinterests of those who produce and accumulate; and theythe rich to guard against this evil by an ampleconsumption.

2. When these writers speak of the supply of commodities asthe demand, it is not clear which of the two elementsdemand they have in view-the desire to possess, or the

meanspurchase; whether their meaning is that there are, in such, more consumable products in existence than the publicto consume, or merely more than it is able to pay for. Inuncertainty, it is necessary to examine both suppositions.

First, let us suppose that the quantity of commoditiesis not greater than the community would be glad to: is it, in that case, possible that there should be aof demand for all commodities, for want of the meanspayment? Those who think so cannot have considered what it isconstitutes the means of payment for commodities. It iscommodities. Each person's means of paying for theof other people consists of those which he himself. All sellers are inevitably and ex vi termini buyers.we suddenly double the productive powers of the country, wedouble the supply of commodities in every market; but we, by the same stroke, double the purchasing power.would bring a double demand as well as supply:would be able to buy twice as much, because every onehave twice as much to offer in exchange. It is probable,, that there would now be a superfluity of certain things.the community would willingly double its aggregate, it may already have as much as it desires of some, and it may prefer to do more than double itsof others, or to exercise its increased purchasingon some new thing. If so, the supply will adapt itself, and the values of things will continue to conform tocost of production. At any rate, it is a sheer absurdityall things should fall in value, and that all producers, in consequence, be insufficiently remunerated. If valuesthe same, what becomes of prices is immaterial, since theof producers does not depend on how much money, buthow much of consumable articles, they obtain for their goods., money is a commodity; and if all commodities areto be doubled in quantity, we must suppose money to betoo, and then prices would no more fall than values.

3. A general over-supply , or excess of all commodities abovedemand, so far as demand consists in means of payment, isshown to be an impossibility. But it may perhaps he supposedit is not the ability to purchase, but the desire to, that falls short, and that the general produce ofmay be greater than the community desires to consume —part, at least, of the community which has an equivalent to. It is evident enough, that produce makes a market for, and that there is wealth in the country with which toall the wealth in the country; but those who have the, may not have the wants, and those who have the wants maywithout the means. A portion, therefore, of the commoditiesmay be unable to find a market, from the absence ofin those who have the desire to consume, and the want ofin those who have the means.

This is much the most plausible form of the doctrine, andnot, like that which we first examined, involve a. There may easily be a greater quantity of anycommodity than is desired by those who have theto purchase, and it is abstractedly conceivable that thisbe the case with all commodities. The error is in notthat though all who have an equivalent to give, mightfully provided with every consumable article which they, the fact that they go on adding to the production provesthis is not actually the case. Assume the most favourablefor the purpose, that of a limited community, everyof which possesses as much of necessaries and of all knownas he desires: and since it is not conceivable thatwhose wants were completely satisfied would labour andto obtain what they did not desire, suppose that aarrives and produces an additional quantity ofof which there was already enough. Here, it will be, is over-production: true, I reply; over-production of thatarticle: the community wanted no more of that, but itsomething. The old inhabitants, indeed,

wanted nothing;did not the foreigner himself want something? When hethe superfluous article, was he labouring without a? He has produced, but the wrong thing instead of the. He wanted, perhaps, food, and has produced watches, witheverybody was sufficiently supplied. The new comer broughthim into the country a demand for commodities, equal to allhe could produce by his industry, and it was his business tothat the supply he brought should be suitable to that demand.he could not produce something capable of exciting a new wantdesire in the community, for the satisfaction of which somewould grow more food and give it to him in exchange, he hadalternative of growing food for himself; either on fresh, if there was any unoccupied, or as a tenant, or partner, or, of some former occupier, willing to be partiallyfrom labour. He has produced a thing not wanted, insteadwhat was wanted; and he himself, perhaps, is not the kind ofwho is wanted; but there is no over-production;is not excessive, but merely ill assorted. We saw, that whoever brings additional commodities to the market,an additional power of purchase; we now see that he bringsan additional desire to consume; since if he had not that, he would not have troubled himself to produce. Neither ofelements of demand, therefore, can be wanting, when there isadditional supply; though it is perfectly possible that themay be for one thing, and the supply may unfortunatelyof another.

Driven to his last retreat, an opponent may perhaps allege,there are persons who produce and accumulate from mere; not because they have any object in growing richer, orto add in any respect to their consumption, but from vis. They continue producing because the machine is ready, and save and re-invest their savings because they haveon which they care to expend them. I grant that this is, and in some few instances probably happens; but thesenot in the smallest degree affect our conclusion. For, what dopersons do with their savings? They invest them. that is, expend them in employing labour. In other, having a purchasing power belonging to them, more thanknow what to do with, they make over the surplus of it forgeneral benefit of the labouring class. Now, will that classnot know what to do with it? Are we to suppose that they tootheir wants perfectly satisfied, and go on labouring fromhabit? Until this is the case; until the working classesalso reached the point of satiety-there will be no want offor the produce of capital, however rapidly it may: since, if there is nothing else for it to do, it canfind employment in producing the necessaries or luxuriesthe labouring class. And when they too had no further desirenecessaries or luxuries, they would take the benefit of anyincrease of wages by diminishing their work; so that theproduction which then for the first time would be possibleidea, could not even then take place in fact, for want of. Thus, in whatever manner the question is looked at,though we go to the extreme verge of possibility to invent afavourable to it, the theory of generalproduction implies an absurdity.

4. What then is it by which men who have reflected much onphenomena, and have even contributed to throw newupon them by original speculations, have been led toso irrational a doctrine? I conceive them to have beenby a mistaken interpretation of certain mercantile. They imagined that the possibility of a general oversupplycommodities was proved by experience. They believed that theythis phenomenon in certain conditions of the markets, theexplanation of which is totally different.

I have already described the state of the markets forwhich accompanies what is termed a commercial crisis.such times there is really an excess of all commodities

abovemoney demand: in other words, there is an under-supply of. From the sudden annihilation of a great mass of credit,one dislikes to part with ready money, and many are anxiousprocure it at any sacrifice. Almost everybody therefore is a, and there are scarcely any buyers; so that there maybe, though only while the crisis lasts, an extremeof general prices, from what may be indiscriminatelya glut of commodities or a dearth of money. But it is aerror to suppose, with Sismondi, that a commercial crisisthe effect of a general excess of production. It is simply theof an excess of speculative purchases. It is not aadvent of low prices, hut a sudden recoil from priceshigh: its immediate cause is a contraction of, and the remedy is, not a dilution of supply , but theof confidence. It is also evident that this temporaryof markets is an evil only because it is temporary.fall being solely of money prices, if prices did not riseno dealer would lose, since the smaller price would beas much to him as the larger price was before. In no mannerthis phenomenon answer to the description which theseeconomists have given of the evil of over-production.permanent decline in the circumstances of producers, for wantmarkets, which those writers contemplate, is a conception tothe nature of a commercial crisis gives no support.

The other phenomenon from which the notion of a generalof wealth and superfluity of accumulation seems to derive, is one of a more permanent nature, namely, the fallprofits and interest which naturally takes place with theof population and production. The cause of this declineprofit is the increased cost of maintaining labour, whichfrom an increase of population and of the demand for, outstripping the advance of agricultural improvement. Thisfeature in the economical progress of nations willfull consideration and discussion in the succeeding.(2*) It is obviously a totally different thing from a wantmarket for commodities, though often confounded with it in theof the producing and trading classes. The trueof the modern or present state of industrial, is, that there is hardly any amount of business whichnot be done, if people will be content to do it on small; and this, all active and intelligent persons in businesswell know. but even those who comply with theof their time, grumble at what they comply with, andthat there were less capital, or as they express it, less, in order that there might be greater profits. Low, however, are a different thing from deficiency of; and the production and accumulation which merely reduce, cannot be called excess of supply or of production. Whatphenomenon really is, and its effects and necessary limits,be seen when we treat of that express subject.

I know not of any economical facts, except the two I have, which can have given occasion to the opinion that aover-production of commodities ever presented itself inexperience. I am convinced that there is no fact inaffairs, which, in order to its explanation, stands inof that chimerical supposition.

The point is fundamental; any difference of opinion on itradically different conceptions of Political Economy,in its practical aspect. On the one view, we have onlyconsider how a sufficient production may be combined with thepossible distribution; but on the other there is a thirdto be considered-how a market can be created for produce,how production can be limited to the capabilities of the. Besides; a theory so essentially self-contradictoryintrude itself without carrying confusion into the veryof the subject, and making it impossible even to conceiveany distinctness many of the more

complicated economicalof society. This error has been, I conceive, fatal tosystems, as systems, of the three distinguished economists toI before referred, Malthus, Chalmers, and Sismondi; all ofhave admirably conceived and explained several of thetheorems of political economy, but this fatalhas spread itself like a veil between them and thedifficult portions of the subject, not suffering one ray ofto penetrate. Still more is this same confused ideacrossing and bewildering the speculations of mindsto theirs. It is but justice to two eminent names, toattention to the fact, that the merit of having placed thisimportant point in its true light, belongs principally, onContinent, to the judicious J.B. Say, and in this country toMill; who (besides the conclusive exposition which he gave ofsubject in his Elements of Political Economy) had set forthcorrect doctrine with great force and clearness in an early, called forth by a temporary controversy, and entitled,"Commerce Defended;" the first of his writings which attained any, and which he pried more as having been his firstto the friendship of David Ricardo, the most valuedmost intimate friendship of his life. :. Supra, vol. i. pp. 66-8.. Infra, book iv. chap. 4.

The Principles of Political Economy

John Stuart Mill

3: Distribution

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a Measure of Value

1. There has been much discussion among political economistsa Measure of Value. An importance has been attached tosubject, greater than it deserved, and what has been writtenit has contributed not a little to the reproach of, which is brought, with much exaggeration, but notwithout ground, against the speculations of political. It is necessary however to touch upon the subject, ifto show how little there is to be said on it.

A Measure of Value, in the ordinary sense of the word, would mean, something, by comparison with which we maywhat is the value of any other thing. When we consider, that value itself is relative, and that two things areto constitute it, independently of the third thingis to measure it; we may define a Measure of Value to be, by comparing with which any two other things, we maytheir value in relation to one another.

In this sense, any commodity will serve as a measure of valuea given time and place; since we can always infer thein which things exchange for one another, when we knowproportion in which each exchanges for any third thing. Toas a convenient measure of value is one of the functions ofcommodity selected as a medium of exchange. It is in thatthat the values of all other things are habitually. We say that one thing is worth 2l., another 3l.; andis then known without express statement, that one is worththirds of the other, or that the things exchange for onein the proportion of 2 to 3. Money is a complete measuretheir value.

But the desideratum sought by political economists is not aof the value of things at the same time and place, but aof the value of the same thing at different times and: something by comparison with which it may be knownany given thing is of greater or less value now than aago, or in this country than in America or China. And foralso, money, or any other commodity, will serve quite asas at the same time and place, provided we can obtain thedata; provided we are able to compare with the measure notcommodity only, but the two or more which are necessary toidea of value. If wheat is now 40s. the quarter, and a fatthe same, and if in the time of Henry the Second wheat wass., and a sheep 10s., we know that a quarter of wheat was thentwo sheep, and is now only worth one, and that the valueof a sheep, estimated in wheat, is twice as great as itthen; quite independently of the value of money at the two, either in relation to those two articles (in respect toof which we suppose it to have fallen), or to other, in respect to which we need not make any.

What seems to be desired, however, by writers on the subject,some means of ascertaining the value of a commodity by merelyit with the measure, without referring it specially toother given commodity. They would wish to be able, from thefact that wheat is now 40s. the quarter, and was formerlys., to decide whether wheat has varied in its value, and indegree, without selecting a second commodity, such as a, to compare it with;

because they are desirous of knowing,how much wheat has varied in value relatively to sheep, butmuch it has varied relatively to things in general.

The first obstacle arises from the necessary indefinitenessthe idea of general exchange value — value in relation not toone commodity, but to commodities at large. Even if we knewhow much a quarter of wheat would have purchased at theperiod, of every marketable article considered, and that it will now purchase more of some things andof others, we should often find it impossible to say whetherhad risen or fallen in relation to things in general. How muchimpossible, when we only know how it has varied in relationthe measure. To enable the money price of a thing at twoperiods to measure the quantity of things in generalit will exchange for, the same sum of money must correspondboth periods to the same quantity of things in general, that, money must always have the same exchange value, the samepurchasing power. Now, not only is this not true of, or of any other commodity, but we cannot even suppose anyof circumstances in which it would be true.

2. A measure of exchange value, therefore, being impossible,have formed a notion of something, under the name of aof value, which would be more properly termed a measurecost of production. They have imagined a commodity invariablyby the same quantity of labour; to which supposition itnecessary to add, that the fixed capital employed in themust bear always the same proportion to the wages ofimmediate labour, and must be always of the same durability:short, the same capital must be advanced for the same lengthtime, so that the element of value which consists of profits,well as that which consists of wages, may be unchangeable. Wethen have a commodity always produced under one and thecombination of all the circumstances which affect permanent. Such a commodity would be by no means constant in itsvalue; for (even without reckoning the temporaryarising from supply and demand) its exchange valuebe altered by every change in the circumstances ofof the things against which it was exchanged. But ifexisted such a commodity, we should derive this advantageit, that whenever any other thing varied permanently into it, we should know that the cause of variation wasin it, but in the other thing. It would thus be suited toas a measure, not indeed of the value of other things, buttheir cost of production. If a commodity acquired a greaterpurchasing power in relation to the invariable, its cost of production must have become greater; andthe contrary case, less. This measure of cost, is whateconomists have generally meant by a measure of value.

But a measure of cost, though perfectly conceivable, can noexist in fact, than a measure of exchange value. There is nowhich is invariable in its cost of production. Gold andare the least variable, but even these are liable toin their cost of production, from the exhaustion of oldof supply, the discovery of new, and improvements in theof working. If we attempt to ascertain the changes in theof production of any commodity from the changes in its money, the conclusion will require to be corrected by the bestwe can make for the intermediate changes in the cost ofproduction of money itself.

Adam Smith fancied that there were two commodities peculiarlyto serve as a measure of value: corn, and labour. Of corn,said that although its value fluctuates much from year to, it does not vary greatly from century to century. This weknow to be an error: corn tends to rise in cost of productionevery increase of population, and to fall with everyin agriculture, either in the country itself, or inforeign country from which it draws a

portion of its. The supposed constancy of the cost of the production ofdepends on the maintenance of a complete equipoise betweenantagonizing forces, an equipoise which, if ever realized,only be accidental. With respect to labour as a measure of, the language of Adam Smith is not uniform. He sometimesof it as a good measure only for short periods, sayingthe value of labour (or wages) does not vary much from yearyear, though it does from generation to generation. On otherhe speaks as if labour were intrinsically the mostmeasure of value, on the ground that one day's ordinaryexertion of one man, may be looked upon as always, to, the same amount of effort or sacrifice. But this, whether in itself admissible or not, discards theof exchange value altogether, substituting a totallyidea, more analogous to value in use. If a day's labourpurchase in America twice as much of ordinary consumableas in England, it seems a vain subtlety to insist onthat labour is of the same value in both countries, andit is the value of the other things which is different., in this case, may be correctly said to be twice as, both in the market and to the labourer himself, inas in England.

If the object were to obtain an approximate measure by whichestimate value in use, perhaps nothing better could be chosenone day's subsistence of an average man, reckoned in thefood consumed by the class of unskilled labourers. If incountry a pound of maize flour will support a labouring mana day, a thing might be deemed more or less valuable into the number of pounds of maize flour it exchanged. If one thing, either by itself or by what it would purchase,maintain a labouring man for a day, and another couldhim for a week, there would be some reason in sayingthe one was worth, for ordinary human uses, seven times asas the other. But this would not measure the worth of theto its possessor for his own purposes, which might beto any amount, though it could not be less, than theof the food which the thing would purchase.

The idea of a Measure of Value must not be confounded withidea of the regulator, or determining principle, of value.it is said by Ricardo and others, that the value of a thingregulated by quantity of labour, they do not mean the quantitylabour for which the thing will exchange, but the quantityfor producing it. This, they mean to affirm, determinesvalue; causes it to be of the value it is, and of no other.when Adam Smith and Malthus say that labour is a measure of, they do not mean the labour by which the thing was or canmade, but the quantity of labour which it will exchange for,purchase; in other words the value of the thing, estimated in. And they do not mean that this regulates the generalvalue of the thing, or has any effect in determiningthat value shall be, but only ascertains what it is, andand how much it varies from time to time and from placeplace. To confound these two ideas, would be much the sameas to overlook the distinction between the thermometer andfire.

The Principles of Political Economy

John Stuart Mill

3: Distribution

16Some Peculiar Cases of Value

1. The general laws of value, in all the more importantof the interchange of commodities in the same country, havebeen investigated. We examined, first, the case of monopoly,which the value is determined by either a natural or anlimitation of quantity, that is, by demand and supply;, the case of free competition, when the article can bein indefinite quantity at the same cost; in which casepermanent value is determined by the cost of production, andthe fluctuations by supply and demand; thirdly, a mixed, that of the articles which can be produced in indefinite, but not at the same cost; in which case the permanentis determined by the greatest cost which it is necessary toin order to obtain the required supply. And lastly, we havethat money itself is a commodity of the third class; thatvalue, in a state of freedom, is governed by the same laws asvalues of other commodities of its class; and that prices,, follow the same laws as values.

From this it appears that demand and supply govern theof values and prices in all cases, and the permanentand prices of all things of which the supply is determinedany agency other than that of free competition: but that,the regime of competition, things are, on the average,for each other at such values, and sold at such prices,afford equal expectation of advantage to all classes of; which can only be when things exchange for one anotherthe ratio of their cost of production.

It is now, however, necessary to take notice of certain, to which, from their peculiar nature, this law of exchangeis inapplicable.

It sometimes happens that two different commodities have whatbe termed a joint cost of production. They are both productsthe same operation, or set of operations, and the outlay isfor the sake of both together, not part for one and partthe other. The same outlay would have to be incurred forof the two, if the other were not wanted or used at all.are not a few instances of commodities thus associated inproduction. For example, coke and coal-gas are bothfrom the same material, and by the same operation. In apartial sense, mutton and wool are an example: beef, hides,tallow: calves and dairy produce: chickens and eggs. Cost ofcan have nothing to do with deciding the value of thecommodities relatively to each other. It only decidesjoint value. The gas and the coke together have to repayexpenses of their production, with the ordinary profit. To do, a given quantity of gas, together with the coke which isresiduum of its manufacture, must exchange for other thingsthe ratio of their joint cost of production. But how much ofremuneration of the producer shall be derived from the coke,how much from the gas, remains to be decided. Cost ofdoes not determine their prices, hut the sum of their. A principle is wanting to apportion the expenses ofbetween the two.

Since cost of production here fails us, we must revert to aof value anterior to cost of production, and more, the law of demand and supply. The law is, that thefor a commodity varies with its value, and that the valueitself so that the demand shall be equal to the supply.supplies the principle of repartition which we are in quest.

Suppose that a certain quantity of gas is produced and solda certain price, and that the residuum of coke is offered at awhich, together with that of the gas, repays the expensesthe ordinary rate of profit. Suppose, too, that at the priceupon the gas and coke respectively, the whole of the gasan easy market, without either surplus or deficiency, butpurchasers cannot be found for all the coke corresponding to. The coke will be offered at a lower price in order to force a. But this lower price, together with the price of the gas,not be remunerating: the manufacture, as a whole, will notits expenses with the ordinary profit, and will not, on these, continue to be carried on. The gas, therefore, must beat a higher price, to make up for the deficiency on the. The demand consequently contracting, the production will bereduced; and prices will become stationary when, by theeffect of the rise of gas and the fall of coke, so muchof the first is sold, and so much more of the second, thatis now a market for all the coke which results from theextent of the gas manufacture. Or suppose the reverse; that more coke is wanted at the present prices, than can beby the operations required by the existing demand for. Coke, being now in deficiency, will rise in price. The wholewill yield more than the usual rate of profit, andcapital will he attracted to the manufacture. Thedemand for coke will he supplied; but this cannot bewithout increasing the supply of gas too; and as thedemand was fully supplied already, an increased quantityonly find a market by lowering the price. The result will bethe two together will yield the return required by theircost of production, but that more of this return thanwill be furnished by the coke, and less by the gas.will be attained when the demand for each articleso well with the demand for the other, that the quantityof each is exactly as much as is generated in producingquantity required of the other. If there is any surplus oron either side; if there is a demand for coke, and notdemand for all the gas produced along with it, or vice versa;values and prices of the two things will so readjustthat both shall find a market.

When, therefore, two or more commodities have a joint cost of, their natural values relatively to each other arewhich will create a demand for each, in the ratio of thein which they are sent forth by the productive. This theorem is not in itself of any great importance:the illustration it affords of the law of demand, and of thein which, when cost of production fails to be applicable,other principle steps in to supply the vacancy, is worthy ofattention, as we shall find in the next chapter butthat something very similar takes place in cases of muchmoment.

2. Another case of values which merits attention, is that ofdifferent kinds of agricultural produce. This is rather acomplex question that the last, and requires that attentionbe paid to a greater number of influencing circumstances.case would present nothing peculiar, if differentproducts were either grown indiscriminately and withadvantage on the same soils, or wholly on different soils.difficulty arises from two things: first, that most soils arefor one kind of produce than another, without beingunfit for any; and secondly, the rotation of crops.

For simplicity, we will confine our supposition to two kindsagricultural produce; for instance, wheat and oats. If allwere equally adapted for wheat and for oats, both would beindiscriminately on all soils, and their relative cost of, being the same everywhere, would govern theirvalue. If the same labour which grows three quarters ofon any given soil, would always grow on that soil fiveof oats, the three and the five quarters would be of

thevalue. If again, wheat and oats could not be grown on thesoil at all, the value of each would be determined by itscost of production on the least favourable of the soilsfor it which the existing demand required a recourse to.fact, however, is that both wheat and oats can be grown onany soil which is capable of producing either: but some, such as the stiff clays, are better adapted for wheat,others (the light sandy soils) are more suitable for oats.might be some soils which would yield, to the same quantitylabour, only four quarters of oats to three of wheat; othersless than three of wheat to five quarters of oats. Amongdiversities, what determines the relative value of the two?

It is evident that each grain will be cultivated in, on the soils which are better adapted for it than forother; and if the demand is supplied from these alone, theof the two grains will have no reference to one another.when the demand for both is such as to require that eachbe grown not only on the soils peculiarly fitted for it,on the medium soils which, without being specifically adaptedeither, are about equally suited for both, the cost ofon those medium soils will determine the relativeof the two grains; while the rent of the soils specificallyto each, will be regulated by their productive power,with reference to that one alone to which they areapplicable. Thus far the question presents no, to any one to whom the general principles of valuefamiliar.

It may happen, however, that the demand for one of the two,for example wheat, may so outstrip the demand for the other,not only to occupy the soils specially suited for wheat, butengross entirely those equally suitable to both, and evenupon those which are better adapted to oats. To createinducement for this unequal apportionment of the cultivation,must be relatively dearer, and oats cheaper, than accordingthe cost of their production on the medium land. Theirvalue must be in proportion to the cost on that qualityland, whatever it may be, on which the comparative demand fortwo grins requires that both of them should be grown. If,the state of the demand, the two cultivations meet on landfavourable to one than to the other, that one will beand the other dearer, in relation to each other and toin general, than if the proportional demand were as we atsupposed.

Here, then, we obtain a fresh illustration, in a somewhatmanner, of the operation of demand, not as andisturber of value, but as a permanent regulator of, conjoined with, or supplementary to, cost of production.

The case of rotation of crops does not require separate, being a case of joint cost of production, like that ofand coke. If it were the practice to grow white and greenon all lands in alternate years, the one being necessary asfor the sake of the other as for its own sake; the farmerderive his remuneration for two years' expenses from oneand one green crop, and the prices of the two would sothemselves as to create a demand which would carry off anbreadth of white and of green crops.

There would be little difficulty in finding other anomalousof value, which it might be a useful exercise to resolve:it is neither desirable nor possible, in a work like the, to enter more into details than is necessary for theof principles. I now therefore proceed to the onlyof the general theory of exchange which has not yet beenupon, that of International Exchanges, or to speak more, exchanges between distant places.

The Principles of Political Economy

John Stuart Mill

3: Distribution

17International Trade

1. The causes which occasion a commodity to be brought from a, instead of being produced, as convenience would seem to, as near as possible to the market where it is to be soldconsumption, are usually conceived in a rather superficial. Some things it is physically impossible to produce,in particular circumstances of heat, soil, water, or. But there are many things which, though they could beat home without difficulty, and in any quantity, are yetfrom a distance. The explanation which would begiven of this would be, that it is cheaper to importto produce them: and this is the true reason. But thisitself requires that a reason be given for it. Of twoproduced in the same place, if one is cheaper than the, the reason is that it can be produced with less labour and, or, in a word, at less cost. Is this also the reason asthings produced in different places? Are things neverbut from places where they can be produced with less(or less of the other element of cost, time) than in theto which they are brought? Does the law, that permanentis proportioned to cost of production, hold good betweenproduced in distant places, as it does between thosein adjacent places?

We shall find that it does not. A thing may sometimes be sold, by being produced in some other place than that atit can be produced with the smallest amount of labour and. England might import corn from Poland and pay for itcloth, even though England had a decided advantage over Polandthe production of both the one and the other. England mightcottons to Portugal in exchange for wine, although Portugalbe able to produce cottons with a less amount of labour andthan England could.

This could not happen between adjacent places. If the northof the Thames possessed an advantage over the south bank inproduction of shoes, no shoes would be produced on the south; the shoemakers would remove themselves and their capitalsthe north bank, or would have established themselves there. for being competitors in the same market with thosethe north side, they could not compensate themselves for theirat the expense of the consumer: the mount of itfall entirely on their profits; and they would not longthemselves with a smaller profit, when, by simplya river, they could increase it. But between distant, and especially between different countries, profits maydifferent; because persons do not usually removeor their capitals to a distant place, without a verymotive. If capital removed to remote parts of the world as, and for as small an inducement, as it moves to anotherof the same town; if people would transport theirto America or China whenever they could save apercentage in their expenses by it; profits would be alike(or equivalent) all over the world, and all things would hein the places where the same labour and capital wouldthem in greatest quantity and of best quality. A tendency, even now, be observed towards such a state of things;is becoming more and more cosmopolitan; there is so muchsimilarity of manners and institutions than formerly, andmuch less alienation of feeling, among the more civilized, that both population and capital now move from one ofcountries to another on much less temptation than. But there are still extraordinary differences, bothwages and of profits, between different parts of the world. Itbut a small

motive to transplant capital, or even persons,Warwickshire to Yorkshire; but a much greater to make themto India, the colonies, or Ireland. To France, Germany, or, capital moves perhaps almost as readily as to the; the difference of language and government beingso great a hindrance as climate and distance. Tostill barbarous, or, like Russia or Turkey, onlyto be civilized, capital will not migrate, unless underinducement of a very great extra profit.

Between all distant places therefore in some degree, butbetween different countries (whether under the samegovernment or not,) there may exist great inequalities inreturn to labour and capital, without causing them to moveone place to the other in such quantity as to level those. The capital belonging to a country will, to a great, remain in the country, even if there be no mode ofit in which it would not be more productive elsewhere.even a country thus circumstanced might, and probably would,on trade with other countries. It would export articles ofsort, even to places which could make them with less labouritself; because those countries, supposing them to have anover it in all productions, would have a greaterin some things than in others, and would find it theirto import the articles in which their advantage was, that they might employ more of their labour and capitalthose in which it was greatest.

2. As I have said elsewhere(1*) after Ricardo (the thinkerhas done most towards clearing up this subject) (2*) "it isa difference in the absolute cost of production, whichthe interchange, but a difference in the comparative. It may be to our advantage to procure iron from Sweden infor cottons, even although the mines of England as wellher manufactories should be more productive than those of; for if we have an advantage of one-half in cottons, andan advantage of a quarter in iron, and could sell ourto Sweden at the price which Sweden must pay for them ifproduced them herself, we should obtain our iron with anof one-half as well as our cottons. We may often, bywith foreigners, obtain their commodities at a smallerof labour and capital than they cost to the foreigners. The bargain is still advantageous to the foreigner,the commodity which he receives in exchange, though itcost us less, would have cost him more." To illustrate thein which interchange of commodities will not, and those init will, take place between two countries, Mr. Mill, in hisof Political Economy,(3*) makes the supposition thathas an advantage over England in the production both ofand of corn. He first supposes the advantage to be of equalin both commodities; the cloth and the corn, each of which100 days' labour in Poland, requiring each 150 days'in England. "It would follow, that the cloth of 150 days'in England, if sent to Poland, would be equal to the cloth100 days' labour in Poland; if exchanged for corn, therefore,would exchange for the corn of only 100 days' labour. But theof 100 days' labour in Poland, was supposed to be the samewith that of 150 days' labour in England. With 150 days'in cloth, therefore, England would only get as much cornPoland, as she could raise with 150 days' labour at home; andwould, in importing it, have the cost of carriage besides. Incircumstances no exchange would take place." In this casecomparative costs of the two articles in England and inwere supposed to be the same, though the absolute costsdifferent; on which supposition we see that there would belabour saved to either country, by confining its industry toof the two productions, and importing the other.

It is otherwise when the comparative, and not merely thecosts of the two articles are different in the two. "If," continues the same author, "while the clothwith 100 days' labour in Poland was produced with 150' labour in England, the corn which was produced in Poland100 days' labour could not be produced in England with less200 days' labour; an adequate motive to exchange wouldarise. With a quantity of cloth which Englandwith 150 days' labour, she would be able to purchase ascorn in Poland as was there produced with 100 days' labour;the quantity which was there produced with 100 days' labour,be as great as the quantity produced in England with 200' labour." By importing corn, therefore, from Poland, andfor it with cloth, England would obtain for 150 days'what would otherwise cost her 200; being a saving of 50' labour on each repetition of the transaction: and nota saving to , for it is not obtained at the expense of, but a saving absolutely. Poland, who, with corn thather 100 days' labour, has purchased cloth which, ifat home, would have cost her the same. Poland,, on this supposition, loses nothing; but also sheno advantage from the trade, the imported cloth costingas much as if it were made at home. To enable Poland to gainby the interchange, something must be abated from theof England : the corn produced in Poland by 100 days', must be able to purchase from England more cloth thancould produce by that amount of labour; more thereforeEngland could produce by 150 days' labour, England thusthe corn which would have cost her 200 days, at a cost150, though short of 200. England therefore no longerthe whole of the labour which is saved to the two jointlytrading with one another.

3. From this exposition we perceive in what consists theof international exchange, or in other words, foreign. Setting aside its enabLing countries to obtainwhich they could not themselves produce at all; itsconsists in a more efficient employment of theforces of the world. If two countries which tradeattempted, as far as was physically possible, to producethemselves what they now import from one another, the labourcapital of the two countries would not be so productive, thetogether would not obtain from their industry so great aof commodities, as when each employs itself in, both for itself and for the other, the things in whichlabour is relatively most efficient. The addition thus madethe produce of the two combined, constitutes the advantage oftrade. It is possible that one of the two countries may beinferior to the other in productive capacities, andits labour and capital could be employed to greatestby being removed bodily to the other. The labour andwhich have been sunk in rendering Holland habitable,have produced a much greater return if transported toor Ireland. The produce of the whole world would be, or the labour less, than it is, if everything werewhere there is the greatest absolute facility for its. But nations do not, at least in modern times,en masse; and while the labour and capital of a countryin the country, they are most beneficially employed in, for foreign markets as well as for its own, the thingswhich it lies under the least disadvantage, if there be nonewhich it possesses an advantage.

4. Before proceeding further, let us contrast this view ofbenefits of international commerce with other theories whichprevailed, and which to a certain extent still prevail, onsame subject. According to the doctrine now stated, the onlyadvantage of foreign commerce consists in the imports. Aobtains things which it either could not have produced at, or which it must have produced at a greater expense ofand labour than the cost of the things which it exportspay for them. It thus obtains a more ample supply of theit wants,

for the same labour and capital; or thesupply, for less labour and capital, leaving the surplusto produce other things. The vulgar theory disregardsbenefit, and deems the advantage of commerce to reside inexports: as if not what a country obtains, but what it parts, by its foreign trade, was supposed to constitute the gainit. An extended market for its produce — an abundantfor its goods — a vent for its surplus — are theby which it has been customary to designate the uses andof commerce with foreign countries. This notionintelligible, when we consider that the authors and leaders ofon mercantile questions have always hitherto been theclass. It is in truth a surviving relic of the Mercantile, according to which, money being the only wealth, selling,in other words, exchanging goods for money, was (to countriesmines of their own) the only way of growing rich — andof goods, that is to say, parting with money, was sosubtracted from the benefit.

The notion that money alone is wealth, has been long defunct,it has left many of its progeny behind it; and even its, Adam Smith, retained some opinions which it isto trace to any other origin. Adam Smith's theory ofbenefit of foreign trade, was that it afforded an outlet forsurplus produce of a country, and enabled a portion of theof the country to replace itself with a profit. Thesesuggest ideas inconsistent with a clear conception ofphenomena. The expression, surplus produce, seems to implya country is under some kind of necessity of producing theor cloth which it exports; so that the portion which it doesitself consume, if not wanted and consumed elsewhere, wouldbe produced in sheer waste, or if it were not produced,corresponding portion of capital would remain idle, and theof productions in the country would be diminished by so. Either of these suppositions would be entirely erroneous.country produces an exportable article in excess of its own, from no inherent necessity, but as the cheapest mode ofitself with other things. If prevented from exportingsurplus, it would cease to produce it, and would no longeranything, being unable to give an equivalent; but theand capital which had been employed in producing with ato exportation, would find employment in producing thoseobjects which were previously brought from abroad: or,some of them could not be produced, in producing substitutesthem. These articles would of course be produced at a greaterthan that of the things with which they had previously beenfrom foreign countries. But the value and price of thewould rise in proportion; and the capital would just asbe replaced, with the ordinary profit from the returns, aswas when employed in producing for the foreign market. Thelosers (after the temporary inconvenience of the change)be the consumers of the heretofore imported articles; whobe obliged either to do without them, consuming in lieu ofsomething which they did not like as well, or to pay aprice for them than before.

There is much misconception in the common notion of whatdoes for a country . When commerce is spoken of as aof national wealth, the imagination fixes itself upon thefortunes acquired by merchants, rather than upon the savingprice to consumers. But the gains of merchants, when theyno exclusive privilege, are no greater than the profitsby the employment of capital in the country itself. Ifbe said that the capital now employed in foreign trade couldfind employment in supplying the home market, I might reply,this is the fallacy of general over-production, discussed informer chapter : but the thing is in this particular case too, to require an appeal to any general theory. We not onlythat the capital of the merchant would find employment, butsee what employment. There would be

employment created, equalthat which would be taken away. Exportation ceasing,to an equal value would cease also, and all that partthe income of the country which had been expended in imported, would be ready to expend itself on the same thingsat home, or on others instead of them. Commerce isa mode of cheapening production; and in all such casesconsumer is the person ultimately benefited; the dealer, inend, is sure to get his profit, whether the buyer obtainsor little for his money. This is said without prejudice toeffect (already touched upon, and to be hereafter fully) which the cheapening of commodities may have inprofits; in the case when the commodity cheapened, beingof those consumed by labourers, enters into the cost of, by which the rate of profits is determined.

5. Such, then, is the direct economical advantage of foreign. But there are, besides, indirect effects, which must beas benefits of a high order. One is, the tendency ofextension of the market to improve the processes of. A country which produces for a larger market than its, can introduce a more extended division of labour, can makeuse of machinery, and is more likely to make inventionsimprovements in the processes of production. Whatever causesgreater quantity of anything to be produced in the same place,to the general increase of the productive powers of the.(4*) There is another consideration, principally applicablean early stage of industrial advancement. A people may be in a, indolent, uncultivated state, with all their tastesfully satisfied or entirely undeveloped, and they may failput forth the whole of their productive energies for want ofsufficient object of desire. The opening of a foreign trade,making them acquainted with new objects, or tempting them byeasier acquisition of things which they had not previouslyattainable, sometimes works a sort of industrialin a country whose resources were previouslyfor want of energy and ambition in the people:those who were satisfied with scanty comforts and little, to work harder for the gratification of their new tastes,even to save, and accumulate capital, for the still moresatisfaction of those tastes at a future time.

But the economical advantages of commerce are surpassed inby those of its effects which are intellectual and. It is hardy possible to overrate the value, in the presentstate of human improvement, of placing human beings inwith persons dissimilar to themselves, and with modes ofand action unlike those with which they are familiar.is now what war once was, the principal source of this. Commercial adventurers from more advanced countries havebeen the first civilizers of barbarians. And commercethe purpose of the far greater part of the communication whichplace between civilized nations. Such communication hasbeen, and is peculiarly in the present age, one of thesources of progress. To human beings, who, as hitherto, can scarcely cultivate even a good quality withoutit into a fault, it is indispensable to be perpetuallytheir own notions and customs with the experience andof persons in different circumstances from themselves:there is no nation which does not need to borrow from others,merely particular arts or practices, but essential points ofin which its own type is inferior. Finally, commercetaught nations to see with good will the wealth andof one another. Before, the patriot, unlessadvanced in culture to feel the world his country,all countries weak, poor, and ill-governed, but his own:now sees in their wealth and progress a direct source ofand progress to his own country. It is commerce which isrendering war obsolete, by strengthening and

multiplyingpersonal interests which are in natural opposition to it. Andmay be said without exaggeration that the great extent andincrease of international trade, in being the principalof the peace of the world, is the great permanentfor the uninterrupted progress of the ideas, the, and the character of the human race. :. Essays on Some Unsettled Questions of Political Economy, Essay.. I at one time believed Mr Ricardo to have been the sole authorthe doctrine now universally received by political economists,the nature and measure of the benefit which a country derivesforeign trade. But Colonel Torrens, by the republication ofof his early writings, "The Economists Refuted," hasat least a joint claim with Mr Ricardo to theof the doctrine, and an exclusive one to its earliest.. Third ed. p. 120.. Vide supra, book i. chap.ix, sect. 1.

The Principles of Political Economy

John Stuart Mill

3: Distribution

18International Trade

1. The values of commodities produced at the same place, orplaces sufficiently adjacent for capital to move freelythem — let us say, for simplicity, of commoditiesin the same country — depend (temporary fluctuations) upon their cost of production. But the value of abrought from a distant place, especially from a foreign, does not depend on its cost of production in the placewhence it comes. On what, then, does it depend? The value ofthing in any place, depends on the cost of its acquisition inplace; which in the case of an imported article, means theof production of the thing which is exported to pay for it.

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

If, then, England imports wine from Spain, giving for everyof wine a bale of cloth, the exchange value of a pipe ofin England will not depend upon what the production of themay have cost in Spain, but upon what the production of thehas cost in England. Though the wine may have cost in Spainequivalent of only ten days' labour, yet, if the cloth costsEngland twenty days' labour, the wine, when brought to, will exchange for the produce of twenty days' English, plus the cost of carriage; including the usual profit onimporter's capital, during the time it is locked up, andfrom other employment.

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

I have discussed this question in a separate Essay, alreadyreferred to; and a quotation of part of the exposition then, will she the best introduction to my present view of the. I must give notice that we are now in the region of thecomplicated questions which political economy affords; thatsubject is one which cannot possibly, and that a moreeffort of attention than be made elementary; has yetrequired, will be necessary to follow the series of. The thread, however, which we are about to take in, is in itself very simple and manageable; the onlyis in following it through the windings andof complex international transactions.

2. "When the trade is established between the two countries,two commodities will exchange for each other at the same rateinterchange in both countries — bating the cost of carriage,which, for the present, it will be more convenient to omit the. Supposing, therefore, for the sake of argument,the carriage of the commodities from one country to thecould be effected without labour and without cost, nowould the trade be opened than the value of the two, estimated in each other, would come to a level incountries.

"Suppose that 10 yards of broadcloth cost in England as muchas 15 yards of linen, and in Germany as much as 20." Inwith most of my predecessors, I find it advisable, inintricate investigations, to give distinctness and fixitythe conception by numerical examples. These examples must, as in the present case, be purely supposititious. Ihave preferred real ones; but all that is essential is,the numbers should be such as admit of being easily followedthe subsequent combinations into which they enter.

This supposition then being made, it would be the interest ofto import linen from Germany, and of Germany to importfrom England. "When each country produced both commoditiesitself, 10 yards of cloth exchanged for 15 yards of linen in, and for 20 in Germany. They will now exchange for thenumber of yards of linen in both. For what number? If foryards, England will be just as she was, and Germany will gain. If for 20 yards, Germany will be as before, and England willthe whole of the benefit. If for any number intermediate15 and 20, the advantage will be shared between the two. If, for example, 10 yards of cloth exchange for 18 of, England will gain an advantage of 3 yards on every 15,will save 2 out of every 20. The problem is, what are thewhich determine the proportion in which the cloth ofand the linen of Germany will exchange for each other.

"As exchange value, in this case as in every other, isfluctuating, it does not matter what we suppose itbe when we begin: we shall soon see whether there be any fixedabout which it oscillates, which it has a tendency alwaysapproach to, and to remain at. Let us suppose, then, that byeffect of what Adam Smith calls the higgling of the market,yards of cloth in both countries, exchange for 17 yards of.

"The demand for a commodity, that is, the quantity of itcan find a purchaser, varies as we have before remarked,to the price. In Germany the price of 10 yards of clothnow 17 yards of linen, or whatever quantity of money isin Germany to 17 yards of linen. Now, that being the, there is some particular number of yards of cloth, whichbe in demand, or will find purchasers, at that price. Theresome given quantity of cloth, more than which could not beof at that price; less than which, at that price, wouldfully satisfy the demand. Let us suppose this quantity to betimes 10 yards.

"Let us now turn our attention to England. There, the price17 yards of linen is 10 yards of cloth, or whatever quantitymoney is equivalent in England to 10 yards of cloth. There isparticular number of yards of linen which, at that price,exactly satisfy the demand, and no more. Let us suppose thatnumber is 1000 times 17 yards.

"As 17 yards of linen are to 10 yards of cloth, so are 100017 yards to 1000 times 10 yards. At the existing exchange, the linen which England requires will exactly pay for theof cloth which, on the same terms of interchange,requires. The demand on each side is precisely sufficientcarry off the supply on the other. The conditions required byprinciple of

demand and supply are fulfilled, and the twowill continue to be interchanged, as we supposed thembe, in the ratio of 17 yards of linen for 10 yards of cloth.

"But our suppositions might have been different. Suppose, at the assumed rate of interchange, England has beento consume no greater quantity of linen than 800 timesyards: it is evident that, at the rate supposed, this wouldhave sufficed to pay for the 1000 times 10 yards of clothwe have supposed Germany to require at the assumed value.would be able to procure no more than 800 times 10 yardsthat price. To procure the remaining 200, which she would havemeans of doing but by bidding higher for them, she would offerthan 17 yards of linen in exchange for 10 yards of cloth:us suppose her to offer 18. At this price, perhaps, Englandbe inclined to purchase a greater quantity of linen. Sheconsume, possibly, at that price, 900 times 18 yards. Onother hand, cloth having risen in price, the demand offor it would probably have diminished. If, instead oftimes 10 yards, she is now contented with 900 times 10, these will exactly pay for the 900 times 18 yards of linenEngland is willing to take at the altered price: the demandeach side will again exactly suffice to take off thesupply; and 10 yards for 18 will be the rate at, in both countries, cloth will exchange for linen.

"The converse of all this would have happened, if, instead oftimes 17 yards, we had supposed that England, at the rate offor 17, would have taken 1200 times 17 yards of linen. In this, it is England whose demand is not fully supplied; it iswho, by bidding for more linen, will alter the rate ofto her own disadvantage; and 10 yards of cloth will, in both countries, below the value of 17 yards of linen. Byfall of cloth, or what is the same thing, this rise of, the demand of Germany for cloth will increase, and theof England for linen will diminish, till the rate ofhas so adjusted itself that the cloth and the linenexactly pay for one another; and when once this point is, values will remain without further alteration.

"Ithe considered, therefore, as established, that when twotrade together in two commodities, the exchange valuethese commodities relatively to each other will adjust itselfthe inclinations and circumstances of the consumers on both, in such manner that the quantities required by each, of the articles which it imports from its neighbour,be exactly sufficient to pay for one another. As theand circumstances of consumers cannot be reduced torule, so neither can the proportions in which the twowill be interchanged. We know that the limits withinthe variation is confined, are the ratio between theirof production in the one country, and the ratio betweencosts of production in the other. Ten yards of cloth cannotfor more than 20 yards of linen, nor for less than 15.they may exchange for any intermediate number. The ratios,, in which the advantage of the trade may be dividedthe two nations, are various. The circumstances on whichproportionate share of each country more remotely depends,only of a very general indication.

"It is even possible to conceive an extreme case, in whichwhole of the advantage resulting from the interchange wouldreaped by one party, the other country gaining nothing at all.is no absurdity in the hypothesis that, of some given, a certain quantity is all that is wanted at any price;that, when that quantity is obtained, no fall in the exchangewould induce other consumers to come forward, or those whoalready supplied, to take more. Let us suppose that this iscase in Germany with cloth. Before her trade with England, when 10 yards of cloth cost her as much labour as 20of linen, she nevertheless

consumed as much cloth as sheunder any circumstances, and, if she could obtain it atrate of 10 yards of cloth for 15 of linen, she would notmore. Let this fixed quantity be 1000 times 10 yards. Atrate, however, of 10 for 20, England would want more linenwould be equivalent to this quantity of cloth. She would, offer a higher value for linen; or, what is thething, she would offer her cloth at a cheaper rate. But, asno lowering of the value could she prevail on Germany to takegreater quantity of cloth, there would be no limit to the riselinen or fall of cloth, until the demand of England for linenreduced by the rise of its value, to the quantity which 100010 yards of cloth would purchase. It might be, that tothis diminution of the demand a less fall would notthan that which would make 10 yards of cloth exchange forof linen. Germany would then gain the whole of the advantage,England would be exactly as she was before the trade. It would be for the interest, however, of Germanyto keep her linen a little below the value at which itbe produced in England, in order to keep herself from beingby the home producer. England, therefore, would alwaysin some degree by the existence of the trade, though itbe a very fig one."

In this statement, I conceive, is contained the firstprinciple of International Values. I have, as isin such abstract and hypothetical cases, supposedcircumstances to be much less complex than they really are:the first place, by suppressing the cost of carriage; next, bythat there are only two countries trading together; and, that they trade only in two commodities. To render theof the principle complete, it is necessary to restorevarious circumstances thus temporarily left out to simplifyargument. Those who are accustomed to any kind of scientificwill probably see, without formal proof, that theof these circumstances cannot alter the theory ofsubject. Trade among any number of countries, and in anyof commodities, must take place on the same essentialas trade between two countries and in two commodities.a greater number of agents precisely similar, cannotthe law of their action, no more than putting additionalinto the two scales of a balance alters the law of. It alters nothing but the numerical results. Forcomplete satisfaction, however, we will enter into thecases with the same particularity with which we havethe simpler one.

3. First, let us introduce the element of cost of carriage.chief difference will then be, that the cloth and the linenno longer exchange for each other at precisely the same rateboth countries. Linen, having to be carried to England, willdearer there by its cost of carriage; and cloth will be dearerGermany by the cost of carrying it from England. Linen,in cloth, will be dearer in England than in Germany, bycost of carriage of both articles: and so will cloth in, estimated in linen. Suppose that the cost of carriage ofis equivalent to one yard of linen; and suppose that, ifcould have been carried without cost, the terms ofwould have been 10 yards of cloth for 17 of linen. Itseem at first that each country will pay its own cost of; that is, the carriage of the article it Sports; that in10 yards of cloth will exchange for 18 of linen, namely,original 17, and 1 to cover the cost of carriage of the; while in England, 10 yards of cloth will only purchase 16linen, 1 yard being deducted for the cost of carriage of the. This, however, cannot be affirmed with certainty; it willbe true, if the linen which the English consumers would takethe price of 10 for 16, exactly pays for the cloth which theconsumers would take at 10 for 18. The values, whateverare, must establish this equilibrium. No absolute rule,, can be laid down for the division of the cost, no morefor the division of the advantage: and it does not followin whatever ratio the one is divided, the other will bein the same. It is impossible to say, if the cost ofcould be

annihilated, whether the producing or thecountry would be most benefited. This would depend onplay of international demand. Cost of carriage has one effect. But for it, every commodity would (if trade be supposed) be either regularly imported or regularly exported. Awould make nothing for itself which it did not also makeother countries. But in consequence of cost of carriage theremany things, especially bulky articles, which every, orevery country produces within itself. After exporting thein which it can employ itself most advantageously, andthose in which it is under the greatest disadvantage,are many lying between, of which the relative cost ofin that and in other countries differs so little, thatcost of carriage would absorb more than the whole saving inof production which would be obtained by importing one andanother. This is the case with numerous commodities ofconsumption; including the coarser qualities of manyof food and manufacture, of which the finer kinds aresubject of extensive international traffic.

4. Let us now introduce a greater number of commodities thantwo we have hitherto supposed. Let cloth and linen, however,still the articles of which the comparative cost of productionEngland and in Germany differs the most; so that if they wereto two commodities, these would be the two which itbe most their interest to exchange. We will now again omitof carriage, which, having been shown not to affect theof the question, does but embarrass unnecessarily theof it. Let us suppose, then, that the demand of Englandlinen is either so much greater than that of Germany for, or so much more extensible by cheapness, that if Englandno commodity but cloth which Germany would take, the demandEngland would force up the terms of interchange to 10 yards offor only 16 of linen, so that England would gain only thebetween 15 and 16, Germany the difference between 1620. But let us now suppose that England has also another, say iron, which is in demand in Germany, and that theof iron which is of equal value in England with 10 yardscloth, (let us call this quantity a hundredweight) will, ifin Germany, cost as much labour as 18 yards of linen, soif offered by England for 17, it will undersell the German. In these circumstances, linen will not be forced up torate of 16 yards for 10 of cloth, but will stop, suppose at; for although, at that rate of interchange, Germany will notenough cloth to pay for all the linen required by England,will take iron for the reminder, and it is the same thing towhether she gives a hundredweight of iron or 10 yards of, both being made at the same cost. If we now superadd coalscottons on the side of England, and wine, or corn, or timber,the side of Germany, it will make no difference in the. The exports of each country must exactly pay for the; meaning now the aggregate exports and imports, not thoseparticular commodities taken singly. The produce of fifty' English labour, whether in cloth, coals, iron, or any other, will exchange for the produce of forty, or fifty, ordays' German labour, in linen, wine, corn, or timber,to the international demand. There is some proportionwhich the demand of the two countries for each other'swill exactly correspond: so that the things supplied byto Germany will be completely paid for, and no more, bysupplied by Germany to England. This accordingly will beratio in which the produce of English and the produce oflabour will exchange for one another.

If, therefore, it be asked what country draws to itself theshare of the advantage of any trade it carries on, theis, the country for whose productions there is in otherthe greatest demand, and a demand the most susceptibleincrease from additional cheapness. In

so far as theof any country possess this property, the countryall foreign commodities at less cost. It gets its imports, the greater the intensity of the demand in foreignfor its exports. It also gets its imports cheaper, thethe extent and intensity of its own demand for them. Theis cheapest to those whose demand is small. A countrydesires few foreign productions, and only a limitedof them, while its own commodities are in great requestforeign countries, will obtain its limited imports atsmall cost, that is, in exchange for the produce of asmall quantity of its labour and capital.

Lastly, having introduced more than the original twointo the hypothesis, let us also introduce more thanoriginal two countries. After the demand of England for theof Germany has raised the rate of interchange to 10 yardscloth for 16 of linen, suppose a trade opened between Englandsome other country which also exports linen. And let usthat if England had no trade but with this third country,play of international demand would enable her to obtain from, for 10 yards of cloth or its equivalent, 17 yards of linen.evidently would not go on buying linen from Germany at therate: Germany would be undersold, and must consent to giveyards, like the other country. In this case, the circumstancesproduction and of demand in the third country are supposed toin themselves more advantageous to England than theof Germany; but this supposition is not necessary:might suppose that if the trade with Germany did not exist,would be obliged to give to the other country the sameterms which she gives to Germany; 10 yards of cloth16, or even less than 16, of linen. Even so, the opening ofthird country makes a great difference in favour of England.is now a double market for English exports, while theof England for linen is only what it was before. Thisobtains for England more advantageous terms of. The two countries, requiring much more of herthan was required by either alone, must, in order toit, force an increased demand for their exports, bythem at a lower value.

It deserves notice, that this effect in favour of Englandthe opening of another market for her exports, will equallyproduced even though the country from which the demand comeshave nothing to sell which England is willing to take.that the third country, though requiring cloth or ironEngland, produces no linen, nor any other article which isdemand there. She however produces exportable articles, or shehave no means of paying for imports: her exports, thoughsuitable to the English consumer, can find a market. As we are only supposing three countries, we musther to find this market in Germany, and to pay for whatimports from England by orders on her German customers., therefore, besides having to pay for her own imports,owes a debt to England on account of the third country, andmeans for both purposes must be derived from her exportable. She must therefore tender that produce to England onsufficiently favourable to force a demand equivalent todouble debt. Everything will take place precisely as if thecountry had bought German produce with her own goods, andthat produce to England in exchange for hers. There is andemand for English goods, for which German goods havefurnish the payment; and this can only be done by forcing andemand for them in England, that is, by lowering their. Thus an increase of demand for a country's exports in anycountry, enables her to obtain more cheaply even thosewhich she procures from other quarters. And conversely,increase of her own demand for any foreign commodity compels, caeteris paribus, to pay dearer for all foreign commodities.

The law which we have now illustrated, may be appropriately, the Equation of International Demand. It may be conciselyas follows. The produce of a country exchanges for theof other countries, at such values as are required inthat the whole of her exports may exactly pay for the wholeher imports. This law of International Values is but anof the more general law of Value, which we called theof Supply and Demand.(1*) We have seen that the value ofcommodity always so adjusts itself as to bring the demand toexact level of the supply. But all trade, either betweenor individuals, is an interchange of commodities, inthe things that they respectively have to sell, constitutetheir means of purchase: the supply brought by the onehis demand for what is brought by the other. So thatand demand are but another expression for reciprocal: and to say that value will adjust itself so as todemand with supply, is in fact to say that it willitself so as to equalize the demand on one side with theon the other.

5. To trace the consequences of this law of Internationalthrough their wide ramifications, would occupy more spacecan be here devoted to such a purpose. But there is one ofapplications which I will notice, as being in itself not, as bearing on the question which will occupy us innext chapter, and especially as conducing to the more fullclear understanding of the law itself.

We have seen that the value at which a country purchases acommodity, does not conform to the cost of production incountry from which the commodity comes. Suppose now a changethat cost of production; an improvement, for example, in theof manufacture. Will the benefit of the improvement beparticipated in by other countries? Will the commodity beas much cheaper to foreigners, as it is produced cheaper at? This question, and the considerations which must be enteredin order to resolve it, are well adapted to try the worth oftheory.

Let us first suppose, that the improvement is of a nature toa new branch of export: to make foreigners resort to thefor a commodity which they had previously produced at. On this supposition, the foreign demand for the productionsthe country is increased; which necessarily alters thevalues to its advantage, and to the disadvantage ofcountries, who, therefore, though they participate in theof the new product, must purchase that benefit by payingall the other productions of the country at a dearer ratebefore. How much dearer, will depend on the degree necessaryre-establishing, under these new conditions, the Equation ofDemand. These consequences follow in a very obviousfrom the law of international values, and I shall notspace in illustrating them, but shall pass to the morecase, of an improvement which does not create a newof export, but lowers the cost of production of somethingthe country already exported.

It being advantageous, in discussions of this complicated, to employ definite numerical amounts, we shall return tooriginal example. Ten yards of cloth, if produced in Germany,require the same amount of labour and capital as twentyof linen; but by the play of international demand, they canobtained from England for seventeen. Suppose now, that by aimprovement made in Germany, and not capable of beingto England, the same quantity of labour and capitalproduced twenty yards of linen, is enabled to produce. Linen falls one-third in value in the German market, aswith other commodities produced in Germany. Will it alsoone-third as compared with English cloth, thus giving to, in common with Germany, the full benefit of the? Or (ought we not rather to say), since the cost toof

obtaining linen was not regulated by the cost toof producing it, and since England, accordingly, did notthe entire benefit even of the twenty yards which Germanyhave given for ten yards of cloth, but only obtained— why should she now obtain more, merely because thislimit is removed ten degrees further off?

It is evident that in the outset, the improvement will lowervalue of linen in Germany, in relation to all otherin the German market, including, among the rest, evenimported commodity, cloth. If 10 yards of cloth previouslyfor 17 yards of linen, they will now exchange for halfmuch more, or 25 1/2 yards. But whether they will continue toso, will depend on the effect which this increased cheapnesslinen produces on the international demand. The demand forin England could scarcely fail to be increased. But itbe increased either in proportion to the cheapness, or in aproportion than the cheapness, or in a less proportion.

If the demand was increased in the same proportion with the, England would take as many times 25 1/2 yards of, as the number of times 17 yards which she took previously.would expend in linen exactly as much of cloth, or of theof cloth, as much in short of the collective incomeher people, as she did before. Germany on her part, wouldrequire, at that rate of interchange, the same quantitycloth as before, because it would in reality cost her exactlymuch; 25 1/2 yards of linen being now of the same value in her, as 17 yards were before. In this case, therefore, 10of cloth for 25 1/2 of linen is the rate of interchangeunder these new conditions would restore the equation ofdemand; and England would obtain linen one-thirdthan before, being the same advantage as was obtained by.

It might happen, however, that this great cheapening of linenincrease the demand for it in England in a greater ratiothe increase of cheapness; and that if she before wantedtimes 17 yards, she would now require more than 1000 times1/2 yards to satisfy her demand. If so, the equation ofdemand cannot establish itself at that rate of; to pay for the linen England must offer cloth onadvantageous terms; say, for example, 10 yards for 21 of; so that England will not have the full benefit of thein the production of linen, while Germany, into that benefit, will also pay less for cloth. But, it is possible that England might not desire to increaseconsumption of linen in even so great a proportion as that ofincreased cheapness; she might not desire so great a quantity1000 times 25 1/2 yards: and in that case Germany must force a, by offering more than 25 1/2 yards of linen for 10 of: linen will be cheapened in England in a still greaterthan in Germany; while Germany will obtain cloth on moreterms; and at a higher exchange value than before.

After what has already been said, it is not necessary tothe manner in which these results might be modifiedintroducing into the hypothesis other countries and other. There is a further circumstance by which they maybe modified. In the case supposed the consumers of Germanyhad a part of their incomes set at liberty by the increasedof linen, which they may indeed expend in increasingconsumption of that article, but which they may likewisein other articles, and among others, in cloth or othercommodities. This would be an additional element in thedemand, and would modify more or less the terms of.

Of the three possible varieties in the influence of cheapnessdemand, which is the more probable — that the demand would bemore than the cheapness, as much as the

cheapness, orthan the cheapness? This depends on the nature of thecommodity, and on the tastes of purchasers. When theis one in general request, and the fall of it priceit within reach of a much larger class of incomes than, the demand is often increased in a greater ratio than theof price, and a larger sum of money is on the whole expendedthe article. Such was the case with coffee, when its price wasby successive reductions of taxation; and such wouldbe the case with sugar, wine, and a large class ofwhich, though not necessaries, are largely consumed,in which many consumers indulge when the articles are cheapeconomize when they are dear. But it more frequently happenswhen a commodity falls in price, less money is spent in itbefore: a greater quantity is consumed, but not so great a. The consumer who saves money by the cheapness of the, will be likely to expend part of the saving inhis consumption of other things: and unless the lowattract a large class of new purchasers who were either notof the article at all, or only in small quantity and, a less aggregate sum will be expended on it.generally, therefore, the third of our three cases ismost probable: and an improvement in an exportable article isto be as beneficial (if not more beneficial) to foreign, as to the country where the article is produced.

6. Thus far had the theory of international values beenin the first and second editions of this work. Butcriticisms (chiefly those of my friend Mr William), and subsequent further investigation, have shown thatdoctrine stated in the preceding pages, though correct as farit goes, is not yet the complete theory of the subject matter.

It has been shown that the exports and imports between thecountries (or, if we suppose more than two, between eachand the world) must in the aggregate pay for each other,must therefore be exchanged for one another at such values asbe compatible with the equation of international demand.this, however, does not furnish the complete law of the, appears from the following consideration: thatdifferent rates of international value may all equallythe conditions of this law.

The supposition was, that England could produce 10 yards ofwith the same labour as 15 of linen, and Germany with thelabour as 20 of linen; that a trade was opened between thecountries; that England thenceforth confined her productioncloth, and Germany to linen; and, that if 10 yards of cloththenceforth exchange for 17 of linen, England and Germanyexactly supply each other's demand: that, for instance, ifwanted at that price 17,000 yards of linen, Germany wouldexactly the 10,000 yards of cloth, which, at that price,would be required to give for the linen. Under theseit appeared, that 10 cloth for 17 linen, would be,point of fact, the international values.

But it is quite possible that some other rate, such as 10for 18 linen, might also fulfil the conditions of theof international demand. Suppose that at this last rate,would want more linen than at the rate of 10 for 17, butin the ratio of the cheapness; that she would not want the,000 which she could now buy with 10,000 yards of cloth, butbe content with 17,500, for which she would pay (at the newof 10 for 18) 9722 yards of cloth. Germany, again, having todearer for cloth than when it could be bought at 10 for 17,probably reduce her consumption to an amount below 10,000, perhaps to the very same number, 9722. Under thesethe Equation of International Demand would still. Thus, the rate of 10 for 17, and that of 10 for 18, wouldsatisfy the Equation of Demand: and many other rates ofmight satisfy it in like manner. It is conceivablethe conditions might be equally satisfied by every numericalwhich could be supposed. There is still therefore a

portionindeterminateness in the rate at which the internationalwould adjust themselves; showing that the whole of thecircumstances cannot yet have been taken into.

7. It will be found that to supply this deficiency, we mustinto consideration not only, as we have already done, thedemanded in each country, of the imported commodities;also the extent of the means of supplying that demand, whichset at liberty in each country by the change in the directionits industry.

To illustrate this point it will be necessary to choose morenumbers than those which we have hitherto employed.it be supposed that in England 100 yards of cloth, previouslythe trade, exchanged for 100 of linen, but that in Germany 100cloth exchanged for 200 of linen. When the trade was opened,would supply cloth to Germany, Germany linen to England,an exchange value which would depend partly on the elementdiscussed, viz. the comparative degree in which, in thecountries, increased cheapness operates in increasing the; and partly on some other element not yet taken into. In order to isolate this unknown element, it will beto make some definite and invariable supposition into the known element. Let us therefore assume, that theof cheapness on demand conforms to some simple law,to both countries and to both commodities. As the simplestmost convenient, let us suppose that in both countries anyincrease of cheapness produces an exactly proportionalof consumption: or, in other words, that the valuein the commodity, the cost incurred for the sake ofit, is always the same, whether that cost affords aor a smaller quantity of the commodity.

Let us now suppose that England, previously to the trade,a million of yards of linen, which were worth at thecost of production, a million yards of cloth. By turningthe labour and capital with which that linen was produced, toproduction of cloth, she would produce for exportation ayards of cloth. Suppose that this is the exact quantityGermany is accustomed to consume. England can dispose ofthis cloth in Germany at the German price; she must consentto take a little less until she has driven the Germanfrom the market, but as soon as this is effected, shesell her million of cloth for two millions of linen; beingquantity that the German clothiers are enabled to make, bytheir whole labour and capital from cloth to linen.England would gain the whole benefit of the trade, andnothing. This would be perfectly consistent with theof international demand: since England (according to thein the preceding paragraph) now requires two millionslinen (being able to get them at the same cost at which sheobtained only one), while the prices in Germany notaltered, Germany requires as before exactly a million of, and can obtain it by employing the labour and capital setliberty from the production of cloth, in producing the twoof linen required by England.

Thus far we have supposed that the additional cloth whichcould make, by transferring to cloth the whole of thepreviously employed in making linen, was exactlyto supply the whole of Germany's existing demand. Butnext that it is more than sufficient. Suppose that whilecould make with her liberated capital a million yards offor exportation, the cloth which Germany had heretoforewas 800,000 yards only, equivalent at the German cost ofto 1,600,000 yards of linen. England therefore coulddispose of a whole million of cloth in Germany at the German. Yet she wants, whether cheap or dear (by our), as much linen as can be bought for a million of: and since this can only be obtained from Germany, or bymore expensive process of production at home, the holders ofmillion of cloth will be

forced by each other's competitionoffer it to Germany on any terms (short of the English cost of) which will induce Germany to take the whole. Whatthese would be, the supposition we have made enables usto define. The 800,000 yards of cloth which Germany, cost her the equivalent of 1,600,000 linen, and thatcost is what she is willing to expend in cloth,the quantity it obtains for her be more or less. England, to induce Germany to take a million of cloth, mustit for 1,600,000 of linen. The international values willbe 100 cloth for 160 linen, intermediate between the ratiothe costs of production in England and that of the costs ofin Germany: and the two countries will divide theof the trade, England gaining in the aggregate 600,000of linen, and Germany being richer by 200,000 additionalof cloth.

Let us now stretch the last supposition still farther, andthat the cloth previously consumed by Germany was notless than the million yards which England is enabled toby discontinuing her production of linen, but less in theproportion of England's advantage in the production, that, that Germany only required half a million. In this case, byaltogether to produce cloth, Germany can add a million,a million only, to her production of linen, and this million,the equivalent of what the half million previously cost, is all that she can be induced by any degree of cheapness toin cloth. England will be forced by her own competition toa whole million of cloth for this million of linen, just aswas forced in the preceding case to give it for 1,600,000.England could have produced at the same cost a million yardslinen for herself. England therefore derives, in this case, nofrom the international trade. Germany gains the whole;a million of cloth instead of half a million, at whathalf million previously cost her. Germany, in short, is inthird case, exactly in the same situation as England was infirst case; which may easily be verified by reversing the.

As the general result of the three cases, it may be laid downa theorem, that under the supposition we have made of a demandin proportion to the cheapness, the law of internationalwill be as follows: —

The whole of the cloth which England can make with thepreviously devoted to linen, will exchange for the wholethe linen which Germany can make with the capital previouslyto cloth.

Or, still more generally,

The whole of the commodities which the two countries canmake for exportation, with the labour and capitalout of employment by importation, will exchange againstanother.

This law, and the three different possibilities arising fromin respect to the division of the advantage, may begeneralized by means of algebraical symbols, as:Let the quantity of cloth which England can make with theand capital withdrawn from the production of linen, be =.

Let the cloth previously required by Germany (at the Germanof production) be = m.

Then n of cloth will always exchange for exactly 2m of linen.

Consequently if n = m, the whole advantage will be on theof England.

If n = 2m, the whole advantage will be on the side of.

If n be greater than m, but less than 2m, the two countriesshare the advantage; England getting 2m of linen where shegot only n; Germany getting n of cloth where she beforeonly m. It is almost superfluous to observe that the figure 2where it does, only because it is the figure whichthe advantage of Germany over England in linen asin cloth, and (what is the same thing) of England overin cloth as estimated in linen. If we had supposed thatGermany, before the trade, 100 of cloth exchanged for 1000of 200 of linen, then n (after the trade commenced) wouldexchanged for 10m instead of 2m. If instead of 1000 or 200had supposed only 150, n would have exchanged for only 3/2 m.(in fine) the cost value of cloth (as estimated in linen) in, exceeds the cost value similarly estimated in England,the ratio of p to q, then will n, after the opening of the, exchange for p/q m.(2*)

8. We have now arrived at what seems a law of International, of great simplicity and generality. But we have done sosetting out from a purely arbitrary hypothesis respecting thebetween demand and cheapness. We have assumed theirto be fixed, though it is essentially variable. We havethat every increase of cheapness produces an exactlyextension of demand; in other words, that the samevalue is laid out in a commodity whether it be cheapdear; and the law which we have investigated holds good onlythis hypothesis, or some other practically equivalent to it.us now, therefore, combine the two variable elements of the, the variations of each of which we have considered. Let us suppose the relation between demand andto vary, and to become such as would prevent the ruleinterchange laid down in the last theorem from satisfying theof the Equation of International Demand. Let it be, for instance, that the demand of England for linen isproportional to the cheapness, but that of Germany for, not proportional. To revert to the second of our three, the case in which England by discontinuing the productionlinen could produce for exportation a million yards of cloth,Germany by ceasing to produce cloth could produce an1,600,000 yards of linen. If the one of theseexactly exchanged for the other, the demand of Englandon our present supposition be exactly satisfied, for sheall the linen which can be got for a million yards of: but Germany perhaps, though she required 800,000 cloth atcost equivalent to 1,600,000 linen, yet when she can get aof cloth at the same cost, may not require the whole; or may require more than a million. First, let her notso much; but only as much as she can now buy for,500,000 linen. England will still offer a million for these,500,000; but even this may not induce Germany to take so mucha million; and if England continues to expend exactly the samecost on linen whatever be the price, she will have toto take for her million of cloth any quantity of linen(not less than a million) which may be requisite to induceto take a million of cloth. Suppose this to be 1,400,000. England has now reaped from the trade a gain not of,000 but only of 400,000 yards; while Germany, besides havingan extra 200,000 yards of cloth, has obtained it withseven-eighths of the labour and capital which she previouslyin supplying herself with cloth, and may expend thein increasing her own consumption of linen, or of anycommodity.

Suppose on the contrary that Germany, at the rate of acloth for 1,600,000 linen, requires more than a millionof cloth. England having only a million which she can givetrenching upon the quantity she previously reserved for, Germany must bid for the extra cloth at a higher rate160 for 100, until she reaches a rate (say 170 for 100)will either

bring down her own demand for cloth to theof a million, or else tempt England to part with some ofcloth she previously consumed at home.

Let us next suppose that the proportionality of demand to, instead of holding good in one country but not in the, does not hold good in either country, and that theis of the same kind in both; that, for instance,of the two increases its demand in a degree equivalent toincrease of cheapness. On this supposition, at the rate ofmillion cloth for 1,600,000 linen, England will not want soas 1,600,000 linen, nor Germany so much as a million cloth:if they fall short of that amount in exactly the same degree:England only wants linen to the amount of nine-tenths of,600,000 (1,440,000), and Germany only nine hundred thousand of, the interchange will continue to take place at the same. And so if England wants a tenth more than 1,600,000, anda tenth more than a million. This coincidence (which, itto be observed, supposes demand to extend cheapness in a, but not in an equal degree(3*)) evidently couldexist unless by mere accident: and in any other case, theof international demand would require a differentof international values.

The only general law, then, which can be laid down, is this.values at which a country exchanges its produce with foreigndepend on two things: first, on the amount andof their demand for its commodities, compiled withdemand for theirs; and secondly, on the capital which it hasspare, from the production of domestic commodities for its own. The more the foreign demand for its commoditiesits demand for foreign commodities, and the less capitalcan spile to produce for foreign markets, compiled with whatspile to produce for its markets, the more favourableit will be the terms of interchange: that is, the more it willof foreign commodities in return for a given quantity ofown.

But these two influencing circumstances are in realityto one: for the capital which a country has to spilethe production of domestic commodities for its own use, isproportion to its own demand for foreign commodities: whateverof its collective income it expends in purchases from, that same proportion of its capital is left without amarket for its productions. The new element, therefore,for the sake of scientific correctness we have introducedthe theory of international values, does not seem to makevery material difference in the practical result. It stillthat the countries which carry on their foreign trade onmost advantageous terms, are those whose commodities are mostdemand by foreign countries, and which have themselves thedemand for foreign commodities. From which, among other, it follows, that the richest countries, caeteris, gain the least by a given amount of foreign commerce:, having a greater demand for commodities generally, theylikely to have a greater demand for foreign commodities, andmodify the terms of interchange to their own disadvantage.aggregate gains by foreign trade, doubtless, are generallythan those of poorer countries, since they carry on aamount of such trade, and gain the benefit of cheapnessa larger consumption: but their gain is less on eacharticle consumed.

9. We now pass to another essential part of the theory of the. There are two senses in which a country obtainscheaper by foreign trade; in the sense of Value, andthe sense of Cost. It gets them cheaper in the first sense, byfalling in value relatively to other things: the sameof them exchanging, in the country, for a smallerthan before of the other produce of the country. Toto our original figures; in England, all consumers ofobtained, after the trade was opened, 17 or some greaterof yards for the same quantity of all other

things forthey before obtained only 15. The degree of cheapness, insense of the term, depends on the claws of International, so copiously illustrated in the preceding sections. Butthe other sense, that of Cost, a country gets a commoditywhen it obtains a greater quantity of the commodity withsame expenditure of labour and capital. In this sense of the, cheapness in a great measure depends upon a cause of anature: a country gets its imports cheaper, into the general productiveness of its domestic; to the general efficiency of its labour. The labour ofcountry may be, as a whole, much more efficient than that of: all or most of the commodities capable of being producedboth, may be produced in one at less absolute cost than in the; which, as we have seen, will not necessity prevent the twofrom exchanging commodities. The things which the morecountry will import from others, are of course those init is least superior; but by importing them it acquires,in those commodities, the same advantage which it possessesthe articles it gives in exchange for them. Thus the countriesobtain their own productions at least cost, also get theirat least cost.

This will be made still more obvious if we suppose twocountries. England sends cloth to Germany, and gives 10of it for 17 yards of linen, or for something else which inis the equivalent of those 17 yards. Another country, asexample France, does the same. The one giving 10 yards offor a certain quantity of German commodities, so must the: if, therefore, in England, these 10 yards are produced byhalf as much labour as that by which they are produced in, the linen or other commodities of Germany will cost toonly half the amount of labour which they will cost to. England would thus obtain her imports at less cost than, in the ratio of the greater efficiency of her labour inproduction of cloth: which might be taken, in the case, as an approximate estimate of the efficiency of hergenerally; since France, as well as England, by selectingas her article of export, would have shown that with herit was the commodity in which labour was relatively the most. It follows, therefore, that every country gets itsat less cost, in proportion to the general efficiency oflabour.

This proposition was first clearly seen and expounded by Mr.,(4*) but only as applicable to the importation of themetals. I think it important to point out that theholds equally true of all other imported commodities;further, that it is only a portion of the truth. For, in thesupposed, the cost to England of the linen which she payswith ten yards of cloth, does not depend solely upon the costherself of ten yards of cloth, but partly also upon how manyof linen she obtains in exchange for them. What her importsto her is a function of two variables; the quantity of hercommodities which she gives for them, and the cost of those. Of these, the last alone depends on the efficiencyher labour: the first depends on the law of international; that is, on the intensity and extensibility of thedemand for her commodities, compared with her demand forcommodities.

In the case just now supposed, of a competition betweenand France, the state of international values affectedcompetitors alike, since they were supposed to trade withsame country, and to export and import the same commodities.difference, therefore, in what their imports cost them,solely on the other cause, the unequal efficiency oflabour. They gave the same quantities; the difference couldbe in the cost of production. But if England traded towith cloth, and France with iron, the comparative demandGermany for those two commodities would bear a share inthe comparative cost, in labour and capital,

withEngland and France would obtain German products. If ironmore in demand in Germany than cloth, France would recover,that channel, part of her disadvantage; if less, herwould be increased. The efficiency, therefore, of a's labour, is not the only thing which determines even theat which that country obtains imported commodities — whilehas no share whatever in determining either their exchange, or, as we shall presently see, their price. :. Supra, book iii, chap. ii. section 4.. It may be asked, why we have supposed the number n to have asextreme limits, m and 2m (or p/q m)? why may not n be lessm, or greater than 2m; and if so, what will be the result?

This we shall now examine, and when we do so it will appearn is always, practically speaking, coded within these.

Suppose, for example, that n is less than m; or, reverting toformer figures, that the million yards of cloth, whichcan make, will not satisfy the whole of Germany'sexisting demand; that demand being (let us suppose) for,200,000 yards. It would then, at first sight, appear thatwould supply Germany with cloth up to the extent of a; that Germany would continue to supply herself with the200,000 by home production: that this portion of thewould regulate the price of the whole; that Englandwould be able permanently to sell her million of cloththe German cost of production (viz. for two millions of linen)would gain the whole advantage of the trade, Germany being nooff than before.

That such, however, would not be the practical result, willbe evident. The residuary demand of Germany for 200,000of cloth furnishes a resource to England for purposes oftrade of which it is still her interest to avail herself;though she has no more labour and capital which she canfrom linen for the production of this extra quantity of, there must be some other commodities in which Germany hasrelative advantage over her (though perhaps not so great as in): these she will now import, instead of producing, and theand capital formerly employed in producing them will beto cloth, until the required amount is made up. Iftransfer just makes up the 200,000 and no more, thisn will now be equal to m; England will sell the whole,200,000 at the German values; and will still gain the wholeof the trade. But if the transfer makes up more than200,000, England will have more cloth than 1,200,000 yards to; n will become greater than m, and England must part withof the advantage to induce Germany to take the surplus.the case which seemed at first sight to be beyond the, is transformed practically into a case either coincidingone of the limits or between them. And so with every otherwhich can be supposed. . The increase of demand from 800,000 to 900,000, and that frommillion to 1,440,000, are neither equal in themselves, nor bearequal proportion to the increase of cheapness. Germany'sfor cloth has increased one-eighth, while the cheapness isone-fourth. England's demand for linen is creased 44cent, while the cheapness is increased 60 per cent.. Three Lectures on the Cost of Obtaining Money.

The Principles of Political Economy

John Stuart Mill3:

Distribution

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Money, Considered as an Imported Commodity

1. The degree of progress which we have now made in theof Foreign Trade, puts it in our power to supply what wasdeficient in our view of the theory of Money; and, when completed, will in its turn enable us to conclude theof Foreign Trade.

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

In the discussion into which we are now about to enter, Iuse the terms Money and the Precious Metals. This may be done without leading to any error;having been shown that the value of money, when it consists ofprecious metals, or of a paper currency convertible into themdemand, is entirely governed by the value of the metals: from which it never permanently differs, except byexpense of coinage when this is paid by the individual andby the state.

Money is brought into a country in two different ways. It is(chiefly in the form of bullion) like any other, as being an advantageous article of commerce. It isimported in its other character of a medium of exchange, tosome debt due to the country, either for goods exported or onother account. There are other ways in which it may becasually; these are the two in which it is received inordinary course of business, and which determine its value.existence of these two distinct modes in which money flowsa country, while other commodities are habitually introducedin the first of these modes, occasions somewhat more ofand obscurity than exists in the case of other, and for this reason only is any special and minutenecessary .

2. In so far as the precious metals are imported in theway of commerce, their value must depend on the same, and conform to the same laws, as the value of any otherproduction. It is in this mode chiefly that gold anddiffuse themselves from the mining countries into allparts of the commercial world. They are the stapleof those countries, or at least are among their greatof regular export; and are shipped on speculation, insame manner as other exportable commodities. The quantity,, which a country (say England) will give of its own, for a certain quantity of bullion, will depend, if weonly two countries and two commodities, upon the demandEngland for bullion, compared with the demand in the mining(which we will call Brazil) for what England has to give.must exchange in such proportions as will leave nodemand on either side, to alter values by its. The bullion required by England must exactly pay forcottons or other English commodities required by Brazil. If,, we substitute for this simplicity the degree ofwhich really exists, the equation of internationalmust be established not between the bullion wanted inand the cottons or broadcloth wanted in Brazil, butthe whole of the imports of England and the

whole of her. The demand in foreign countries for English products,be brought into equilibrium with the demand in England forproducts of foreign countries; and all foreign commodities,among the rest, must be exchanged against Englishin such proportions, as will, by the effect they producethe demand, establish this equilibrium.

There is nothing in the peculiar nature or uses of themetals, which should make them an exception to theprinciples of demand. So far as they are wanted forof luxury or the arts, the demand increases with the, in the same irregular way as the demand for any other. So far as they are required for money, the demandwith the cheapness in a perfectly regular way, theneeded being always in inverse proportion to the value.is the only real difference, in respect to demand, betweenand other things; and for the present purpose it is aaltogether immaterial.

Money, then, if imported solely as a merchandize, will, likeimported commodities, be of lowest value in the countrieswhose exports there is the greatest foreign demand, and whichthemselves the least demand for foreign commodities. Totwo circumstances it is however necessary to add two, which produce their effect through cost of carriage. Theof obtaining bullion is compounded of two elements; thegiven to purchase it, and the expense of transport: oflast, the bullion countries will bear a part, (though anpart,) in the adjustment of international values. Theof transport is partly that of carrying the goods to thecountries, and partly that of bringing back the bullion;these items are influenced by the distance from the mines;the former is also much affected by the bulkiness of the. Countries whose exportable produce consists of the finer, obtain bullion, as well as all other foreign, caeteris paribus, at less expense than countries whichnothing but bulky raw produce.

To be quite accurate, therefore, we must say — The countriesexportable productions are most in demand abroad, andgreatest value in smallest bulk, which are nearest to the, and which have least demand for foreign productions, arein which money will be of lowest value, or in other words,which prices will habitually range the highest. If we arenot of the value of money, but of its cost, (that is,quantity of the country's labour which must be expended toit,) we must add to these four conditions of cheapness acondition, namely, "whose productive industry is the most." This last, however, does not at all affect the valuemoney, estimated in commodities: it affects the generaland facility with which all things, money andtogether, can be obtained.

Although, therefore, Mr Senior is right in pointing out theefficiency of English labour as the chief cause why themetals are obtained at less cost by England than by mostcountries, I cannot admit that it at all accounts for theirof less value; for their going less far in the purchase of. This, in so far as it is a fact, and not an, must be occasioned by the great demand in foreignfor the staple commodities of England, and theunbulky character of those commodities, compared withcorn, wine, timber, sugar, wool, hides, tallow, hemp, flax,, raw cotton, &c., which form the exports of othercountries. These two causes will account for ahigher range of general prices in England than, notwithstanding the counteracting influence of her owndemand for foreign commodities. I am, however, strongly ofthat the high prices of commodities, and low purchasingof money in England, are more apparent than real. Food,, is somewhat dearer; and food composes so large a portionthe expenditure when the income is small and the family large,to such families England is a dear country. Services, also,most descriptions, are dearer than in the other

countries of, from the less costly mode of living of the poorer classesthe Continent. But manufactured commodities (except most ofin which good taste is required) are decidedly cheaper; orbe so, if buyers would be content with the same quality ofand of workmanship. What is called the dearness ofin England, is mainly an affair not of necessity but ofcustom; it being thought imperative by all classes inabove the condition of a day-labourer, that the thingsconsume should either be of the same quality with those usedmuch richer people, or at least should be as nearly asundistinguishable from them in outward appearance.

3. From the preceding considerations, it appears that thosegreatly in error who contend that the value of money, inwhere it is an imported commodity, must be entirelyby its value in the countries which produce it; andbe raised or lowered in any permanent manner unless somehas taken place in the cost of production at the mines. Oncontrary, any circumstance which disturbs the equation ofdemand with respect to a particular country, notmay, but must, affect the value of money in that country —value at the mines remaining the same. The opening of a newof export trade from England; an increase in the foreignfor English products, either by the natural course of, or by the abrogation of duties; a check to the demand infor foreign commodities, by the laying on of importin England or of export duties elsewhere; these and allevents of similar tendency, would make the imports of(bullion and other things taken together) no longer anfor the exports; and the countries which take herwould be obliged to offer their commodities, and bullionthe rest, on cheaper terms, in order to re-establish theof demand: and thus England would obtain money cheaper,would acquire a generally higher range of prices. Incidentsreverse of these would produce effects the reverse — wouldprices; or, in other words, raise the value of themetals. It must be observed, however, that money wouldthus raised in value only with respect to home commodities: into all imported articles it would remain as before,their values would be affected in the same way and in thedegree with its own. A country which, from any of the causes, gets money cheaper, obtains all its other importslikewise.

It is by no means necessary that the increased demand forcommodities: which enables England to supply herself withat a cheaper rate, should be a demand in the mining. England might export nothing whatever to those, and yet might be the country which obtained bullionthem on the lowest terms, provided there were a sufficientof demand in other foreign countries for English goods,would be paid for circuitously, with gold and silver frommining countries. The whole of its exports are what a countryagainst the whole of its imports, and not its exportsimports to and from any one country; and the general foreignfor its productions will determine what equivalent it mustfor imported goods, in order to establish an equilibriumits sales and purchases generally; without regard to theof a similar equilibrium between it and any country.

The Principles of Political Economy

John Stuart Mill3:

Distribution

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the Foreign Exchanges

1. We have thus far considered the precious metals as a, imported like other commodities in the common coursetrade, and have examined what are the circumstances whichin that case determine their value. But those metals areimported in another character, that which belongs to them asmedium of exchange; not as an article of commerce, to he soldmoney, but as themselves money, to pay a debt, or effect aof property. It remains to consider whether theof gold and silver to be transported from country tofor such purposes, in any way modifies the conclusions wealready arrived at, or places those metals under a differentof value from that to which, in common with all othercommodities, they would be subject if internationalwere an affair of direct barter.

Money is sent from one country to another for various: such as the payment of tributes or subsidies;of revenue to or from dependencies, or of rents orincomes to their absent owners; emigration of capital, orof it for foreign investment. The most usual, however, is that of payment for goods. To show in whatmoney actually passes from country to country foror any of the other purposes mentioned, it is necessaryto state the nature of the mechanism by whichtrade is carried on, when it takes place not bybut through the medium of money.

2. In practice, the exports and imports of a country not onlynot exchanged directly against each other, but often do notpass through the same hands. Each is separately bought andfor with money. We have seen, however, that, even in thecountry, money does not actually pass from hand to hand eachthat purchases are made with it, and still less does thisbetween different countries. The habitual mode of payingreceiving payment for commodities, between country and, is by bills of exchange.

A merchant in England, A, has exported English commodities,them to his correspondent B in France. Anotherin France, C, has exported French commodities, supposeequivalent value, to a merchant D in England. It is evidentlythat B in France should send money to A in England,that D in England should send an equal sum of money to C in. The one debt may be applied to the payment of the other,the double cost and risk of carriage be thus saved. A draws aon B for the amount which B owes to him: D, having an equalto pay in France, buys this bill from A, and sends it to, who, at the expiration of the number of days which the billto run, presents it to B for payment. Thus the debt due fromto England, and the debt due from England to France, arepaid without sending an ounce of gold or silver from oneto the other.

In this statement, however, it is supposed, that the sum ofdebts due from France to England, and the sum of those dueEngland to France, are equal; that each country has exactlysame number of ounces of gold or silver to pay and to. This implies (if we exclude for the present any otherpayments than those occurring in the course of), that the exports

and imports exactly pay for one, or in other words, that the equation of internationalis established. When such is the fact, the internationalare liquidated without the passage of any money fromcountry to the other. But if there is a greater sum due fromto France, than is due from France to England, or vice, the debts cannot be simply written off against one. After the one has been applied, as far as it will go,covering the other, the balance must be transmitted inprecious metals. In point of fact, the merchant who has theto pay, will even then pay for it by a bill. When a persona remittance to make to a foreign country, he does notsearch for some one who has money to receive from that, and ask him for a bill of exchange. In this as in otherof business, there is a class of middlemen or brokers,bring buyers and sellers together, or stand between them,bills from those who have money to receive, and sellingto those who have money to pay. When a customer comes to afor a bill on Paris or Amsterdam, the broker sells to him,the bill he may himself have bought that morning from a, perhaps a bill on his own correspondent in the foreign: and to enable his correspondent to pay, when due, all thehe has granted, he remits to him all those which he haSand has not resold. In this manner these brokers take uponthe whole settlement of the pecuniary transactionsdistant places, being remunerated by a small commissionpercentage on the amount of each bill which they either sellbuy. Now, if the brokers find that they are asked for bills onone part, to a greater amount than bills are offered to themthe other, they do not on this account refuse to give them;since, in that case, they have no means of enabling theon whom their bills are drawn, to pay them when, except by transmitting part of the amount in gold or silver,require from those to whom they sell bills an additional, sufficient to cover the freight and insurance of the goldsilver, with a profit sufficient to compensate them for theirand for the temporary occupation of a portion of their. This premium (as it is called) the buyers are willing to, because they must otherwise go to the expense of remittingprecious metals themselves, and it is done cheaper by thosemake doing it a part of their especial business. But thoughsome of those who have a debt to pay would have actually tomoney, all will be obliged, by each other's competition, tothe premium; and the brokers are for the same reason obligedpay it to those whose bills they buy. The reverse of all this, if on the comparison of exports and imports, the, instead of having a balance to pay, has a balance to. The brokers find more bills offered to them, than areto cover those which they are required to grant. Billsforeign countries consequently fall to a discount; and theamong the brokers, which is exceedingly active,them from retaining this discount as a profit for, and obliges them to give the benefit of it to thosebuy the bills for purposes of remittance.

Let us suppose that all countries had the same currency, asthe progress of political improvement they one day will have:, as the most familiar to the reader, though not the best, letsuppose this currency to be the English. When England had thenumber of pounds sterling to pay to France, which France hadpay to her, one set of merchants in England would want bills,another set would have bills to dispose of, for the very sameof pounds sterling; and consequently a bill on France forl. would sell for exactly 100l., or, in the phraseology of, the exchange would be at par. As France also, on this, would have an equal number of pounds sterling to payto receive, bills on England would be at par in France,bills on France were at par in England.

If, however, England had a larger sum to pay to France thanreceive from her, there would be persons requiring bills onfor a greater number of pounds sterling than there weredrawn by persons to whom money was due. A bill on France100l. would then sell for more than 100l., and biLls would beto be at a premium. The premium, however, could not exceedcost and risk of making the remittance in gold, together withtrifling profit; because if it did, the debtor wouLd send theitself, in preference to buying the bill.

If, on the contrary, England had more money to receive fromthan to pay, there would be bills offered for a greaterof pounds than were wanted for remittance, and the pricebills would fall below par: a bill for 100l. might be boughtsomewhat less than 100l., and bills would be said to be at a.

When England has more to pay than to receive, France has morereceive than to pay, and vice versa. When, therefore, in, bills on France bear a premium, then, in France, billsEngland are at a discount: and when bills on France are at ain England, bills on England are at a premium in France.they are at par in either country, they are so, as we haveseen, in both.

Thus do matters stand between countries, or places, whichthe same currency. So much of barbarism, however, stillin the transactions of the most civilized nations, thatall independent countries choose to assert theirby having, to their own inconvenience and that ofneighbours, a peculiar currency of their own. To ourpurpose this makes no other difference, than that insteadspeaking of equal sums of money, we have to speak ofsums. By equivalent sums, when both currencies areof the same metal, are meant sums which contain exactlysame quantity of the metal, in weight and fineness; but when,in the case of France and England, the metals are different,is meant is that the quantity of gold in the one sum, andquantity of silver in the other, are of the same value in themarket of the world: there being no material differenceone place and another in the relative value of these. Suppose 25 francs to be (as within a trifling fraction it) the equivalent of a pound sterling. The debts and credits oftwo countries would be equal, when the one owed as many timesfrancs, as the other owed pounds. When this was the case, aon France for 2500 francs would be worth in England 100l.,a bill on England for 100l. would be worth in France 2500. The exchange is then said to be at par: and 25 francs (in25 francs and a trifle more) (1*) is called the par ofwith France. When England owed to France more than theof what France owed to her, a bill for 2500 francsbe at a premium, that is, would be worth more than 100l.France owed to England more than the equivalent of whatowed to France, a bill for 2500 francs would be worththan 100l., or would be at a discount.

When bills on foreign countries are at a premium, it isto say that the exchanges are against the country, orto it. In order to understand these phrases, we mustnotice of what "the exchange," in the language of merchants,means. It means the power which the money of the countryof purchasing the money of other countries. Supposing 25to be the exact par of exchange, then when it requiresthan 100l. to buy a bill for 2500 francs, 100l. of Englishare worth less than their real equivalent of French money:this is called an exchange unfavourable to England. The onlyin England, however, to whom it is really unfavourable,those who have money to pay in France; for they come into themarket as buyers, and have to pay a premium : but to thosehave money to receive in France, the same state of things is; for they come as sellers, and receive the premium.premium,

however, indicates that a balance is due by England,might have to be eventually liquidated in the precious: and since, according to the old theory, the benefit of aconsisted in bringing money into the country, thisintroduced the practice of calling the exchangewhen it indicated a balance to receive, andwhen it indicated one to pay: and the phrases intended to maintain the prejudice.

3. It might be supposed at first sight that when the exchangeunfavourable, or in other words, when bills are at a premium,premium must alWays amount to a full equivalent for the costtransmitting money: since, as there is really a balance to, and as the full cost must therefore be incurred by some ofwho have remittances to make, their competition will compelto submit to an equivalent sacrifice. And such wouldbe the case, if it were always necessary that whateverdestined to be paid should be paid immediately. Theof great and immediate foreign payments sometimesa most startling effect on the exchanges.(2*) But aexcess of imports above exports, or any other small amountdebt to be paid to foreign countries, does not usually affectexchanges to the full extent of the cost and risk ofbullion. The length of credit allowed, generally, on the part of some of the debtors, a postponement of, and in the mean time the balance may turn the other way,restore the equality of debts and credits without any actualof the metals. And this is the more likely to, as there is a self-adjusting power in the variations ofexchange itself. Bills are at a premium because a greatervalue has been imported than exported. But the premium isan extra profit to those who export. Besides the priceobtain for their goods, they draw for the amount and gainpremium. It is, on the other hand, a diminution of profit towho import. Besides the price of the goods, they have toa premium for remittance. So that what is called anexchange is an encouragement to export, and ato import. And if the balance due is of small, and is the consequence of some merely casual disturbancethe ordinary course of trade, it is soon liquidated in, and the account adjusted by means of bills, withouttransmission of any bullion. Not so, however, when the excessimports above exports, which has made the exchange, arises from a permanent cause. In that case, whatthe equilibrium must have been the state of prices, andcan only be restored by acting on prices. It is impossibleprices should be such as to invite to an excess of imports,yet that the exports should be kept permanently up to theby the extra profit on exportation derived from theon bills; for if the exports were kept up to the imports,would not be at a premium, and the extra profit would not. It is through the prices of commodities that themust be administered.

Disturbances, therefore, of the equilibrium of imports and, and consequent disturbances of the exchange, may beas of two classes; the one casual or accidental,, if not on too large a scale, correct themselves throughpremium on bills, without any transmission of the precious; the other arising from the general state of prices, whichbe corrected without the subtraction of actual money fromcirculation of one of the counties, or an annihilation ofequivalent to it; since the mere transmission of bullion(as distinguished from money), not having any effect on prices,of no avail to abate the cause from which the disturbance.

It remains to observe, that the exchanges do not depend onbalance of debts and credits with each country separately,with all counties taken together. England may owe a balancepayments to France; but it does not follow that the exchangeFrance will be against

England, and that bills on Francebe at a premium; because a balance may be due to EnglandHolland or Hamburg, and she may pay her debts to France withon those places; which is technically called arbitration of. There is some little additional expense, partlyand partly loss of interest, in settling debts in thismanner, and to the extent of that small difference thewith one country may vary apart from that with others;in the main, the exchanges with all foreign countries vary, according as the country has a balance to receive or toon the general result of its foreign transactions. :. Written before the change in the relative value of the twoproduced by the gold discoveries. The par of exchangegold and silver currencies is now variable, and no oneforesee at what point it will ultimately rest. . On the news of Bonaparte's landing from Elba, the price ofadvanced in one day as much as ten per cent. Of course thiswas not a mere equivalent for cost of carriage, since theof such an article as gold, even with the addition of war, could never have amounted to so much. This great pricean equivalent not for the difficulty of sending gold, but foranticipated difficulty of procuring it to send; thebeing that there would be such immense remittances toContinent in subsidies and for the support of armies, aspress hard on the stock of bullion in the country (whichthen entirely denuded of specie), and this, too, in a shorterthan would allow of its being replenished. Accordingly theof bullion rose likewise, with the same suddenness. It isnecessary to say that this took place during the Bank. In a convertible state of the currency, no suchcould have occurred until the Bank stopped payment.

The Principles of Political Economy

John Stuart Mill

3:

Distribution

21

the Distribution of the Precious Metals Through the Commercial

1. Having now examined the mechanism by which the commercialbetween nations are actually conducted, we have nextinquire whether this mode of conducting them makes anyin the conclusions respecting international values,we previously arrived at on the hypothesis of barter.

The nearest analogy would lead us to presume the negative. Wenot find that the intervention of money and its substitutesany difference in the law of value as applied to adjacent. Things which would have been equal in value if the modeexchange had been by barter, are worth equal sums of money.introduction of money is a mere addition of one more, of which the value is regulated by the same laws asof all other commodities. We shall not be surprised,, if we find that international values also areby the same causes under a money and bill system, aswould be under a system of barter; and that money has littledo in the matter, except to furnish a convenient mode ofvalues.

All interchange is, in substance and effect, barter: whoevercommodities for money, and with that money buys other, really buys those goods with his own commodities. And sonations: their trade is a mere exchange of exports for: and whether money is employed or not, things are only inpermanent state when the exports and imports exactly payeach other. When this is the case, equal sums of money arefrom each country to the other, the debts are settled by, and there is no balance to be paid in the precious metals.trade is in a state like that which is called in mechanics aof stable equilibrium.

But the process by which things are brought back to thiswhen they happen to deviate from it, is, at least, not the same in a barter system and in a money system.the first, the country which wants more imports than itswill pay for, must offer its exports at a cheaper rate,the sole means of creating a demand for them sufficient toestablish the equilibrium. When money is used, the countryto do a thing totally different. She takes the additionalat the same price as before, and as she exports no, the balance of payments turns against her; thebecomes unfavourable, and the difference has to be paidmoney. This is in appearance a very distinct operation fromformer. Let us see if it differs in its essence, or only inmechanism.

Let the country which has the balance to pay be England, andcountry which receives it, France. By this transmission ofprecious metals, the quantity of the currency is diminishedEngland, and increased in France. This I am at liberty to. As we shall see hereafter, it would be a very erroneousif made in regard to all payments of international. A balance which has only to be paid once, such as themade for an extra importation of corn in a season of, may be paid from hoards, or from the reserves of bankers,acting on the circulation. But we are now supposing thatis an excess of imports over exports, arising

from the factthe equation of international demand is not yet established:there is at the ordinary prices a permanent demand infor more French goods than the English goods required inat the ordinary prices will pay for. When this is the, if a change were not made in the prices, there would be arenewed balance to be paid in money. The importsto be permanently diminished, or the exports to be; which can only be accomplished through prices; and, even if the balances are at first paid from hoards, or byexportation of bullion, they will reach the circulation at, for until they do, nothing can stop the drain.

When, therefore, the state of prices is such that theof international demand cannot establish itself, therequiring more imports than can be paid for by the; it is a sign that the country has more of the preciousor their substitutes, in circulation, than can permanently, and must necessarily part with some of them before thecan be restored. The currency is accordingly contracted:fall, and among the rest, the prices of exportable; for which, accordingly, there arises, in foreign, a greater demand: while imported commodities haverisen in price, from the influx of money into foreign, and at all events have not participated in the general. But until the increased cheapness of English goods inducescountries to take a greater pecuniary value, or until thedearness (positive or comparative) of foreign goodsEngland take a less pecuniary value, the exports of Englandbe no nearer to paying for the imports than before, and theof the precious metals which had begun to flow out of, will still flow on. This efflux will continue, until theof prices in England brings within reach of the foreignsome commodity which England did not previously send; or until the reduced price of the things which she did, has forced a demand abroad for a sufficient quantity to paythe imports, aided, perhaps, by a reduction of the Englishfor foreign goods, through their enhanced price, eitheror comparative.

Now this is the very process which took place on our originalof barter. Not only, therefore, does the tradenations tend to the same equilibrium between exports and, whether money is employed or not, but the means by whichequilibrium is established are essentially the same. Thewhose exports are not sufficient to pay for her imports,them on cheaper terms, until she succeeds in forcing thedemand: in other words, the Equation of International, under a money system as well as under a barter system, islaw of international trade. Every country exports and importsvery same things, and in the very same quantity, under thesystem as under the other. In a barter system, the tradeto the point at which the sum of the imports exactlyfor the sum of the exports: in a money system, itto the point at which the sum of the imports and theof the exports exchange for the same quantity of money. Andthings which are equal to the same thing are equal to one, the exports and imports which are equal in money price,, if money were not used, precisely exchange for one. (1*)

2. It thus appears that the law of international values, and,, the division of the advantages of trade among thewhich carry it on, are the same, on the supposition of, as they would be in a state of barter. In international,in ordinary domestic interchanges, money is to commerce onlyoil is to machinery, or railways to locomotion-a contrivancediminish friction. In order still further to test these, let us proceed to re-examine, on the supposition of, a question which we have already investigated on theof barter, namely, to what extent the benefit of anin the production of an exportable article, isin by the countries importing it.

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

The first effect is that the article falls in price, and aarises for it abroad. This new exportation disturbs the, turns the exchanges, money flows into the country (whichshall suppose to be England), and continues to flow untilrise. This higher range of prices will somewhat check thein foreign countries for the new article of export; andthe demand which existed abroad for the other thingsEngland was in the habit of exporting. The exports willbe diminished; while at the same time the English public,more money, will have a greater power of purchasingcommodities. If they make use of this increased power of, there will be an increase of imports: and by this, andcheck to exportation, the equilibrium of imports and exportsbe restored. The result to foreign countries will be, thathave to pay dearer than before for their other imports, andthe new commodity cheaper than before, but not so muchas England herself does. I say this, being well awarethe article would be actually at the very same price (costcarriage excepted) in England and in other countries. The, however, of the article is not measured solely by theprice, but by that price compared with the money incomes ofconsumers. The price is the same to the English and to theconsumers; but the former pay that price from moneywhich have been increased by the new distribution of themetals; while the latter have had their money incomesdiminished by the same cause. The trade, therefore, hasimparted to the foreign consumer the whole, but only a, of the benefit which the English consumer has derivedthe improvement; while England has also benefited in theof foreign commodities. Thus, then, any industrialwhich leads to the opening of a new branch of export, benefits a country not only by the cheapness of thein which the improvement has taken place, but by acheapening of all imported products.

Let us now change the hypothesis, and suppose that the, instead of creating a new export from England,an existing one. When we examined this case on theof barter, it appeared to us that the foreignmight either obtain the same benefit from theas England herself, or a less benefit, or even abenefit, according to the degree in which the consumptionthe cheapened article is calculated to extend itself as thediminishes in price. The same conclusions will be foundon the supposition of money.

Let the commodity in which there is an improvement, be cloth.first effect of the improvement is that its price falls, andis an increased demand for it in the foreign market. Butdemand is of uncertain amount. Suppose the foreign consumersincrease their purchases in the exact ratio of the cheapness,in other words, to lay out in cloth the same sum of money as, the same aggregate payment as before will be due fromcountries to England; the equilibrium of exports andwill remain undisturbed, and foreigners will obtain theadvantage of the increased cheapness of cloth. But if thedemand for cloth is of such a character as to increase ingreater ratio than the cheapness, a larger sum than formerlybe due to England for cloth, and when paid will raiseprices, the price of cloth included; this rise, however,affect only the foreign purchaser, English incomes beingin a corresponding proportion; and the foreign consumerthus derive a less advantage than England from the. If, on the contrary, the cheapening of cloth doesextend the foreign demand for it in a

proportional degree, asum of debts than before will be due to England for cloth,there will be the usual sum of debts due from England tocountries; the balance of trade will turn against, money will be exported, prices (that of cloth included)fall, and cloth will eventually be cheapened to the foreignin a still greater ratio, than the improvement hasit to England. These are the very conclusions which weon the hypothesis of barter.

The result of the preceding discussion cannot be betterup than in the words of Ricardo.(2*) "Gold and silverbeen chosen for the general medium of circulation, they, by the competition of commerce, distributed in suchamongst the different countries of the world as tothemselves to the natural traffic which would takeif no such metals existed, and the trade between countriespurely a trade of barter." Of this principle, so fertile in, previous to which the theory of foreign trade wasunintelligible chaos, Mr. Ricardo, though he did not pursue itits ramifications, was the real originator. No writer whohim appears to have had a glimpse of it: and few arewho even since his time have had an adequate conception ofscientific value.

3. It is now necessary to inquire, in what manner this law ofdistribution of the precious metals by means of the, affects the exchange value of money itself; and how itwith the law by which we found that the value of money iswhen imported as a mere article of merchandize. Foris here a semblance of contradiction, which has, I think,more than anything else to make some distinguishedeconomists resist the evidence of the preceding. Money, they justly think, is no exception to thelaws of value; it is a commodity like any other, and itsor natural value must depend on the cost of producing, orleast of obtaining it. That its distribution through the, therefore, and its different value in different places,be liable to be altered, not by causes affecting itself,by a hundred causes unconnected with it; by everything whichthe trade in other commodities, so as to derange theof exports and imports; appears to these thinkers aaltogether inadmissible.

But the supposed anomaly exists only in semblance. The causesbring money into or carry it out of a country through the, to restore the equilibrium of trade, and which therebyits value in some countries and lower it in others, are thesame causes on which the local value of money would depend,it were never imported except as a merchandize, and neverdirectly from the mines. When the value of money in ais permanently lowered by an influx of it through theof trade, the cause, if it is not diminished cost of, must be one of those causes which compel a new, more favourable to the country, of the equation ofdemand: namely, either an increased demand abroadher commodities, or a diminished demand on her part for thoseforeign countries. Now an increased foreign demand for theof a country, or a diminished demand in the countryimported commodities, are the very causes which, on theprinciples of trade, enable a country to purchase all, and consequently the precious metals, at a lower value.is therefore no contradiction, but the most perfectin the results of the two different modes in which themetals may be obtained. When money flows from country toin consequence of changes in the international demand for, and by so doing alters its own local value, itrealizes, by a more rapid process, the effect which wouldtake place more slowly, by an alteration in thebreadth of the streams by which the precious metals flowdifferent regions of the earth from the mining countries. Aswe before saw that the use of money as a medium ofdoes not in the least alter the law on which the valuesother things, either in the same country or internationally,, so neither does it alter

the law of the value of themetal itself: and there is in the whole doctrine ofvalues as now laid down, a unity and harmony whicha strong collateral presumption of truth.

4. Before closing this discussion, it is fitting to point outwhat manner and degree the preceding conclusions are affectedthe existence of international payments not originating in, and for which no equivalent in either money oris expected or received; such as a tribute, orof rent to absentee landlords, or of interest tocreditors, or a government expenditure abroad, such asincurs in the management of some of her colonial.

To begin with the case of barter. The supposed annualbeing made in commodities, and being exports forthere is to be no return, it is no longer requisite thatimports and exports should pay for one another: on the, there must be an annual excess of exports over imports,to the value of the remittance. If, before the countryliable to the annual payment, foreign commerce was in itsstate of equilibrium, it will now be necessary for theof effecting the remittance, that foreign countriesbe induced to take a greater quantity of exports than: which can only be done by offering those exports onterms, or in other words, by paying dearer for foreign. The international values will so adjust themselveseither by greater exports, or smaller imports, or both, theexcess on the side of exports will be brought about;this excess will become the permanent state. The result isa country which makes regular payments to foreign countries,losing what it pays, loses also something more, by theadvantageous terms on which it is forced to exchange itsfor foreign commodities.

The same results follow on the supposition of money. Commercesupposed to be in a state of equilibrium when theremittances begin, the first remittance is necessarilyin money. This lowers prices in the remitting country, andthem in the receiving. The natural effect is that moreare exported than before, and fewer imported, and, on the score of commerce alone, a balance of money will bedue from the receiving to the paying country. When thethus annually due to the tributary country becomes equal toannual tribute or other regular payment due from it, notransmission of money takes place; the equilibrium ofand imports will no longer exist, but that of payments; the exchange will be at par, the two debts will be set offone another, and the tribute or remittance will bepaid in goods. The result to the interest of the twowill be as already pointed out: the paying country willa higher price for all that it buys from the receiving, while the latter, besides receiving the tribute, obtainsexportable produce of the tributary country at a lower price.:. The subjoined extract from the separate Essay previouslyto, will give some assistance in following the course ofphenomena. It is adapted to the imaginary case used forthroughout that Essay, the case of a trade betweenand Germany in cloth and linen.

"We may, at first, make whatever supposition we will withto the value of money. Let us suppose, therefore, thatthe opening of the trade, the price of cloth is the sameboth countries, namely, six shillings per yard. As ten yardscloth were supposed to exchange in England for 15 yards of, in Germany for 20, we must suppose that linen is sold inat four shillings per yard, in Germany at three. Cost ofand importer's profit are left, as before, out of.

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

"The efflux of money from England, and its influx into, will raise money prices in the latter country, and lowerin the former. Linen will rise in Germany above threeper yard, and cloth above six shillings. Linen in, being imported from Germany, will (since cost ofis not reckoned) sink to the same price as in that, while cloth will fall below six shillings. As soon asprice of cloth is lower in England than in Germany, it willto be exported, and the price of cloth in Germany will fallwhat it is in England. As long as the cloth exported does notto pay for the linen imported, money will continue tofrom England into Germany, and prices generally willto fall in England and rise in Germany. By the fall,, of cloth in England, cloth will fall in Germany also,the demand for it will increase. By the rise of linen in, linen must rise in England also, and the demand for itdiminish. As cloth fell in price and linen rose, there wouldsome particular price of both articles at which the clothand the linen imported would exactly pay for each other.this point prices would remain, because money would then ceasemove out of England into Germany. What this point might be,entirely depend upon the circumstances and inclinations ofpurchasers on both sides. If the fall of cloth did not muchthe demand for it in Germany, and the rise of linen diddiminish very rapidly the demand for it in England, muchmust pass before the equilibrium is restored; cloth wouldvery much, and linen would rise, until England, perhaps, hadpay nearly as much for it as when she produced it for herself.if, on the contrary, the fall of cloth caused a very rapidof the demand for it in Germany, and the rise of linenGermany reduced very rapidly the demand in England from whatwas under the influence of the first cheapness produced by theof the trade; the cloth would very soon suffice to paythe linen, little money would pass between the two countries,England would derive a large portion of the benefit of the. We have thus arrived at precisely the same conclusion, inthe employment of money, which we found to hold undersupposition of barter.

"In what shape the benefit accrues to the two nations fromtrade is clear enough. Germany, before the commencement oftrade, paid six shillings per yard for broadcloth: she nowit at a lower price. This, however, is not the whole ofadvantage. As the money-prices of all her other commoditiesrisen, the money-incomes of all her producers have. This is no advantage to them in buying from each, because the price of what they buy has risen in the samewith their means of paying for it: but it is an advantagethem in buying anything which has not risen, and, still more,which has fallen. They, therefore, benefit as consumerscloth, not merely to the extent to which cloth has fallen, butto the extent to which other prices have risen. Suppose thatis one-tenth. The same proportion of their [48 these]incomes as before, will suffice to supply their other; and the remainder, being increased one-tenth in amount,enable them to purchase one-tenth more cloth than before,though cloth had not fallen: but it has fallen; so that theydoubly gainers. They purchase the same quantity with less, and have more to expend upon their other wants.

"In England, on the contrary, general money-prices have. Linen, however, has fallen more than the rest, havinglowered in price by importation from a country where it was; whereas the others have fallen only from the consequentof money. Notwithstanding,

therefore, the general fall ofprices, the English producers will be exactly as they wereall other respects, while they will gain as purchasers of.

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

In practice, the cloth and the linen would not, as here, be at the same price in England and in Germany: eachbe dearer in money-price in the country which imported thanthat which produced it, by the amount of the cost of carriage,with the ordinary profit on the importer's capital foraverage length of time which elapsed before the commoditybe disposed of. But it does not follow that each countrythe cost of carriage of the commodity it imports; for theof this item to the price may operate as a greater checkdemand on one side than on the other; and the equation ofdemand, and consequent equilibrium of payments, maybe maintained. Money would then flow out of one country intoother, until, in the manner already illustrated, thewas restored: and, when this was effected, onewould be paying more than its own cost of carriage, andother less. . Principles of Political Economy and Taxation, 3rd. ed. p. 143.

The Principles of Political Economy

John Stuart Mill3:

Distribution

22

of the Currency on the Exchanges and on Foreign Trade

1. In our inquiry into the laws of international trade, wewith the principles which determine internationaland international values on the hypothesis of barter.next showed that the introduction of money as a medium of, makes no difference in the laws of exchanges and ofbetween country and country, no more than betweenand individual: since the precious metals, under theof those same laws, distribute themselves in suchamong the different countries of the world, as tothe very same exchanges to go on, and at the same values,would be the case under a system of barter. We lastlyhow the value of money itself is affected, by thosein the state of trade which arise from alterationsin the demand and supply of commodities, or in their costproduction. It remains to consider the alterations in theof trade which originate not in commodities but in money.

Gold and silver may vary like other things, though they areso likely to vary as other things, in their cost of. The demand for them in foreign countries may also. It may increase, by augmented employment of the metals forof art and ornament, or because the increase ofand of transactions has created a greater amount ofto be done by the circulating medium. It may diminish,the opposite reasons; or from the extension of theexpedients by which the use of metallic money isdispensed with. These changes act upon the tradeother countries and the mining countries, and upon theof the precious metals, according to the general laws ofvalue of imported commodities: which have been set forth inprevious chapters with sufficient fulness.

What I propose to examine in the present chapter, is notcircumstances affecting money, which alter the permanentof its value; but the effects produced ontrade by casual or temporary variations in theof money, which have no connexion with any causes affectingpermanent value. This is a subject of importance, on accountits bearing upon the practical problem which has excited sodiscussion for sixty years past, the regulation of the.

2. Let us suppose in any country a circulating medium purely, and a sudden casual increase made to it; for example,bringing into circulation hoards of treasure, which had beenin a previous period of foreign invasion or internal. The natural effect would be a rise of prices. Thischeck exports, and encourage imports; the imports wouldthe exports, the exchanges would become unfavourable, andnewly acquired stock of money would diffuse itself over allwith which the supposed country carried on trade, andthem, progressively, through all parts of the commercial. The money which thus overflowed would spread itself to andepth over all commercial countries. For it would go onuntil the exports and imports again balanced one another:this (as no change is supposed in the permanent circumstancesinternational demand) could only be, when the money haditself so equally that prices had risen in the samein all countries, so that the alteration of price would beall practical purposes ineffective, and the exports and, though at a higher money valuation, would be exactly theas they were originally. This diminished value of moneythe world, (at

least if the diminution was) would cause a suspension, or at least a diminution,the annual supply from the mines: since the metal would nocommand a value equivalent to its highest cost of. The annual waste would, therefore, not be fully made, and the usual causes of destruction would gradually reduceaggregate quantity of the precious metals to its former; after which their production would recommence on itsscale. The discovery of the treasure would thus producetemporary effects; namely, a brief disturbance oftrade until the treasure had disseminated itselfthe world, and then a temporary depression in the valuethe metal, below that which corresponds to the cost ofor of obtaining it; which depression would gradually be, by a temporarily diminished production in thecountries, and importation in the importing countries.

The same effects which would thus arise from the discovery oftreasure, accompany the process by which bank notes, or any ofother substitutes for money, take the place of the precious. Suppose that England possessed a currency wholly, of twenty millions sterling, and that suddenly twentyof bank notes were sent into circulation. If these wereby bankers, they would be employed in loans, or in theof securities, and would therefore create a sudden fallthe rate of interest, which would probably send a great partthe twenty millions of gold out of the country as capital, toa higher rate of interest elsewhere, before there had beenfor any action on prices. But we will suppose that the notesnot issued by bankers, or money-lenders of any kind, but by, in the payment of wages and purchase of materials,by the government in its ordinary expenses, so that the wholewould be rapidly carried into the markets for commodities.following would be the natural order of consequences. Allwould rise greatly. Exportation would almost cease;would be prodigiously stimulated. A great balance ofwould become due; the exchanges would turn against, to the full extent of the cost of exporting money; andsurplus coin would pour itself rapidly forth, over thecountries of the world, in the order of their proximity,and commercially, to England. The efflux wouldduntil the currencies of all countries had come to a; by which I do not mean, until money became of the sameeverywhere, but until the differences were only those whichbefore, and which corresponded to permanent differencesthe cost of obtaining it. When the rise of prices had extendedin an equal degree to all countries, exports and importseverywhere revert to what they were at first, would balanceanother, and the exchanges would return to par. If such a summoney as twenty millions, when spread over the whole surfacethe commercial world, were sufficient to raise the generalin a perceptible degree, the effect would be of no long. No alteration having occurred in the general conditionswhich the metals were procured, either in the world ator in any part of it, the reduced value would no longer be, and the supply from the mines would cease partiallywholly, until the twenty millions were absorbed;(1*) afterabsorption, the currencies of all countries would be, inand in value, nearly at their original level. I say, for in strict accuracy there would be a slight. A somewhat smaller annual supply of the preciouswould now be required, there being in the world twentyless of metallic money undergoing waste. The equilibriumpayments, consequently, between the mining countries and theof the world, would thenceforth require that the miningshould either export rather more of something else, orrather less of foreign commodities; which implies alower range of prices than previously in the mining, and a somewhat higher in all others; a scantierin the former, and rather fuller currencies in the. This effect, which would be too trifling to requireexcept for the illustration of a

principle, is the onlychange which would be produced on international trade,on the value or quantity of the currency of any country.

Effects of another kind, however, will have been produced.millions which formerly existed in the unproductive formmetallic money, have been converted into what is, or isof becoming, productive capital. This gain is at firstby England at the expense of other countries, who have takensuperfluity of this costly and unproductive article off her, giving for it an equivalent value in other commodities. Bythe loss is made up to those countries by diminishedfrom the mines, and finally the world has gained a virtualof twenty millions to its productive resources. Adam's illustration, though so well known, deserves for itsaptness to be once more repeated. He compares theof paper in the room of the precious metals, to theof a highway through the air, by which the groundoccupied by roads would become available for agriculture. Asthat case a portion of the soil, so in this a part of thewealth of the country, would be relieved from ain which it was only employed in rendering other soilscapitals productive, and would itself become applicable to; the office it previously fulfilled being equally wellby a medium which costs nothing.

The value saved to the community by thus dispensing withmoney, is a clear gain to those who provide the. They have the use of twenty millions of circulatingwhich have cost them only the expense of an engraver's. If they employ this accession to their fortunes ascapital, the produce of the country is increased, andcommunity benefited, as much as by any other capital of equal. Whether it is so employed or not, depends, in some, upon the mode of issuing it. If issued by the government,employed in paying off debt, it would probably becomecapital. The government, however, may prefer employingextraordinary resource in its ordinary expenses; mayit uselessly, or make it a mere temporary substitute forto an equivalent amount; in which last case the amountsaved by the taxpayers at large, who either add it to theiror spend it as income. When paper currency is supplied,in our own country, by bankers and banking companies, theis almost wholly turned into productive capital: for the, being at all times liable to be called upon to refundvalue, are under the strongest inducements not to squander, and the only cases in which it is not forthcoming are casesfraud or mismanagement. A banker's profession being that of a, his issue of notes is a simple extension of hisoccupation. He lends the amount to farmers,, or dealers, who employ it in their several. So employed, it yields, like any other capital, wageslabour and profits of stock. The profit is shared between the, who receives interest, and a succession of borrowers,for short periods, who after paying the interest, gain ain addition, or a convenience equivalent to profit. Theitself in the long run becomes entirely wages, and whenby the sale of the produce, becomes wages again; thusa perpetual fund, of the value of twenty millions, formaintenance of productive labour, and increasing the annualof the country by all that can be produced through theof a capital of that value. To this gain must be added asaving to the country, of the annual supply of themetals necessary for repairing the wear and tear, andwaste, of a metallic currency.

The substitution, therefore, of paper for the precious, should always be carried as far as is consistent with; no greater amount of metallic currency being retainedis necessary to maintain, both in fact and in public belief,convertibility of the paper. A country with the extensiverelations of England is liable to be suddenly calledfor large foreign payments, sometimes in loans, or otherof capital abroad, sometimes as the price of someimportation

of goods, the most frequent case being thatlarge importations of food consequent on a bad harvest. Tosuch demands it is necessary that there should be, either inor in the coffers of the banks, coin or bullion to aconsiderable amount, and that this, when drawn out by any, should be allowed to return after the emergency is. But since gold wanted for exportation is almost invariablyfrom the reserves of the banks, and is never likely to bedirectly from the circulation while the banks remain, the only advantage which can be obtained from retaininga metallic currency for daily purposes is, that themay occasionally replenish their reserves from it.

3. When metallic money had been entirely superseded andfrom circulation, by the substitution of an equal amountbank notes, any attempt to keep a still further quantity ofin circulation must, if the notes are convertible, be afailure. The new issue would again set in motion thetrain of consequences by which the gold coin had alreadyexpelled. The metals would, as before, be required for, and would be for that purpose demanded from the, to the full extent of the superfluous notes; which thusnot possibly be retained in circulation. If, indeed, thewere inconvertible, there would be no such obstacle to theof their quantity. An inconvertible paper acts in theway as a convertible, while there remains any coin for it to: the difference begins to manifest itself when all theis driven from circulation (except what may be retained forconvenience of small change), and the issues still go on. When the paper begins to exceed in quantity thecurrency which it superseded, prices of course rise;which were worth 5l. in metallic money, become worth 6l.inconvertible paper, or more, as the case may be. But thisof price will not, as in the cases before examined,import, and discourage export. The imports and exportsdetermined by the metallic prices of things, not by the paper: and it is only when the paper is exchangeable at pleasurethe metals, that paper prices and metallic prices must.

Let us suppose that England is the country which has thepaper. Suppose that some English production could be, while the currency was still metallic, for 5l., and soldFrance for 5l. 10s., the difference covering the expense and, and affording a profit to the merchant. On account of thethis commodity will now cost in England 6l., andbe sold in France for more than 5l. 10s., and yet it willexported as before. Why? Because the 5l. 10s. which thecan get for it in France, is not depreciated paper, butor silver. and since in England bullion has risen, in theproportion with other things-if the merchant brings the goldsilver to England, he can sell his 5l. 10s. for 6l. 12s., andas before 10 per cent for profit and expenses.

It thus appears, that a depreciation of the currency does notthe foreign trade of the country: this is carried onas if the currency maintained its value. But though theis not affected, the exchanges are. When the imports andare in equilibrium, the exchange, in a metallic currency,be at par; a bill on France for the equivalent of five, would be worth five sovereigns. But five sovereigns,the quantity of gold contained in them, having come to bein England 6l., it follows that a bill on France for 5l.be worth 6l. When, therefore, the real exchange is at par,will be a nominal exchange against the country, of as muchcent as the amount of the depreciation. If the currency is10, 15, or 20 per cent, then in whatever way the real, arising from the variations of international debts and, may vary, the quoted exchange will always differ 10, 15,20 per cent from it. However high this nominal premium may be,has no tendency to send gold out of the country, for theof drawing a bill

against it and profiting by the; because the gold so sent must be procured, not from theand at par, as in the case of a convertible currency, butthe market at an advance of price equal to the premium. Incases, instead of saying that the exchange is unfavourable,would be a more correct representation to say that the par has, since there is now required a larger quantity of Englishto be equivalent to the same quantity of foreign. The, however, continue to be computed according to thepar. The quoted exchanges, therefore, when there is acurrency, are compounded of two elements or factors;real exchange, which follows the variations of international, and the nominal exchange, which varies with theof the currency, but which, while there is anyat all, must always be unfavourable. Since theof depreciation is exactly measured by the degree in whichmarket price of bullion exceeds the Mint valuation, we have acriterion to determine what portion of the quoted exchange,referable to depreciation, may be struck off as nominal;result so corrected expressing the real exchange.

The same disturbance of the exchanges and of international, which is produced by an increased issue of convertiblenotes, is in like manner produced by those extensions of, which, as was so fully shown in a preceding chapter, havesame effect on prices as an increase of the currency.circumstances have given such an impulse to the spiritspeculation as to occasion a great increase of purchases on, money prices rise, just as much as they would have riseneach person who so buys on credit had bought with money. Alleffects, therefore, must be similar. As a consequence of high, exportation is checked and importation stimulated; thoughfact the increase of importation seldom waits for the rise ofwhich is the consequence of speculation, inasmuch as somethe great articles of import are usually among the things inspeculative overtrading first shows itself. There is,, in such periods, usually a great excess of importsexports; and when the time comes at which these must be paid, the exchanges become unfavourable, and gold flows out of the. In what precise manner this efflux of gold takes effectprices, depends on circumstances of which we shall presentlymore fully; but that its effect is to make them recoil, is certain and evident. The recoil, once begun,becomes a total rout, and the unusual extension ofis rapidly exchanged for an unusual contraction of it., when credit has been imprudently stretched, and thespirit carried to excess, the turn of the exchanges,consequent pressure on the banks to obtain gold for, are generally the proximate cause of the. But these phenomena, though a conspicuous, are no essential part, of the collapse of credita commercial crisis; which, as we formerly showed,(2*)happen to as great an extent, and is quite as likely to, in a country, if any such there were, altogetherof foreign trade. :. I am here supposing a state of things in which gold and silverare a permanent branch of industry, carried on under known; and not the present state of uncertainty, in whichgathering is a game of chance, prosecuted (for the present)the spirit of an adventure, not in that of a regularpursuit.. Supra, pp. 540-1.

The Principles of Political Economy

John Stuart Mill3:

Distribution

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the Rate of Interest

1. The present seems the most proper place for discussing thewhich determine the rate of interest. The interestloans, being really a question of exchange value, fallsinto the present division of our subject: and the twoof Currency and Loans, though in themselves distinct, areintimately blended in the phenomena of what is called themarket, that it is impossible to understand the one withoutother, and in many minds the two subjects are mixed up in theinextricable confusion.

In the preceding Book(1*) we defined the relation in whichstands to profit. We found that the gross profit ofmight be distinguished into three parts, which arethe remuneration for risk, for trouble, and for theitself, and may be termed insurance, wages of, and interest. After making compensation for, that is, after covering the average losses to which capitalexposed either by the general circumstances of society or byhazards of the particular employment, there remains a, which partly goes to repay the owner of the capital forabstinence, and partly the employer of it for his time and. How much goes to the one and how much to the other, isby the amount of the remuneration which, when the twoare separated, the owner of capital can obtain from thefor its use. This is evidently a question of demand and. Nor have demand and supply any different meaning orin this case from what they have in all others. The rateinterest will be such as to equalize the demand for loans withsupply of them. It will be such, that exactly as much as someare desirous to borrow at that rate, others shall beto lend. If there is more offered than demanded, interestfall; if more is demanded than offered, it will rise; and incases, to the point at which the equation of supply andis re-established.

Both the demand and supply of loans fluctuate morethan any other demand or supply whatsoever. Thein other things depend on a limited number ofcircumstances; but the desire to borrow, and theto lend, are more or less influenced by everywhich affects the state or prospects of industry or, either generally or in any of their branches. The rateinterest, therefore, on good security, which alone we haveto consider (for interest in which considerations of riska part may swell to any amount) is seldom, in the greatof money transactions, precisely the same for two days; as is shown by the never-ceasing variations in theprices of the funds and other negotiable securities., there must be, as in other cases of value, somewhich (in the language of Adam Smith and Ricardo) may bethe natural rate; some rate about which the market rate, and to which it always tends to return. This ratedepends on the amount of accumulation going on in theof persons who cannot themselves attend to the employmenttheir savings, and partly on the comparative taste existing incommunity for the active pursuits of industry, or for the, ease, and independence of an annuitant.

2. To exclude casual fluctuations, we will suppose commercebe in a quiescent condition, no employment being unusually, and none particularly distressed. In these, the

more thriving producers and traders have theirfully employed, and many are able to transact business toconsiderably greater extent than they have capital for. Thesenaturally borrowers: and the amount which they desire to, and can obtain credit for, constitutes the demand foron account of productive employment. To these must be addedloans required by Government, and by landowners, or otherconsumers who have good security to give. Thisthe mass of loans for which there is an habitual.

Now it is conceivable that there might exist, in the hands ofdisinclined or disqualified for engaging personally in, a mass of capital equal to, and even exceeding, this. In that case there would be an habitual excess ofon the part of lenders, and the rate of interestbear a low proportion to the rate of profit. Interest wouldforced down to the point which would either tempt borrowers toa greater amount of loans than they had a reasonableof being able to employ in their business, or woulddiscourage a portion of the lenders, as to make them eitherto accumulate, or endeavour to increase their income byin business on their own account, and incurring the, if not the labours, of industrial employment.

On the other hand, the capital owned by persons who preferit at interest, or whose avocations prevent them fromsuperintending its employment, may be short of thedemand for loans. It may be in great part absorbed byinvestments afforded by the public debt and by mortgages, andremainder may not be sufficient to supply the wants of. If so, the rate of interest will be raised so high assome way to re-establish the equilibrium. When there is only adifference between interest and profit, many borrowers maylonger be willing to increase their responsibilities andtheir credit for so small a remuneration: or some whootherwise have engaged in business, may prefer leisure, andlenders instead of borrowers: or others, under theof high interest and easy investment for their, may retire from business earlier, and with smaller, than they otherwise would have done. Or, lastly, thereanother process by which, in England and other commercial, a large portion of the requisite supply of loans is. Instead of its being afforded by persons not in, the affording it may itself become a business. Aof the capital employed in trade may be supplied by aof professional money lenders. These money lenders,, must have more than a mere interest; they must have therate of profit on their capital, risk and all otherbeing allowed for. But it can never answer to anywho borrows for the purposes of his business, to pay a fullfor capital from which he will only derive a full profit:money-lending, as an employment, for the regular supply of, cannot, therefore, be carried on except by persons who, into their own capital, can lend their credit, or, inwords, the capital of other people: that is, bankers, and(such as bill-brokers) who are virtually bankers, sincereceive money in deposit. A bank which lends its notes,capital which it borrows from the community, and for whichpays no interest. A bank of deposit lends capital which itfrom the community in small parcels; sometimes withoutany interest, as is the case with the London private; and if, like the Scotch, the joint stock, and most ofcountry banks, it does pay interest, it still pays much lessit receives; for the depositors, who in any other way couldobtain for such small balances no interest worth takingtrouble for, are glad to receive even a little. Having thisresource, bankers are enabled to obtain, by lending at, the ordinary rate of profit on their own capital. Inother manner, money-lending could not be carried on as amode of business, except upon terms on which none wouldto borrow but persons either counting

on extraordinary, or in urgent need: unproductive consumers who havetheir means, or merchants in fear of bankruptcy. Thecapital deposited in banks; that represented by bank; the capital of bankers themselves, and that which theirin any way in which they use it, enables them to dispose; these, together with the funds belonging to those who, eithernecessity or preference, live upon the interest of their, constitute the general loan fund of the country: andamount of this aggregate fund, when set against the habitualof producers and dealers, and those of the Government andunproductive consumers, determines the permanent or averageof interest; which must always be such as to adjust theseamounts to one another.(2*) But while the whole of this masslent capital takes effect upon the permanent rate of interest,fluctuations depend almost entirely upon the portion which isthe hands of bankers; for it is that portion almost, which, being lent for short times only, isin the market seeking an investment. The capital ofwho live on the interest of their own fortunes, hassought and found some fixed investment, such as thefunds, mortgages, or the bonds of public companies, which, except under peculiar temptations or necessities, ischanged.

3. Fluctuations in the rate of interest arise from variationsin the demand for loans; or in the supply. The supply isto variation, though less so than the demand. Theto lend is greater than usual at the commencement ofperiod of speculation, and much less than usual during thewhich follows. In speculative times, money-lenders asas other people are inclined to extend their business bytheir credit; they lend more than usual (just as otherof dealers and producers employ more than usual) ofwhich does not belong to them. Accordingly, these are thewhen the rate of interest is low; though for this too (asshall hereafter see) there are other causes. During the, on the contrary, interest always rises inordinately,, while there is a most pressing need on the part of manyto borrow, there is a general disinclination to lend.disinclination, when at its extreme point, is called a. It occurs when a succession of unexpected failures hasin the mercantile, and sometimes also in themercantile public, a general distrust in each other's; disposing every one not only to refuse fresh credit,on very onerous terms, but to call in, if possible, allwhich he has already given. Deposits are withdrawn from; notes are returned on the issuers in exchange for specie;raise their rate of discount, and withhold theiradvances; merchants refuse to renew mercantile bills.such times the most calamitous consequences were formerlyfrom the attempt of the law to prevent more than alimited rate of interest from being given or taken.who could not borrow at five per cent, had to pay, notor seven, but ten or fifteen per cent, to compensate thefor risking the penalties of the law: or had to sellor goods for ready money at a still greater sacrifice.

In the intervals between commercial crises, there is usuallytendency in the rate of interest to a progressive decline, fromgradual process of accumulation : which process, in the greatcountries, is sufficiently rapid to account for theperiodical recurrence of these fits of speculation; since,a few years have elapsed without a crisis, and no new andchannel for investment has been opened in the meantime,is always found to have occurred in those few years soan increase of capital seeking investment, as to haveconsiderably the rate of interest, whether indicated byprices of securities or by the rate of discount on bills; anddiminution of interest tempts the possessor to incur hazardshopes of a more considerable return.

The rate of interest is, at times, affected more or lessby circumstances, though not of frequent, yet ofoccurrence, which tend to alter the proportion betweenclass of interest-receiving and that of profit-receiving. Two causes of this description, operating inways, have manifested themselves of late years, and areproducing considerable effects in England. One is, the gold. The masses of the precious metals which arearriving from the gold countries, are, it may safelysaid, wholly added to the funds that supply the loan market.great an additional capital, not divided between the twoof capitalists, but aggregated bodily to the capital ofinterest-receiving class, disturbs the pre-existing ratiothe two, and tends to depress interest relatively to. Another circumstance of still more recent date, butto the contrary effect, is the legalization ofstock associations with limited liability. The shareholdersthese associations, now so rapidly multiplying, are drawnexclusively from the lending class; from those who eithertheir disposable funds in deposit, to be lent out by, or invested them in public or private securities, andthe interest. To the extent of their shares in any ofcompanies (with the single exception of banking companies)have become traders on their own capital; they have ceasedbe lenders, and have even, in most cases, passed over to theof borrowers. Their subscriptions have been abstracted fromfunds which feed the loan market, and they themselves havecompetitors for a share of the remainder of those funds:all which, the natural effect is a rise of interest. And itnot be surprising if, for a considerable time to come, therate of interest in England should bear a higherto the common rate of mercantile profit, than it hasat any time since the influx of new gold set in.(3*)

The demand for loans varies much more largely than the, and embraces longer cycles of years in its aberrations. Aof war, for example, is a period of unusual drafts on themarket. The Government, at such times, generally incurs new, and as these usually succeed each other rapidly as long aswar lasts, the general rate of interest is kept higher in warin peace, without reference to the rate of profit, andindustry is stinted of its usual supplies. During partthe last war with France, the Government could not borrowsix per cent, and of course all other borrowers had to payleast as much. Nor does the influence of these loanscease when the Government ceases to contract others;those already contracted continue to afford an investment forgreatly increased amount of the disposable capital of the, which if the national debt were paid off, would be addedthe mass of capital seeking investment, and (independently ofdisturbance) could not but, to some extent, permanentlythe rate of interest.

The same effect on interest which is produced by Governmentfor war expenditure, is produced by the sudden opening ofnew and generally attractive mode of permanent investment.only instance of the kind in recent history on a scaleto that of the war loans, is the absorption of capitalthe construction of railways. This capital must have beendrawn from the deposits in banks, or from savingswould have gone into deposit, and which were destined to beemployed in buying securities from persons who wouldemployed the purchase money in discounts or other loans at: in either case, it was a draft on the general loan. It is, in fact, evident, that unless savings were madeto be employed in railway adventure, the amount thusmust have been derived either from the actual capital ofin business, or from capital which would have been lentpersons in business. In the first case,

the subtraction, bytheir means, obliges them to be larger borrowers; insecond, it leaves less for them to borrow; in either case ittends to raise the rate of interest.

4. I have, thus far, considered loans, and the rate of, as a matter which concerns capital in general, inopposition to the popular notion, according to which itconcerns money. In loans, as in all other money, I have regarded the money which passes, only as the, and commodities as the thing really transferred — thesubject of the transaction. And this is, in the main,: because the purpose for which, in the ordinary course of, money is borrowed, is to acquire a purchasing power over. In an industrious and commercial country, theintention commonly is, to employ the commodities as: but even in the case of loans for unproductive, as those of spendthrifts, or of the Government, theborrowed is taken from a previous accumulation, whichotherwise have been lent to carry on productive industry;is, therefore, so much subtracted from what may correctly bethe amount of loanable capital.

There is, however, a not unfrequent case, in which theof the borrower is different from what I have here. He may borrow money, neither to employ it as capitalto spend it unproductively, but to pay a previous debt. Incase, what he wants is not purchasing power, but legal, or something which a creditor will accept as equivalentit. His need is specifically for money, not for commodities or. It is the demand arising from this cause, which producesall the great and sudden variations of the rate of. Such a demand forms one of the earliest features of acrisis. At such a period, many persons in business whocontracted engagements, have been prevented by a change offrom obtaining in time the means on which theyfor fulfilling them. These means they must obtain atsacrifice, or submit to bankruptcy; and what they must havemoney. Other capital, however much of it they may possess,answer the purpose unless money can first be obtained for; while, on the contrary, without any increase of the capitalthe country, a mere increase of circulating instruments of(be they of as little worth for any other purpose as theof one pound notes discovered in the vaults of the Bank ofduring the panic of 1825) will effectually serve theirif only they are allowed to make use of it. An increasedof notes, in the form of loans, is all that is required tothe demand, and put an end to the accompanying panic. But, in this case, it is not capital, or purchasing power,the borrower needs, but money as money, it is not only moneyis transferred to him. The money carries its purchasing, with it wherever it goes; and money thrown into the loanreally does, through its purchasing power, turn over anportion of the capital of the country into theof loans. Though money alone was wanted, capital; and it may still be said with truth that it is by anto loanable capital that the rise of the rate ofis met and corrected.

Independently of this, however, there is a real relation,it is indispensable to recognise, between loans and money.capital is all of it in the form of money. Capitaldirectly for production exists in many forms; butdestined for lending exists normally in that form alone.to this circumstance, we should naturally expect that amongcauses which affect more or less the rate of interest, wouldfound not only causes which act through capital, but somewhich act, directly at least, only through money.

The rate of interest bears no necessary relation to theor value of the money in circulation. The permanentof the circulating medium, whether great or small, affectsprices; not the rate of interest. A depreciation of the, when it has become an accomplished fact,

affects theof interest in no manner whatever. It diminishes indeed theof money to buy commodities, but not the power of money tomoney. If a hundred pounds will buy a perpetual annuity ofpounds a year, a depreciation which makes the hundred poundsonly half as much as before, has precisely the same effectthe four pounds, and cannot therefore alter the relationthe two. The greater or smaller number of counters whichbe used to express a given amount of real wealth, makes noin the position or interests of lenders or borrowers,therefore makes no difference in the demand and supply of. There is the same amount of real capital lent and; and if the capital in the hands of lenders isby a greater number of pounds sterling, the samenumber of pounds sterling will, in consequence of theof prices, be now required for the purposes to which theintend to apply them.

But though the greater or less quantity of money makes inno difference in the rate of interest, a change from aquantity to a greater, or from a greater to a less, may andmake a difference in it.

Suppose money to be in processdepreciation by means of an inconvertible currency, issued bygovernment in payment of its expenses. This fact will in no waythe demand for real capital on loan; but it willthe real capital loanable, because, this existing onlythe form of money, the increase of quantity depreciates it.in capital, the amount offered is less, while therequired is the same as before. Estimated in currency, theoffered is only the same as before, while the mount, owing to the rise of prices, is greater. Either way,rate of interest must rise. So that in this case increase ofreally affects the rate of interest, but in the contraryto that which is generally supposed; by raising, not byit.

The reverse will happen as the effect of calling in, orin quantity, a depreciated currency. The money in theof lenders, in common with all other money, will bein value, that is, there vill be a greater amount ofcapital seeking borrowers; while the real capital wanted bywill be only the same as before, and the money mount: the rate of interest, therefore, will tend to fall.

We thus see that depreciation, merely as such, while inof taking place, tends to raise the rate of interest: andexpectation of further depreciation adds to this effect;lenders who expect that their interest will be paid andprincipal perhaps redeemed, in a less valuable currency thanlent, of course require a rate of interest sufficient tothis contingent loss.

But this effect is more than counteracted by a contrary one,the additional money is thrown into circulation not bybut by loans. In England, and in most other commercial, the paper currency in common use, being a currencyby bankers, is all issued in the way of loans, exceptpart employed in the purchase of gold and silver. The same, therefore, which adds to the currency also adds to the: the whole increase of currency in the first instancethe loan market. Considered as an addition to loans itto lower interest, more than in its character ofit tends to raise it; for the former effect dependsthe ratio which the new money bears to the money lent, whilelatter depends on its ratio to all the money in circulation.increase, therefore, of currency issued by banks, tends, whileprocess continues, to bring down or to keep down the rate of. A similar effect is produced by the increase of moneyfrom the gold discoveries; almost the whole of which, asnoticed, is, when brought to Europe, added to thein banks, and consequently to the mount of loans; anddrawn out

and invested in securities, liberates anamount of other loanable capital. The newly-arrivedcan only get itself invested, in any given state of, by lowering the rate of interest; and as long as thecontinues, it cannot fail to keep interest lower than, allcircumstances being supposed the same, would otherwise havethe case.

As the introduction of additional gold and silver, which goesthe loan market, tends to keep down the rate of interest, soconsiderable abstraction of them from the country invariablyit; even when occurring in the course of trade, as infor the extra importations caused by a bad harvest, or forhigh-priced cotton which, under the influence of the Americanwar, was imported from so many parts of the world. Therequired for these payments is taken in the first instancethe deposits in the hands of bankers, and to that extentthe fund that supplies the loan market.

The rate of interest, then, depends essentially andon the comparative amount of real capital offered andin the way of loan; but is subject to temporaryof various sorts, from increase and diminution ofcirculating medium; which derangements are somewhat, and sometimes in direct opposition to first. All these distinctions are veiled over and, by the unfortunate misapplication of language whichthe rate of interest by a phrase ("the value of") which properly expresses the purchasing power of themedium. The public, even mercantile, habituallythat ease in the money market, that is, facility ofat low interest, is proportional to the quantity ofin circulation. Not only, therefore, are bank notesto produce effects as currency, which they only produceloans, but attention is habitually diverted from effectsin kind and much greater in degree, when produced by anon loans which does not happen to be accompanied by anyon the currency.

For example, in considering the effect produced by theof banks in encouraging the excesses of speculation,immense effect is usually attributed to their issues of notes,until of late hardly any attention was paid to the managementtheir deposits; though nothing is more certain than that theirextensions of credit take place more frequently byof their deposits than of their issues. "There is no," says Mr. Tooke,(4*) "that banks, whether private or joint, may, if imprudently conducted, minister to an undueof credit for the purpose of speculations, whether in, or in overtrading in exports or imports, or inor mining operations, and that they have so ministeredunfrequently, and in some cases to an extent ruinous to, and without ultimate benefit to the parties to whosetheir resources were made subservient." But, "supposing alldeposits received by a banker to be in coin, is he not, justmuch as the issuing banker, exposed to the importunity of, whom it may be impolitic to refuse, for loans or, or to be tempted by a high interest? and may he not beto encroach so much upon his deposits as to leave him,not improbable circumstances, unable to meet the demands ofdepositors? In what respect, indeed, would the case of ain a perfectly metallic circulation, differ from that of abanker at the present day? He is not a creator of money,cannot avail himself of his privilege as an issuer in aid ofother business, and yet there have been lamentable instancesLondon bankers issuing money in excess."

In the discussions, too, which have been for so many yearson respecting the operations of the Bank of England, andeffects produced by those operations on the state of credit,for nearly half a century there never has been acrisis which the Bank has not been strenuously accusedof producing or of aggravating, it has been almostassumed that the influence of its acts was felt onlythe amount of its notes in circulation, and that if itbe

prevented from exercising any discretion as to that onein its position, it would no longer have any power liableabuse. This at least is an error which, after the experiencethe year 1847, we may hope has been committed for the last. During that year the hands of the bank were absolutely, in its character of a bank of issue; but through itsas a bank of deposit it exercised as great an, or apparent influence, on the rate of interest and theof credit, as at any former period; it was exposed to asaccusations of abusing that influence; and a crisis, such as few that preceded it had equalled, and nonesurpassed, in intensity.

5. Before quitting the general subject of this chapter, Imake the obvious remark, that the rate of interestthe value and price of all those saleable articlesare desired and bought, not for themselves, but for thewhich they are capable of yielding. The public funds,in joint-stock companies, and all descriptions of, are at a high price in proportion as the rate ofis low. They are sold at the price which will give therate of interest on the purchase money, with allowance fordifferences in the risk incurred, or in any circumstance of. Exchequer bills, for example, usually sell at aprice than consols, proportionally to the interest whichyield; because, though the security is the same, yet thebeing annually paid off at par unless renewed by the, the purchaser (unless obliged to sell in a moment ofemergency), is in no danger of losing anything by the, except the premium he may have paid.

The price of land, mines, and all other fixed sources of, depends in like manner on the rate of interest. Landsells at a higher price, in proportion to the incomeby it, than the public funds, not only because it is, even in this country, to be somewhat more secure, butideas of power and dirty are associated with its. But these differences are constant, or nearly so; andthe variations of price, land follows, caeteris paribus, the(though of course not the daily) variations of the rateinterest. When interest is low, land will naturally be dear;interest is high, land will be cheap. The last long wara striking exception to this rule, since the price ofas well as the rate of interest was then remarkably high.this, however, there was a special cause. The continuance ofvery high average price of corn for many years, had raised theof land even more than in proportion to the rise of interestfall of the selling price of fixed incomes. Had it not beenthis accident, chiefly dependent on the seasons, land mustsustained as great a depreciation in value as the public: which it probably would do, were a similar war to breakhereafter; to the signal disappointment of those landlordsfarmers who, generalizing from the casual circumstances of aperiod, so long persuaded themselves that a state ofwas peculiarly advantageous, and a state of peace, to what they chose to call the interests of.:. Supra, book ii, ch. xv. section 1.. I do not include in the general loan fund of the country the, large as they sometimes are, which are habituallyin speculatively buying and selling the public funds andsecurities. It is true that all who buy securities add, fortime, to the general amount of money on loan, and lower prothe rate of interest. But as the persons I speak of buyto sell again at a higher price, they are alternately in theof lenders and of borrowers: their operations raise theof interest at one time, exactly as much as they lower it at. Like all persons who buy and sell on speculation, theiris to equalize, not to raise or lower, the value of the. When they speculate prudently, they temper theof price; when imprudently, they often aggravate. . To the cause of augmentation in the rate of interest,in the text, must be added another, forcibly insistedby the author of an able article in the Edinburgh Review for, 1865; the

increased and increasing willingness to sendabroad for investment. Owing to the vastly augmentedof access to foreign countries, and the abundantincessantly received from them, foreign investmentsceased to inspire the terror that belongs to the unknown;flows, without misgiving, to any place which affords anof high profit; and the loan market of the wholeworld is rapidly becoming one. The rate of interest,, in the part of the world out of which capital mostflows, cannot any longer remain so much inferior to theelsewhere, as it has hitherto been. . Inquiry into the Currency Principle, ch. xiv.

The Principles of Political Economy

John Stuart Mill3:

Distribution
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the Regulation of a Convertible Paper Currency

1. The frequent recurrence during the last half century ofpainful series of phenomena called a commercial crisis, hasmuch of the attention both of economists and ofpoliticians to the contriving of expedients for, or at the least, mitigating its evils. And the habitgrew up during the era of the Bank restriction, ofall alternations of high and low prices to the issuesbanks, has caused inquirers in general to fix their hopes ofin moderating those vicissitudes, upon schemes for theof bank notes. A scheme of this nature, after havingthe sanction of high authorities, so far establishedin the public mind, as to be, with general approbation,into a law, at the renewal of the Charter of the BankEngland in 1844: and the regulation is still in force, thougha great abatement of its popularity, and with its prestigeby three temporary suspensions, on the responsibility ofexecutive, the earliest little more than three years afterenactment. It is proper that the merits of this plan for theof a convertible bank note currency should be here. Before touching upon the practical provisions of SirPeel's Act of 1844, I shall briefly state the nature, andthe grounds, of the theory on which it is founded.

It is believed by many, that banks of issue universally, orBank of England in particular, have a power of throwing theirinto circulation, and thereby raising prices, arbitrarily;this power is only limited by the degree of moderation withthey think fit to exercise it; that when they increaseissues beyond the usual mount, the rise of prices, thus, generates a spirit of speculation in commodities, whichprices still higher, and ultimately causes a reaction and, mounting in extreme cases to a commercial crisis; andevery such crisis which has occurred in this country withinmemory, has been either originally produced by this, or greatly aggravated by it. To this extreme length thetheory has not been carried by the eminent politicalwho have given to a more moderate form of the samethe sanction of their names. But I have not overstated theof the popular version; which is a remarkableto what lengths a favourite theory will hurry, not thestudents whose competency in such questions is oftenwith so much contempt, but men of the world and of, who pique themselves on the practical knowledge whichhave at least had ample opportunities of acquiring. Not onlythis fixed idea of the currency as the prime agent in theof price, made them shut their eyes to the multitudecircumstances which, by influencing the expectation of supply,the true causes of almost all speculations, and of almost allof price; but in order to bring about theagreement required by their theory, between theof bank issues and those of prices, they have playedfantastic tricks with facts and dates as would be thought, if an eminent practical authority ad not taken theof meeting them, on the ground of mere history, with anexposure. I refer, as all conversant with the subjectbe aware, to Mr Tooke's History of Prices. The result of Mr's investigations was thus stated by himself, in hisbefore the Commons' Committee on the Bank Charterin 1832; and the evidences of it stand recorded in his: "In point of fact, and historically, as far as myhave

gone, in every signal instance of a rise or fallprices, the rise or fall has preceded, and therefore could notthe effect of, an enlargement or contraction of the bank."

The extravagance of the currency theorists, in attributingevery rise or fall of prices to an enlargement orof the issues of bank notes, has raised up, by, a theory the extreme opposite of the former, of which,scientific discussion, the most prominent representatives areTooke and Mr Fullarton. This counter-theory denies to bank, so long as their convertibility is maintained, any powerof raising prices, and to banks any power of increasingcirculation, except as a consequence of, and in proportion, an increase of the business to be done. This last statementsupported by the unanimous assurances of all the countrywho have been examined before successive Parliamentaryon the subject. They all bear testimony that (in theof Mr Fullarton(1*)) "the amount of their issues isregulated by the extent of local dealings andin their respective districts, fluctuating with theof production and price, and that they neither cantheir issues beyond the limits which the range of suchand expenditure prescribes, without the certainty oftheir notes immediately returned to them, nor diminish, but at an almost equal certainty of the vacancy beingup from some other source." from these premises it isby Mr Tooke and Mr Fullarton, that bank issues, since theybe increased in amount unless there be an increased, cannot possibly raise prices; cannot encourage, nor occasion a commercial crisis; and that theto guard against that evil by an artificial management ofissue of notes, is of no effect for the intended purpose, andto produce other consequences extremely calamitous.

2. As much of this doctrine as rests upon testimony, and notinference, appears to me incontrovertible. I give completeto the assertion of the country bankers, very clearlycorrectly condensed into a small compass in the sentence justfrom Mr Fullarton. I am convinced that they cannotincrease their issue of notes in any other circumstancesthose which are there stated. I believe, also, that the, grounded by Mr Fullarton upon this fact, contains a largeof truth, and is far nearer to being the expression ofwhole truth than any form whatever of the currency theory.

There are two states of the markets: one which may be termedquiescent state, the other the expectant, or speculative. The first is that in which there is nothing tending toin any considerable portion of the mercantile public ato extend their operations. The producers produce and thepurchase only their usual stocks, having no expectationa more than usually rapid vent for them. Each person transactsordinary amount of business, and no more; or increases itin correspondence with the increase of his capital or, or with the gradual growth of the demand for his, occasioned by the public prosperity. Not meditatingunusual extension of their own operations, producers anddo not need more than the usual accommodation fromand other money lenders; and as it is only by extendingloans that bankers increase their issues, none but aaugmentation of issues is in these circumstances. If at a certain time of the year a portion of thehave larger payments to make than at other times, or if an, under some peculiar exigency, requires an extra, they may apply for more bank notes, and obtain them; butnotes will no more remain in circulation, than the extraof Bank of England notes which are issued once in everymonths in payment of the dividends. The person to whom,being borrowed, the notes are paid away, has no extrato make, and no peculiar exigency, and he keeps them byunused, or sends them into deposit, or repays with them aadvance made to him by some banker: in

any case he doesbuy commodities with them, since by the supposition there isto induce him to lay in a larger stock of commoditiesbefore. Even if we suppose, as we may do, that bankersan artificial increase of the demand for loans by offeringbelow the market rate of interest, the notes they issue willremain in circulation; for when the borrower, havingthe transaction for which he availed himself of them,paid them away, the creditor or dealer who receives them,no demand for the immediate use of an extra quantity of, sends them into deposit. In this case, therefore, therebe no addition, at the discretion of bankers, to the generalmedium: any increase of their issues either comesto them, or remains idle in the hands of the public, and notakes place in prices.

But there is another state of the markets, strikinglywith the preceding, and to this state it is not sothat the theory of Mr Tooke and Mr Fullarton is; namely, when an impression prevails, whether wellor groundless, that the supply of one or more greatof commerce is likely to fall short of the ordinary. In such circumstances all persons connected withcommodities desire to extend their operations. Theor importers desire to produce or import a larger, speculators desire to lay in a stock in order to profitthe expected rise of price, and holders of the commodityadditional advances to enable them to continue holding.these classes are disposed to make a more than ordinary usetheir credit, and to this desire it is not denied that bankersoften unduly administer. Effects of the same kind may beby anything which, exciting more than usual hopes of, gives increased briskness to business. for example, aforeign demand for commodities on a large scale, or theof it; such as occurred on the opening of Spanishto English trade, and has occurred on various occasionsthe trade with the United States. Such occurrences produce ato a rise of price in exportable articles, and generate, sometimes of a reasonable, and (as long as a largeof men in business prefer excitement to safety)of an irrational or immoderate character. In suchthere is a desire in the mercantile classes, or in someof them, to employ their credit, in a more than usual, as a power of purchasing. This is a state of business, when pushed to an extreme length, brings on the revulsiona commercial crisis; and it is a known fact that suchof speculation hardly ever pass off without having been, during some part of their progress, by a considerableof bank notes.

To this, however, it is replied by Mr Tooke and Mr Fullarton,the increase of the circulation always follows instead ofthe rise of prices, and is not its cause, but its. That in the first place, the speculative purchases byprices are raised, are not effected by bank notes but by, or still more commonly on a simple book credit: and, even if they were made with bank notes borrowed forexpress purpose from bankers, the notes, after being usedthat purpose, would, if not wanted for current transactions,returned into deposit by the persons receiving them. In this Iconcur, and I regard it as proved, both scientifically and, that during the ascending period of speculation,as long as it is confined to transactions between dealers,issues of bank notes are seldom materially increased, noranything to the speculative rise of prices. It seemsme, however, that this can no longer be affirmed whenhas proceeded so far as to reach the producers.orders given by merchants to manufacturers induceto extend their operations, and to become applicants tofor increased advances, which if made in notes, are notaway to persons who return them into deposit, but areexpended in paying wages, and pass into the variousof retail trade, where they become directly effective ina further rise of prices. I cannot but think that thisof bank

notes must have been powerfully operative onat the time when notes of one and two pounds value wereby law. Admitting, however, that the prohibition ofbelow five pounds has now rendered this part of theircomparatively insignificant by greatly limiting theirto the payment of wages, there is another form ofinstrumentality which comes into play in the latter stagesspeculation, and which forms the principal argument of themoderate supporters of the currency theory. Though advancesbankers are seldom demanded for the purpose of buying on, they are largely demanded by unsuccessfulfor the purpose of holding on; and the competition ofspeculators for a share of the loanable capital, makes evenwho have not speculated, more dependent than before onfor the advances they require. Between the ascendingof speculation and the revulsion, there is an intervalto weeks and sometimes months, of struggling against a. The tide having shown signs of turning, the speculativeare unwilling to sell in a falling market, and in thethey require funds to enable them to fulfil even theirengagements. It is this stage that is ordinarily markeda considerable increase in the amount of the banknote. That such an increase does usually take place, isby no one. And I think it must be admitted that thistends to prolong the duration of the speculations; thatenables the speculative prices to be kept up for some timethey would otherwise have collapsed; and therefore prolongsincreases the drain of the precious metals for exportation,is a leading feature of this stage in the progress of acrisis: the continuance of which drain at lastthe power of the banks to fulfil their engagement oftheir notes on demand, they are compelled to contractcredit more suddenly and severely than would have beenif they had been prevented from propping up speculationincreased advances, after the time when the recoil had become.

3. To prevent this retardation of the recoil, and ultimateof its severity, is the object of the scheme forthe currency, of which Lord Overstone, Mr Norman, andTorrens, were the first promulgators, and which has, in amodified form, been enacted into law.(2*)

According to the scheme in its original purity, the issue ofnotes for circulation was to be confined to one body.the form adopted by Parliament, all existing issuers wereto retain this privilege, but none were to be hereafterto it, even in the place of those who might discontinueissues: and, for all except the Bank of England, a maximumissues was prescribed, on a scale intentionally low. To theof England no maximum was fixed for the aggregate amount ofnotes, but only for the portion issued on securities, or inwords, on loan. These were never to exceed a certain limit,in the first instance at fourteen millions.(3*) All issuesthat amount must be in exchange for bullion; of which theis bound to purchase, at a trifle below the Mint valuation,quantity which is offered to it, giving its notes in. In regard, therefore, to any issue of notes beyond theof fourteen millions, the Bank is purely passive, having nobut the compulsory one of giving its notes for gold atl. 17s. 9d., and gold for its notes at 3l. 17s. 10 1/2d.,and by whomsoever it is called upon to do so.

The object for which this mechanism is intended is, that thenote currency may vary in its amount at the exact times, andthe exact degree, in which a purely metallic currency would. And the precious metals being the commodity that hasapproached nearest to that invariability in all theinfluencing value, which fits a commodity for beingas a medium of exchange, it seems to be thought that theof the Act of 1844 is fully made out, if

under itsthe issues conform in all their variations of quantity,therefore, as is inferred, of value, to the variations whichtake place in a currency wholly metallic.

Now, all reasonable opponents of the Act, in common with its, acknowledge as an essential requisite of anyfor the precious metals, that it should conformin its permanent value to a metallic standard. And they, that so long as it is convertible into specie on demand, itand must so conform. But when the value of a metallic or ofother currency is spoken of, there are two points to be; the permanent or average value, and the fluctuations.is to the permanent value of a metallic currency, that theof a paper currency ought to conform. But there is noreason why it should be required to conform to thetoo. The only object of its conforming at all, isof value; and with respect to fluctuations the soledesirable is that they should be the smallest possible. Nowfluctuations in the value of the currency are determined, notits quantity, whether it consist of gold or of paper, but byexpansions and contractions of credit. To discover,, what currency will conform the most nearly to thevalue of the precious metals, we must find under whatthe variations in credit are least frequent and least. Now, whether this object is best attained by a metallic(and therefore by a paper currency exactly conforming into it) is precisely the question to be decided. If itprove that a paper currency which follows all thein quantity of a metallic, leads to more violentof credit than one which is not held to this rigid, it will follow that the currency which agrees mostin quantity with a metallic currency is not that whichclosest to its value; that is to say, its permanent, with which alone agreement is desirable.

Whether this is really the case or not we will now inquire.first, let us consider whether the Act effects the practicalchiefly relied on in its defence by the more sober of its, that of arresting speculative extensions of credit atearlier period, with a less drain of gold, and consequently bymilder and more gradual process. I think it must be admittedto a certain degree it is successful in this object.

I am aware of what may be urged, and reasonably urged, into this opinion. It may be said, that when the timeat which the banks are pressed for increased advances tospeculators to fulfil their engagements, a limitation ofissue of notes will not prevent the banks, if otherwise, from making these advances; that they have still theiras a source from which loans may be made beyond thewhich is consistent with prudence as bankers; and that eventhey refused to do so, the only effect would be, that thethemselves would be drawn out to supply the wants of the; which would be just as much an addition to the bankand coin in the hands of the public, as if the noteswere increased. This is true, and is a sufficientto those who think that the advances of banks to prop upspeculations are objectionable chiefly as an increase ofcurrency. But the mode in which they are really, is as an extension of credit. If, instead oftheir discounts, the banks allow their deposits to beout, there is the same increase of currency (for a shortat least), but there is not an increase of loans, at thewhen there ought to be a diminution. If they do increasediscounts, not by means of notes, but at the expense of thealone, their deposits (properly so called) are definiteexhaustible, while notes may be increased to any amount, or,being returned, may be re-issued without limit. It is truea bank, if willing to add indefinitely to its liabilities,the power of making its nominal deposits as unlimited a fundits issues could be; it has only to make its advances in acredit, which is creating deposits out of its own, the money for

which it has made itself responsiblea deposit in its hands, to be drawn against by cheques;the cheques when drawn may be liquidated (either at the sameor at the clearing house) without the aid of notes, by atransfer of credit from one account to another. I apprehendis chiefly in this way that undue extensions of credit, inof speculation, are commonly made. But the banks are notto persist in this course when the tide begins to turn. Itnot when their deposits have already begun to flow out, thatare likely to create deposit accounts which represent,of funds placed in their hands, fresh liabilities ofown. But experience proves that extension of credit, whenthe form of notes, goes on long after the recoil fromspeculation has commenced. When this mode of resisting theis made impossible, and deposits and book credits areas the only sources from which undue advances can be made,rate of interest is not so often, or so long, prevented from, after the difficulties consequent on excess ofbegin to be felt. On the contrary, the necessitythe banks feel of diminishing their advances to maintainsolvency, when they find their deposits flowing out, andsupply the vacant place by their own notes, acceleratesrise of the rate of interest. Speculative holders areobliged to submit earlier to that loss by resale, whichnot have been prevented from coming on them at last: theof prices and collapse of general credit take place.

To appreciate the effects which this acceleration of thehas in mitigating its intensity, let us advert moreto the nature and effects of that leading feature inperiod just preceding the collapse, the drain of gold. A riseprices produced by a speculative extension of credit, evenbank notes have not been the instrument, is not the less(if it lasts long enough) in turning the exchanges: andthe exchanges have turned from this cause, they can only beback, and the drain of gold stopped, either by a fall ofor by a rise of the rate of interest. A fall of pricesstop it by removing the cause which produced it, and bygoods a more advantageous remittance than gold, evenpaying debts already due. A rise of the rate of interest, andfall of the prices of securities, will accomplish thestill more rapidly, by inducing foreigners, instead ofaway the gold which is due to them, to leave it forwithin the country, and even send gold into theto take advantage of the increased rate of interest. Oflast mode of stopping a drain of gold, the year 1847signal examples. But until one of these two things takesuntil either prices fall, or the rate of interestnothing can possibly arrest, or even moderate, the effluxgold. Now, neither will prices fall nor interest rise, so longthe unduly expanded credit is upheld by the continued advancesbankers. It is well known that when a drain of gold has set, even if bank notes have not increased in quantity, it is uponthat the contraction first falls, the gold wanted forbeing always obtained from the Bank of England infor its notes. But under the system which preceded 1844,Bank of England, being subjected, in common with other banks,the importunities for fresh advances which are characteristicsuch a time, could, and often did, immediately re-issue thewhich had been returned to it in exchange for bullion. Ita great error, certainly, to suppose that the mischief of thisissue chiefly consisted in preventing a contraction of the. It was, however, quite as mischievous as it has eversupposed to be. As long as it lasted, the efflux of goldnot cease, since neither would prices fall nor interestwhile these advances continued. Prices, having risen withoutincrease of bank notes, could well have fallen without aof them; but having risen in consequence of anof credit, they could not fall without a contraction of. As long, therefore, as the Bank of England and the otherpersevered in this course, so long gold continued to flow, until so little was left that

the Bank of England, being inof suspension of payments, was compelled at last toits discounts so greatly and suddenly as to produce amore extreme variation in the rate of interest, inflict muchloss and distress on individuals, and destroy a muchamount of the ordinary credit of the country, than anynecessity required.

I acknowledge, (and the experience of 1847 has proved towho overlooked it before,) that the mischief now described,be wrought, and in large measure, by the Bank of England,its deposits alone. It may continue or even increase itsand advances, when it ought to contract them: with theeffect of making the contraction much more severe andthan necessary. I cannot but think, however, that bankscommit this error with their deposits, would commit itmore if they were at liberty to make increased loans withissues as well as their deposits. I am compelled to thinkthe being restricted from increasing their issues, is a realto their making those advances which arrest the tideits turn, and make it rush like a torrent afterwards.. andthe Act is blamed for interposing obstacles at a time whenobstacles but facilities are needed, it must in justicecredit for interposing them when they are an acknowledged. In this particular, therefore, I think it cannot be, that the new system is a real improvement upon the old.

4. But however this may be, it seems to me certain that these, whatever value may be put on them, are purchased bygreater disadvantages. In the first place, a largeof credit by bankers, though most hurtful when, creditalready in an inflated state, it can only serve to retardaggravate the collapse, is most salutary when the collapsecome, and when credit instead of being in excess is indeficiency, and increased advances by bankers,of being an addition to the ordinary amount of floating, serve to replace a mass of other credit which has beendestroyed. Antecedently to 1844, if the Bank of Englandaggravated the severity of a commercial revulsion bythe collapse of credit more tardy and hence morethan necessary, it in return rendered invaluable servicesthe revulsion itself, by coming forward with advances tosolvent firms, at a time when all other paper and almostmercantile credit had become comparatively valueless. Thiswas eminently conspicuous in the crisis of 1825-6, theprobably ever experienced; during which the Bankwhat is called its circulation by many millions, into those mercantile firms of whose ultimate solvency itno doubt; advances which if it had been obliged to withhold,severity of the crisis would have been still greater than it. If the Bank, it is justly remarked by Mr Fullarton, (4*)with such applications, "it must comply with them by anof notes, for notes constitute the only instrumentalitywhich the Bank is in the practice of lending its credit.those notes are not intended to circulate, nor do they. There is no more demand for circulation than there was. On the contrary, the rapid decline of prices which thein supposition presumes, would necessarily contract thefor circulation. The notes would either be returned to theof England, as fast as they were issued, in the shape of, or would be locked up in the drawers of the privatebankers, or distributed by them to their correspondents incountry, or intercepted by other capitalists, who, during theof the previous excitement, had contracted liabilitiesthey might be imperfectly prepared on the sudden to. In such emergencies, every man connected with, who has been trading on other means than his own, ison the defensive, and his whole object is to make himselfstrong as possible, an object which cannot be more effectuallythan by keeping by him as large a reserve as possible inwhich the law has made a legal tender. The notes themselvesfind their way into the produce

market; and if they at allto retard" (or, as I should rather say, to moderate)"the fall of prices, it is not by promoting in the slightestthe effective demand for commodities, not by enablingto buy more largely for consumption, and so givingto commerce, but by a process exactly the reverse, bythe holders of commodities to hold on, by obstructingand repressing consumption."

The opportune relief thus afforded to credit, during thecontraction which succeeds to an undue expansion, iswith the principle of the new system; for ancontraction of credit, and fall of prices,draw gold into the country, and the principle of theis that the bank-note currency shall be permitted, andcompelled, to enlarge itself, in all cases in which acurrency would do the same. But, what the principle oflaw would encourage, its provisions in this instance, by not suffering the increased issues to take placethe gold has actually arrived: which is never until thepart of the crisis has passed, and almost all the lossesfailures attendant on it are consummated. The machinery ofsystem withholds, until for many purposes it comes too late,very medicine which the theory of the system prescribes asappropriate remedy.(5*)

This function of banks in filling up the gap made incredit by the consequences of undue speculation andrevulsion, is so entirely indispensable, that if the Act ofcontinues unrepealed, there can be no difficulty inthat its provisions must be suspended, as they were in, in every period of great commercial difficulty, as soon ascrisis has really and completely set in.(6*) Were this all,would be no absolute inconsistency in maintaining theas a means of preventing a crisis, and relaxing itthe purpose of relieving one. But there is another objection,a still more radical and comprehensive character, to the new.

Professing, in theory, to require that a paper currency shallin its amount in exact conformity to the variations of acurrency, it provides, in fact, that in every case of anof gold, a corresponding diminution shall take place inquantity of bank notes; in other words, that everyof the precious metals shall be virtually drawn fromcirculation; it being assumed that this would be the case ifcurrency were wholly metallic. This theory, and thesearrangements, are adapted to the case in which theof gold originates in a rise of prices produced by an undueof currency or credit; but they are adapted to no case.

When the efflux of gold is the last stage of a series ofarising from an increase of the currency, or from anof credit tantamount in its effect on prices to anof currency, it is in that case a fair assumption thata purely metallic system the gold exported would be drawn fromcurrency itself; because such a drain, being in its nature, will necessarily continue as long as currency andare undiminished. But an exportation of the precious metisarises from no causes affecting currency or credit, butfrom an unusual extension of foreign payments, arisingfrom the state of the markets for commodities, or fromcircumstance not commercial. In this class of causes, four,powerful operation, are included, of each of which the lastyears of English history afford repeated instances. Theis that of an extraordinary foreign expenditure by, either political or military. as in the revolutionary, and, as long as it lasted, during the Crimean war. Theis the case of a large exportation of capital for foreign; such as the loans and mining operations which partlyto the crisis of 1825, and the American speculationswere the principal cause of the crisis of 1839. The thirda failure of crops in the countries which supply the rawof important manufactures; such as the cotton failure in, which compelled England, in 1847, to incur unusualfor the

purchase of that commodity at an advanced. The fourth is a bad harvest, and a great consequentof food; of which the years 1846 and 1847 presentedexample surpassing all antecedent experience.

In none of these cases, if the currency were metallic, wouldgold or silver exported for the purposes in question be, or even probably, drawn wholly from the circulation.would be drawn from the hoards, which under a metallicalways exist to a very large amount; in uncivilized, in the hands of all who can afford it; in civilizedchiefly in the form of bankers' reserves. Mr Tooke, in"Inquiry into the Currency Principle," bears testimony tofact; but it is to Mr Fullarton that the public are indebtedthe clearest and most satisfactory elucidation of it. As I amaware that this part of the theory of currency has been setby any other writer with anything like the same degree of, I shall quote somewhat largely from this able.

"No person who has ever resided in an Asiatic country, whereis carried on to a far larger extent in proportion toexisting stock of wealth, and where the practice has becomemore deeply engrafted in the habits of the people, byapprehensions of insecurity and the difficulty ofsafe and remunerative investments, than in any European— no person who has had personal experience of thisof society, can be at a loss to recollect innumerableof large metallic treasures extracted in times ofdifficulty from the coffers of individuals by theof a high rate of interest, and brought in aid of thenecessities, nor, on the other hand, of the facility withthose treasures have been absorbed again, when thewhich had drawn them into light were no longer in. In countries more advanced in civilization and wealththe Asiatic principalities, and where no man is in fear ofthe cupidity of power by an external display of, but where the interchange of commodities is still almostconducted through the medium of a metric circulation,is the case with most of the commercial countries on theof Europe, the motives for amassing the precious metalsbe less powerful than in the majority of Asiatic; but the ability to accumulate being more widely, the absolute quantity amassed will be found probably toa considerably larger proportion to the population.(7*) Instates which lie exposed to hostile invasion, or whosecondition is unsettled and menacing, the motive indeedstill be very strong; and in a nation carrying on ancommerce, both foreign and internal, without anyaid from any of the banking substitutes for money,reserves of gold and silver indispensably required to secureregularity of payments, must of themselves engross a share ofcirculating coin which it would not be easy to estimate.

"In this country, where the banking system has been carriedan extent and perfection unknown in any other part of Europe,may be said to have entirely superseded the use of coin,for retail dealings and the purposes of foreign commerce,incentives to private hoarding exist no longer, and thehave all been transferred to the banks, or rather, Isay, to the Bank of England. But in France, where thenote circulation is still comparatively limited, theof gold l and silver coin in existence I find nowestimated, on what are described as the latest, at the enormous sum of 120 millions sterling; nor isestimate at all at variance with the reasonable probabilitiesthe case. Of this vast treasure there is every reason tothat a very large proportion, probably by much thepart, is absorbed in the hoards. If you present fora bill for a thousand francs to a french banker, heyou the silver in a sealed bag from his strong room. Andthe banker only, but every merchant and

trader, according tomeans, is under the necessity of keeping by him a stock ofsufficient not only for his ordinary disbursements, but toany unexpected demands. That the quantity of speciein these innumerable depots, not in France only, butover the Continent, where banking institutions are stillentirely wanting or very imperfectly organized, is notimmense in itself, but admits of being largely drawn upon,transferred even in vast masses from one country to another,very little, if any, effect on prices, or other material, we have had some remarkable proofs: "among others,"the signal success which attended the simultaneous efforts ofof the principal European powers (Russia, Austria, Prussia,, and Denmark) to replenish their treasuries, and towith coin a considerable portion of the depreciated paperthe necessities of the war had forced upon them, and thisthe very time when the available stock of the precious metalsthe world had been reduced by the exertions of England toher metallic currency..... There can be no doubt thatcombined operations were on a scale of very extraordinary, that they were accomplished without any sensibleto commerce or public prosperity, or any other effect thantemporary derangement of the exchanges, and that the privateof treasure accumulated throughout Europe during the warhave been the principal source from which all this gold andwas collected. And no person, I think, can fairlythe vast superflux of metallic wealth thus proved toat all times in existence, and, though in a dormant and inert, always ready to spring into activity on the firstof a sufficiently intense demand, without feelingcompelled to admit the possibility of the mines beingshut up for years together, and the production of the metalssuspended, while there might be scarcely a perceptiblein the exchangeable value of the metal." (8*)

Applying this to the currency doctrine and its advocates,"one might imagine," says Mr Fullarton,(9*) "that they supposedgold which is drained off for exportation from a countrya currency exclusively metallic, to be collected byat the fairs and markets, or from the tills of theand mercers. They never even allude to the existence ofa thing as a great hoard of the metals, though upon theof the hoards depends the whole economy of internationalbetween specie-circulating communities, while anyof the money collected in hoards upon prices must, evento the currency hypothesis, be wholly impossible. Wefrom experience what enormous payments in gold and silvercirculating countries are capable, at times, of making,the least disturbance of their internal prosperity; andis it supposed that these payments come, but from their? let us think how the money market of a countryall its exchanges through the medium of the preciousonly, would be likely to be affected by the necessity ofa foreign payment of several millions. Of course thecould only be satisfied by a transmission of capital;would not the competition for the possession of capital forwhich the occasion would call forth, necessarilythe market rate of interest? If the payment was to be madethe government, would not the government, in all probability,to open a new loan on terms more than usually favourable tolender?" If made by merchants, would it not be drawn eitherthe deposits in banks, or from the reserves which merchantsby them in default of banks, or would it not oblige them tothe necessary amount of specie by going into the moneyas borrowers? "And would not all this inevitably act uponhoards, and draw forth into activity a portion of the goldsilver which the money-dealers had been accumulating, andof them with the express view of watching such opportunitiesturning their treasures to advantage?....

"To come to the present time, the balance of payments withall Europe has for about four years past been in favour ofcountry, and gold has been pouring in till the influxto the unheard-of sum of about fourteen millions. Yet in all this time, has any one heard a complaint ofserious suffering inflicted on the people of the Continent?prices there been greatly depressed beyond their range incountry? Have wages fallen, Or have merchants beenruined by the universal depreciation of their stock?has occurred nothing of the kind. The tenor of commercialmonetary affairs has been everywhere even and tranquil; andFrance more particularly, an improving revenue and extendedbear testimony to the continued progress of internal. It may be doubted, indeed, if this great efflux ofhas withdrawn from that portion of the metallic wealth ofnation which really circulates, a single napoleon. And it hasequally obvious, from the undisturbed state of credit, thatonly has the supply of specie indispensable for the conductbusiness in the retail market been all the while, but that the hoards have continued to furnishfacility requisite for the regularity of mercantile. It is of the very essence of the metallic system, thathoards, in all cases of probable occurrence, should be equalboth objects; that they should, in the first place, supply thedemanded for exportation, and in the next place, shouldup the home circulation to its legitimate complement. Everytrading under that system, who, in the corse of his business,have frequent occasion to remit large sums in specie tocountries, must either keep by him a sufficient treasurehis own or must have the means of borrowing enough from his, not only to make up when wanted the amount of his, but to enable him, moreover, to carry on histransactions at home without interruption."

In a country in which credit is carried to so great an extentin England, one great reserve, in a single establishment, theof England, supplies the place, as far as the preciousare concerned, of the multitudinous reserves of other. The theoretical principle, therefore, of the currencywould require, that all those drains of the metal,, if the currency were purely metallic, would be taken fromhoards, should be allowed to operate freely upon the reservethe coffers of the Bank of England, without any attempt toit either by a diminution of the currency or by aof credit. Nor to this would there be anygrounded objection, unless the drain were so great as tothe exhaustion of the reserve, and a consequent stoppagepayments; a danger against which it is possible to takeprecautions, because in the cases which we are, the drain is for foreign payments of definite, and stops of itself as soon as these are effected. And insystems it is admitted that the habitual reserve of the Bankexceed the utmost amount to which experience warrants thethat such a drain may extend; which extreme limit Mraffirms to be seven millions, but Mr Tooke recommendsaverage reserve of ten, and in his last publication, of twelve. Under these circumstances, the habitual reserve, whichnever be employed in discounts, but kept to be paid outin exchange for cheques or bank notes, would befor a crisis of this description; which thereforepass off without having its difficulties increased by aeither of credit or of the circulation. But this, theadvantageous denouement that the case admits of, and notconsistent with but required by the professed principle ofsystem, the panegyrists of the system claim for it as a greatthat it prevents. They boast, that on the first appearancea drain for exportation-whatever may be its cause, and, under a metallic currency, it would involve aof credit or not — the Bank is at once obliged toits advances. And this, be it remembered, when there hasno speculative rise of prices which it is indispensable to, no unusual extension of credit requiring contraction;the demand for gold is solely occasioned

by foreign paymentsaccount of government, or large corn importations consequenta bad harvest.

Even supposing that the reserve is insufficient to meet thepayments, and that the means wherewith to make them havebe taken from the loanable capital of the country, theof which is a rise of the rate of interest; in suchsome pressure on the money market is unavoidable,that pressure is much increased in severity by the separationthe banking from the issue department. The case is generallyas if the Act only operated in one way, namely, bythe Bank, when it has parted with (say) three millionsbullion in exchange for three millions of its notes, fromlending those notes, in discounts or other advances. ButAct really does much more than this. It is well known, thatfirst operation of a drain is always on the banking. The bank deposits constitute the bulk of theand disposable capital of the country; and capitalfor foreign payments is almost always obtained mainly byout deposits. Supposing three millions to be the amount, three millions of notes are drawn from the banking(either directly or through the private bankers, whothe bulk of their reserves with the Bank of England), andthree millions of notes, thus obtained, are presented at theDepartment, and exchanged against gold for exportation.a drain upon the country at large of only three millions, isdrain upon the Bank virtually of six millions. The depositslost three millions, and the reserve of the Issue Departmentlost an equal amount. As the two departments, so long as theremains in operation, cannot even in the utmost extremityone another, each must take its separate precautions for itssafety. Whatever measures, therefore, on the part of the, would have been required under the old system by a drain ofmillions, are now rendered necessary by a drain only of. The Issue Department protects itself in the mannerby the Act, by not re-issuing the three millions ofwhich have been returned to it. But the Banking Departmenttake measures to replenish its reserve, which has beenby three millions. Its liabilities having also decreasedmillions, by the loss of that amount of deposits, the, on the ordinary banking principle of a third of the, will bear a reduction of one million. But the othermillions it must procure by letting that amount of advances, and not renewing them. Not only must it raise its rate of, but it must effect, by whatever means, a diminution ofmillions in the total amount of its discounts: or it mustsecurities to an equal amount. This violent action on themarket for the purpose of replenishing the Banking reserve,wholly occasioned by the Act of 1844. If the restrictions ofAct did not exist, the Bank, instead of contracting its, would simply transfer two millions, either in gold ornotes, from the Issue to the Banking Department; not in orderlend them to the public, but to secure the solvency of theDepartment in the event of further unexpected demands bydepositors. And unless the drain continued, and reached soan amount as to seem likely to exceed the whole of the goldthe reserves of both departments, the Bank would be under no, while the pressure lasted, of withholding fromits accustomed amount of accommodation, at a rate ofcorresponding to the increased demand.(10*)

I am aware it will be said that by allowing drains of thisto operate freely upon the Bank reserve until theyof themselves, a contraction of the currency and of creditnot be prevented, but only postponed; since if a limitationissues were not resorted to for the purpose of checking thein its commencement, the same or a still greater limitationtake place afterwards, in order, by acting on prices, toback this large quantity of gold, for the

indispensableof replenishing the Bank reserve. But in this argumentthings are overlooked. In the first place, the gold mightbrought back, not by a fall of prices, but by the much moreand convenient medium of a rise of the rate of interest,no fall of any prices except the price of securities.English securities would be bought on account of, or foreign securities held in England would be sentfor sale, both which operations took place largely duringmercantile difficulties of 1847, and not only checked theof gold, but turned the tide and brought the metal back.was not, therefore, brought back by a contraction of the, though in this case it certainly was so by aof loans. But even this is not always indispensablein the second place, it is not necessary that the gold shouldwith the same suddenness with which it went out. A greatwould probably return in the ordinary way of commerce, infor exported commodities. The extra gains made by dealersproducers in foreign countries through the extra paymentsreceive from this country, are very likely to be partlyin increased purchases of English commodities, eitherconsumption or on speculation, though the effect may notitself with sufficient rapidity to enable theof gold to be dispensed with in the first instance.extra purchases would turn the balance of payments inof the country, and gradually restore a portion of thegold; and the remainder would probably be brought back,any considerable rise of the rate of interest in England,the fall of it in foreign countries, occasioned by theof some millions of gold to the loanable capital ofcountries. Indeed, in the state of things consequent on thediscoveries, when the enormous quantity of gold annuallyin Australia, and much of that from California, isto other countries through England, and a monthpasses without a large arrival, the Bank reserves canthemselves without any re-importation of the goldcarried off by a drain. All that is needful is an, and a very brief intermission is sufficient, of the.

For these reasons it appears to me, that notwithstanding theoperation of the Act of 1844 in the first stages ofkind of commercial crisis (that produced byspeculation), it on the whole materially aggravates theof commercial revulsions. And not only are contractionscredit made more severe by the Act, they are also made greatlyfrequent. "Suppose," says Mr George Walker, in a clear,, and conclusive series of papers in the Aberdeen, forming one of the best existing discussions of thequestion-"suppose that, of eighteen millions of gold, tenin the issue department and eight are in the banking. The result is the same as under a metric currencyonly eight millions in reserve, instead of eighteen.....effect of the Bank Act is, that the proceedings of the Banka drain are not determined by the amount of gold within its, but are, or ought to be, determined by the portion of itto the banking department. With the whole of the goldits disposal, it may find it unnecessary to interfere with, or force down prices, if a drain leave a fair reserve. With only the banking reserve at its disposal, it must,the narrow margin it has to operate on, meet all drains bymore or less strong, to the injury of theworld; and if it fail to do so, as it may fail, theis destruction. Hence the extraordinary and frequentof the rate of interest under the Bank Act. Since; when the eyes of the Bank were opened to its true position,has felt it necessary, as a precautionary measure, that everyin the reserve should be accompanied by an iteration inrate of interest." To make the Act innocuous, therefore, itbe necessary that the Bank, in addition to the whole of thein the Issue Department, should retain as great a reserve inor notes in the Banking Department alone, as would sufficethe old system for the security both of the issues and ofdeposits.

5. There remain two questions respecting a bank-note, which have also been a subject of considerableof late years: whether the privilege of providing itbe confined to a single establishment, such as the Bank of, or a plurality of issuers should be allowed; and in thecase, whether any peculiar precautions are requisite or, to protect the holders of notes against lossesby the insolvency of the issuers.

The course of the preceding speculations has led us to attachmuch less of peculiar importance to bank notes, as comparedother forms of credit, than accords with the notionscurrent, that questions respecting the regulation of sosmall a part of the general mass of credit, cannot appear toof such momentous import as they are sometimes considered.notes, however, have so far a real peculiarity, that theythe only form of credit sufficiently convenient for all theof circulation, to be able entirely to supersede the usemetallic money for internal purposes. Though the extension ofuse of cheques has a tendency more and more to diminish theof bank notes, as it would that of the sovereigns or otherwhich would take their place if they were abolished; theresure, for a long time to come, to be a considerable supply of, wherever the necessary degree of commercial confidence, and their free use is permitted. The exclusive privilege,, of issuing them, if reserved to the Government or toone body, is a source of great pecuniary gain. That thisshould be obtained for the nation at large is bothand desirable: and if the management of a bank-noteought to be so completely mechanical, so entirely aof fixed rule, as it is made by the Act of 1844, thereno reason why this mechanism should be worked for theof any private issuer, rather than for the public. If, however, a plan be preferred which leaves thein the amount of issues in any degree whatever to theof the issuers, it is not desirable that to thegrowing attributions of the Government, so delicate ashould be superadded; and that the attention of theof the state should be diverted from larger objects, bybeing besieged with the applications, and made a mark forthe attacks, which are never spared to those deemed to befor any acts, however minute, connected with theof the currency. It would be better that treasury, exchangeable for gold on demand, should be issued to aamount, not exceeding the minimum of a bank-note currency;remainder of the notes which may be required being left to beeither by one or by a number of private banking. Or an establishment like the Bank of Englandsupply the whole country, on condition of lending fifteentwenty millions of its notes to the government without; which would give the same pecuniary advantage to theas if it issued that number of its own notes.

The reason ordinarily alleged in condemnation of the systemplurality of issuers which existed in England before the Act1844, and under certain limitations still subsists, is thatcompetition of these different issuers induces them tothe amount of their notes to an injurious extent. But weseen that the power which bankers have of augmenting their, and the degree of mischief which they can produce by it,quite trifling compared with the current over-estimate. Asby Mr Fullarton, (11*) the extraordinary increase ofcompetition occasioned by the establishment of thestock banks, a competition often of the most reckless kind,proved utterly powerless to enlarge the aggregate mass of thenote circulation; that aggregate circulation having, on the, actually decreased. In the absence of any special casean exception to freedom of industry, the general rule oughtprevail. It appears desirable, however, to maintain one greatlike the Bank of England, distinguished from otherof issue in this, that it alone is required to pay in gold,others being at liberty to

pay their notes with notes of theestablishment. The object of this is that there may bebody, responsible for maintaining a reserve of the precioussufficient to meet any drain that can reasonably beto take place. By disseminating this responsibilitya number of banks, it is prevented from operatingupon any. or if it be still enforced against one,reserves of the metals retained by all the others are capitalidle in pure waste, which may be dispensed with by allowingat their option to pay in Bank of England notes.

6. The question remains whether, in case of a plurality of, any peculiar precautions are needed to protect theof notes from the consequences of failure of payment.1826, the insolvency of banks of issue was a frequent andserious evil, often spreading distress through a whole, and at one blow depriving provident industry ofresults of long and painful saving. This was one of the chiefwhich induced Parliament, in that year, to prohibit theof bank notes of a denomination below five pounds, that theclasses at least might be as little as possible exposedparticipate in this suffering. As an additional safeguard, itbeen suggested to give the holders of notes a priority overcreditors, or to require bankers to deposit stock or othersecurities as a pledge for the whole amount of their. The insecurity of the former bank-note currency ofwas partly the work of the law, which, in order to give amonopoly of banking business to the Bank of England,actually made the formation of safe banking establishments aoffence, by prohibiting the existence of any banks, inor country, whether of issue or deposit, with a number ofexceeding six. This truly characteristic specimen of thesystem of monopoly and restriction vas done away with in, both as to issues and deposits, everywhere but in aof sixty-five miles radius round London, and in 1833 indistrict also, as far as relates to deposits. It was hopedthe numerous joint-stock banks since established would havea more trustworthy currency, and that under theirthe banking system of England would have been almost asto the public as that of Scotland (where banking wasfree) has been for two centuries past. But the almostinstances of reckless and fraudulent mismanagementthese institutions have of late afforded (though in some ofmost notorious cases the delinquent establishments have notbanks of issue), have shown only too clearly that, south ofTweed at least, the joint-stock principle applied to bankingnot the adequate safeguard it was so confidently supposed to: and it is difficult now to resist the conviction, that ifof issuers is allowed to exist, some kind of specialin favour of the holders of notes should be exacted asimperative condition. :. Regulation of Currencies, p. 85.. I think myself justified in affirming that the mitigation ofrevulsions is the real, and only serious, purpose ofAct of 1844. I am quite aware that its supporters insist(especially since 1847) on its supreme efficacy in "maintainingconvertibility of the Bank note." But I must be excused forattaching any serious importance to this one among itsmerits. The convertibility of the Bank note was, and would have continued to be maintained, atcost, under the old system. As was well said by Lordin his Evidence, the Bank can always, by a sufficientlyaction on credit, save itself at the expense of thepublic. That the Act of 1844 mitigates the violence ofprocess, is a sufficient claim to prefer in its behalf., if we suppose such a degree of mismanagement, on theof the Bank, as, were it not for the Act, would endanger theof convertibility, the same (or a less) degree of, practised under the Act, would suffice to producesuspension of payments by the Banking Department; an eventthe compulsory separation of the two departments bringsnearer to possibility than it was before, and which,as it would the probable stoppage of every privateestablishment in London, and perhaps also the non-

paymentthe dividends to the national creditor, would be a far greatercalamity than a brief interruption of theof the note; insomuch that, to enable the Bank topayment of its deposits, no Government would hesitate ato suspend payment of the notes, if suspension of the Act1844 proved insufficient. . A conditional increase of this maximum is permitted, but onlyby arrangement with any country bank the issues of that bankdiscontinued, and Bank of England motes substituted; and eventhe increase is limited to two-thirds of the amount of thenotes to be thereby superseded. Under the provision theof notes which the Bank of England is now at liberty toagainst securities, is about fifteen millions.. p. 106.. True the Bank is not precluded from making increased advancesits deposits, which are likely to be of unusually large, since, at these periods, every one leaves his money inin order to have it within call. But, that the depositsnot always sufficient, was conclusively proved in 1847, whenBank stretched to the very utmost the means of relievingwhich its deposits afforded, without allaying the panic,however ceased at once when the Government decided onthe Act.. This prediction was verified on the very next occurrence of acrisis, in 1857; when Government were again under theof suspending, on their own responsibility, theof the Act.. It is known, from unquestionable facts, that the hoards ofat all times existing in the hands of the French peasantry,from a remote date, surpass any amount which could haveimagined possible; and even in so poor a country as Ireland,has of late been ascertained, that the small farmers sometimeshoards quite disproportioned to their visible means of.. Fullarton on the Regulation of Currencies, pp. 71-4.. Ib. pp. 139-42.. This, which I have called "the double action of drains." hasstrangely understood as if I had asserted that the Bank isto part with six millions' worth of property by a drainthree millions. such an assertion would be too absurd toany refutation. Drains have a double action, not upon theposition of the Bank itself, but upon the measures itforced to take in order to stop the drain. Though the Bankis no poorer, its two reserves, the reserve in the bankingand the reserve in the issue department, have eachreduced by three millions by a drain of only three. And asseparation of the departments renders it necessary that eachthem separately should be kept as strong as the two togetherbe if they could help one another, the Bank's action on themarket must be as violent on a drain of three millions, ashave been required on the old system for one of six. Thein the banking department being less than it otherwisebe by the entire amount of the bullion in the issue, and the whole amount of the drain falling in theinstance on that diminished reserve, the pressure of thedrain on the half reserve is as much felt, and requires asmeasures to stop it, as a pressure of twice the amount onentire reserve. As I have said elsewhere "it is as if a manto lift a weight were restricted from using both hands toit, and where only allowed to use one hand at a time: in whichit would be necessary that each of his hands should be asas the two together." {Evidence before the Committee ofHouse of Commons on the Bank Acts, in 1857.. Pp. 89-92.

The Principles of Political Economy

John Stuart Mill3:

Distribution

25

the Competition of Different Countries in the Same Market

1. In the phraseology of the Mercantile System, the languagedoctrines of which are still the basis of what may be calledpolitical economy of the selling classes, as distinguishedthe buyers or consumers, there is no word of more frequentor more perilous import than the word underselling. Toother countries — not to be undersold by other— were spoken of, and are still very often spoken of,as if they were the sole purposes for which production andexist. The feelings of rival tradesmen, prevailingnations, overruled for centuries all sense of the generalof advantage which commercial countries derive from theof one another: and that commercial spirit which isone of the strongest obstacles to wars, was during a certainof European history their principal cause.

Even in the more enlightened view now attainable of theand consequences of international commerce, some, though asmall, space must still be made for the fact ofrivality. Nations may, like individual dealers, be, with opposite interests, in the markets of some, while in others they are in the more fortunateof reciprocal customers. The benefit of commerce doesconsist, as it was once thought to do, in the commodities; but, since the commodities sold are the means of obtainingwhich are bought, a nation would be cut off from the realof commerce, the imports, if it could not induce otherto take any of its commodities in exchange; and inas the competition of other counties compels it toits commodities on cheaper terms, on pain of not sellingat all, the imports which it obtains by its foreign tradeprocured at greater cost.

These points have been adequately, though incidentally,in some of the preceding chapters. But the great spacethe topic has filled, and continues to fill, in economical, and in the practical anxieties both of politiciansof dealers and manufacturers, makes it desirable, beforethe subject of international exchange, to subjoin a fewon the things which do, and on those which do not,countries to undersell one another.

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

Let us revert to the imaginary hypothesis of a trade betweenand Germany in cloth and linen: England being capable of10 yards of cloth at the same cost with 15 yards of, Germany at the same cost with 20, and the two commoditiesexchanged between the two countries (cost of carriage) at some intermediate rate, say 10 for 17. Germany couldbe

permanently undersold in the English market, and expelledit, unless by a country which offered not merely more than, but more than 20 yards of linen for 10 of cloth. Short of, the competition would only oblige Germany to pay dearer for, but would not disable her from exporting linen. The, therefore, which could undersell Germany, must, in theplace, be able to produce linen at less cost, compared with, than Germany herself; and in the next place, must havea demand for cloth, or other English commodities, as wouldher, even when she became sole occupant of the market, toa greater advantage to England than Germany could give bythe whole of hers; to give, for example, 21 yards for. For if not — if, for example, the equation of international, after Germany was excluded, gave a ratio of 18 for 10,could again enter into the competition; Germany would bethe underselling nation; and there would be a point, perhapsfor 10, at which both countries would be able to maintainground, and to sell in England enough linen to pay for the, or other English commodities, for which, on theseadjusted terms of interchange, they had a demand. In like, England, as an exporter of cloth, could only be driventhe German market by some rival whose superior advantages inproduction of cloth enabled her, and the intensity of whosefor German produce compelled her, to offer 10 yards of, not merely for less than 17 yards of linen, but for less15. In that case, England could no longer carry on the tradeloss; but in any case short of this, she would merely beto give to Germany more cloth for less linen than she hadgiven.

It thus appears that the alarm of being permanently undersoldbe taken much too easily; may be taken when the thing reallybe anticipated is not the loss of the trade, but the minorof carrying it on at a diminished advantage; anchiefly falling on the consumers of foreign, and not on the producers or sellers of the exported. It is no sufficient ground of apprehension to theproducers, to find that some other country can sell clothforeign markets at some particular time, a trifle cheaper thancan themselves afford to do in the existing state of pricesEngland. Suppose them to be temporarily undersold, and theirdiminished; the imports will exceed the exports, therebe a new distribution of the precious metals, prices will, and as all the money expenses of the English producers willdiminished, they will be able (if the case falls short of thatin the preceding paragraph) again to compete with their. The loss which England will incur, will not fall upon the, but upon those who consume imported commodities; who,money incomes reduced in amount, will have to pay the sameeven an increased price for all things produced in foreign.

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

According to the preceding doctrine, a country cannot bein any commodity, unless the rival country has ainducement than itself for devoting its labour andto the production of the commodity; arising from the factby doing so it occasions a greater saving of labour and, to be shared between itself and its customers — aincrease of the aggregate produce of the world. The, therefore, though a loss to the undersold country,an advantage to the world at large; the substituted commerceone which economies more of the labour and capital of, and adds more to their collective wealth, than thesuperseded by it. The advantage, of course, consists inable to produce the commodity of better quality, or withlabour (compared with other things); or perhaps not withlabour, but in less time;

with a less prolonged detention ofcapital employed. This may arise from greater natural(such as soil, climate, richness of mines); superior, either natural or acquired, in the labourers; betterof labour, and better tools, or machinery. But there isplace left in this theory for the case of lower wages. This,, in the theories commonly current, is a favourite causeunderselling. We continually hear of the disadvantage underthe British producer labours, both in foreign markets andin his own, through the lower wages paid by his foreign. These lower wages, we are told, enable, or are always onpoint of enabling them to sell at lower prices, and tothe English manufacturer from all markets in which he isartificially protected.

Before examining this opinion on grounds of principle, it iswhile to bestow a moment's consideration upon it as aof fact. Is it true, that the wages of manufacturingare lower in foreign countries than in England, in anyin which low wages are an advantage to the capitalist? Theof Ghent or Lyons may earn less wages in a day, but doesnot do less work? Degrees of efficiency considered, does hiscost less to his employer? Though wages may be lower onContinent, is not the Cost of Labour, which is the realin the competition, very nearly the same? That it is sothe opinion of competent judges, and is confirmed by thelittle difference in the rate of profit between England andContinental countries. But if so, the opinion is absurd thatproducers can be undersold by their Continental rivalsthis cause. It is only in America that the supposition isfacie admissible. In America, wages are much higher than in, if we mean by wages the daily earnings of a labourer:the productive power of American labour is so great — its, combined with the favourable circumstances in whichis exerted, makes it worth so much to the purchaser, that theof Labour is lower in America than in England; as isby the fact that the general rate of profits and ofis higher.

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

If wages, in any of the departments of industry which supply, are kept, artificially, or by some accidental cause,the general rate of wages in the country, this is a realin the foreign market. It lessens the comparative costproduction of those articles, in relation to others; and hassame effect as if their production required so much less. Take, for instance, the case of the United States into certain commodities, prior to the civil war. Tobaccocotton, two great articles of export, were produced by slave, while food and manufactures generally were produced bylabourers, neither working on their own account or paid by. In spite of the inferior efficiency of slave labour, therebe no reasonable doubt that in a country where the wages oflabour were so high, the work executed by slaves was abargain to the capitalist. To whatever extent it was so,smaller cost of labour, being not general, but limited toemployments, was just as much a cause of cheapness in the, both in the home and in the foreign market, as if theybeen made by a less quantity of labour. If, when the slavesthe Southern States were emancipated, their wages rose to thelevel of the earnings of free labour in America, thatmight have been obliged to erase some of the slave-grownfrom the catalogue of its exports, and would certainlyunable to sell any of them in the foreign market at theprice. Accordingly, American cotton is now habituallya much higher price than before the war. Its previouswas partly an artificial cheapness,

which may beto that produced by a bounty on production or on: or, considering the means by which it was obtained,apter comparison would be with the cheapness of stolen goods.

An advantage of a similar economical, though of a verymoral character, is that possessed by domestic; fabrics produced in the leisure hours of familiesoccupied in other pursuits, who, not depending foron the produce of the manufacture, can afford to sellat any price, however low, for which they think it worth whiletake the trouble of producing. In an account of the Canton of, to which I have had occasion to refer on another subject,is observed,(1*) "The workman of Zurich is to-day a, to-morrow again an agriculturist, and changes hiswith the seasons, in a continual round. Manufacturingand tillage advance hand in hand, in inseparable, and in this union of the two occupations the secret mayfound, why the simple and unlearned Swiss manufacturer cango on competing, and increasing in prosperity, in the facethose extensive establishments fitted out with great economic,(what is still more important) intellectual, resources. Eventhose parts of the Canton where manufactures have extendedthe most widely, only one-seventh of all the familiesto manufactures alone; four-sevenths combine thatwith agriculture. The advantage of this domestic ormanufacture consists chiefly in the fact, that it iswith all other avocations, or rather that it may inbe regarded as only a supplementary employment. In winter indwellings of the operatives, the whole family employin it: but as soon as spring appears, those on whomearly field labours devolve, abandon the in-door work; many astands still; by degrees, as the field-work increases,member of the family follows another, till at last, at the, and during the so-called 'great works,' all hands seizeimplements of husbandry; but in unfavourable weather, and inotherwise vacant hours, the work in the cottage is resumed,when the ungenial season again recurs, the people return insame gradual order to their home occupation, until they haveresumed it."

In the case of these domestic manufactures, the comparativeof production, on which the interchange between countries, is much lower than in proportion to the quantity ofemployed. The workpeople, looking to the earnings of theirfor a part only, if for any part, of their actual, can afford to work for a less remuneration than therate of wages which can permanently exist in theby which the labourer has to support the wholeof a family. Working, as they do, not for an employer butthemselves, they may be said to carry on the manufacture atcost at all, except the small expense of a loom and of the; and the limit of possible cheapness is not theof living by their trade but that of earning enough bywork to make that social employment of their leisure hoursdisagreeable.

4. These two cases, of slave labour and of domestic, exemplify the conditions under which low wagesa country to sell its commodities cheaper in foreign, and consequently to undersell its rivals, or to avoidundersold by them. But no such advantage is conferred bywages when common to all branches of industry. General lownever caused any country to undersell its rivals, nor didhigh wages ever hinder it from doing so.

To demonstrate this, we must return to an elementarywhich was discussed in a former chapter.(2*) Generalwages do not cause low prices, nor high wages high prices,the country itself. General prices are not raised by aof wages, any more than they would be raised by an increasethe quantity of labour required in all production. Expensesaffect all commodities equally, have no influence on. If the maker of broadcloth or cutlery, and nobody else,to pay higher wages, the price of his commodity would rise,as it would if he

had to employ more labour; becausehe would gain less profit than other producers, andwould engage in the employment. But if everybody has tohigher wages, or everybody to employ more labour, the lossbe submitted to; as it affects everybody alike, no one canto get rid of it by a change of employment, each thereforehimself to a diminution of profits, and prices remain aswere. In like manner, general low wages, or a generalin the productiveness of labour, does not make prices, but profits high. If wages fall, (meaning here by wages theof labour,) why, on that account, should the producer lowerprice? He will be forced, it may be said, by the competitionother capitalists who will crowd into his employment. Butcapitalists are also paying lower wages, and by enteringcompetition with him they would gain nothing but what theygaining already. The rate then at which labour is paid, asas the quantity of it which is employed, affects neither thenor the price of the commodity produced, except in so farit is peculiar to that commodity, and not common togenerally.

Since low wages are not a cause of low prices in the country, so neither do they cause it to offer its commodities inmarkets at a lower price. It is quite true that if theof labour is lower in America than in England, America couldher cottons to Cuba at a lower price than England, and stillas high a profit as the English manufacturer. But it is notthe profit of the English manufacturer that the Americanspinner will make his comparison; it is with the profitsother American capitalists. These enjoy, in common with, the benefit of a low cost of labour, and havea high rate of profit. This high profit the cottonmust also have: he will not content himself with theprofit. It is true he may go on for a time at that lower, rather than change his employment; and a trade may beon, sometimes for a long period, at a much lower profitthat for which it would have been originally engaged in.which have a low cost of labour, and high profits, dofor that reason undersell others, but they do oppose a moreresistance to being undersold, because the producersoften submit to a diminution of profit without being unablelive, and even to thrive, by their business. But this is alltheir advantage does for them: and in this resistance theynot long persevere, when a change of times which may giveequal profits with the rest of their countrymen has becomehopeless.

5. There is a class of trading and exporting communities, ona few words of explanation seem to be required. These areto be looked upon as countries, carrying on an exchange ofwith other countries, but more properly as outlyingor manufacturing establishments belonging to acommunity. Our West india colonies, for example, cannot beas countries, with a productive capital of their own. If, instead of being where it is, were on a rock in theSea, (its present industry nevertheless continuing,) itstill be but a town of England, not a country trading with; it would be merely, as now, a place where England findsconvenient to carry on her cotton manufacture. The West, in like manner, are the place where England finds itto carry on the production of sugar, coffee, and a fewtropical commodities. All the capital employed is English; almost all the industry is carried on for English uses;is little production of anything except the staple, and these are sent to England, not to be exchangedthings exported to the colony and consumed by its, but to be sold in England for the benefit of thethere. The trade with the West Indies is thereforeto be considered as external trade, but more resembles thebetween town and country, and is amenable to theof the home trade. The rate of profit in the coloniesbe regulated by English

profits; the expectation of profitbe about the same as in England, with the addition offor the disadvantages attending the more distant andemployment: and after allowance is made for those, the value and price of West India produce in themarket must be regulated, (or rather must have beenformerly,) like that of any English commodity, by theof production. For the last twelve or fifteen years thishas been in abeyance: the price was first kept upthe ratio of the cost of production by deficient supplies,could not, owing to the deficiency of labour, be increased;more recently the admission of foreign competition hasanother element, and some of the West India Islandsundersold, not so much because wages are higher than in CubaBrazil, as because they are higher than in England: for werenot so, Jamaica could sell her sugars at Cuban prices, andobtain, though not a Cuban, an English rate of profit.

It is worth while also to notice another class of small, butthis case mostly independent communities, which have supportedenriched themselves almost without any productions of their, (except ships and marine equipments,) by a mere carrying, and commerce of entrepot; by buying the produce of one, to sell it at a profit in another. Such were Venice andHanse Towns. The case of these communities is very simple.made themselves and their capital the instruments, not of, but of accomplishing exchanges between theof other countries. These exchanges are attended withadvantage to those countries — an increase of the aggregateto industry — part of which went to indemnify the agentsthe necessary expenses of transport, and another part tothe use of their capital and mercantile skill. Thethemselves had not capital disposable for the. When the Venetians became the agents of the generalof Southern Europe, they had scarcely any competitors:thing would not have been done at all without them, and therereally no limit to their profits except the limit to what thefeudal nobility could and would give for the unknownthen first presented to their sight. At a later periodarose, and the profit of this operation, like that of, became amenable to natural laws. The carrying trade wasup by Holland, a country with productions of its own and aaccumulated capital. The other nations of Europe also hadcapital to spare, and were capable of conducting theirtrade for themselves: but Holland, having, from a varietycircumstances, a lower rate of profit at home, could afford tofor other countries at a smaller advance on the originalof the goods, than would have been required by their own; and Holland, therefore, engrossed the greatest partthe carrying trade of all those countries which did not keepto themselves by Navigation Laws, constructed, like those of, for that express purpose. :. Historisch-geographisch- staatistisches Germalde der Schweiz.Heft, 1834, p. 105.. Supra, book iii. ch. iv.

The Principles of Political Economy

John Stuart Mill3:

Distribution

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Distribution, as Affected by Exchange

1. We have now completed, as far as is compatible with ourand limits, the exposition of the machinery throughthe produce of a country is apportioned among the differentof its inhabitants; which is no other than the machineryExchange, and has for the exponents of its operation, the lawsValue and of Price. We shall now avail ourselves of the lightacquired, to cast a retrospective glance at the subject of. The division of the produce among the three, Labourers, Capitalists, and Landlords, when consideredany reference to Exchange, appeared to depend on certainlaws. It is fit that we should now consider whether theselaws still operate, when the distribution takes placethe complex mechanism of exchange and money; or whetherproperties of the mechanism interfere with and modify theprinciples.

The primary division of the produce of human exertion andis, as we have seen, into three shares, wages, profits,rent; and these shares are portioned out to the personsto them, in the form of money, and by a process of; or rather, the capitalist, with whom in the usualof society the produce remains, pays in money, toother two sharers, the market value of their labour and land.we examine, on what the pecuniary value of labour, and thevalue of the use of land, depend, we shall find that iton the very same causes by which we found that wages and rentbe regulated if there were no money and no exchange of.

It is evident, in the first place, that the law of Wages isaffected by the existence or non-existence of Exchange or. Wages depend on the ratio between population and capital;would do so if all the capital in the world were the propertyone association, or if the capitalists among whom it is sharedeach an establishment for the production of everyconsumed in the community, exchange of commodities havingexistence. As the ratio between capital and population, in allcountries, depends on the strength of the checks by which therapid increase of population is restrained, it may be said,speaking, that wages depend on the checks to; that when the check is not death, by starvation or, wages depend on the prudence of the labouring people;that wages in any country are habitually at the lowest rate,which in that country the labourer will suffer them to berather than put a restraint upon multiplication.

What is here meant, however, by wages, is the labourer's realof comfort; the quantity he obtains of the things whichor habit has made necessary or agreeable to him: wages insense in which they are of importance to the receiver. In thein which they are of importance to the payer, they do notexclusively on such simple principles. Wages in the first, the wages on which the labourer's comfort depends, we willreal wages, or wages in kind. Wages in the second sense, webe permitted to call, for the present, money wages; assuming,it is allowable to do, that money remains for the time anstandard, no iteration taking place in the conditionswhich the circulating medium itself is produced or. If money

itself undergoes no variation in cost, theprice of labour is an exact measure of the Cost of Labour,may be made use of as a convenient symbol to express it.

The money wages of labour are a compound result of two: first, real wages, or wages in kind, or in other words,quantity which the labourer obtains of the ordinary articlesconsumption; and secondly, the money prices of those articles.all old countries — all countries in which the increase ofis in any degree checked by the difficulty ofsubsistence — the habitual money price of labour iswhich will just enable the labourers, one with another, tothe commodities without which they neither cannot ornot keep up the population at its customary rate of. Their standard of comfort being given, (and by theof comfort in a labouring class, is meant that, ratherforego which, they will abstain from multiplication,) moneydepend on the money price, and therefore on the cost of, of the various articles which the labourersconsume: because if their wages cannot procure them aquantity of these, their increase will slacken, and theirrise. Of these articles, food and other agriculturalare so much the principal, as to leave little influenceanything else.

It is at this point that we are enabled to invoke the aid ofprinciples which have been laid down in this Third Part. Theof production of food and agricultural produce has beenin a preceding chapter. It depends on the productivenessthe least fertile land, or of the least productively employedof capital, which the necessities of society have as yetin requisition for agricultural purposes. The cost ofof the food grown in these least advantageous, determines, as we have seen, the exchange valuemoney price of the whole. In any given state, therefore, oflabourers' habits, their money wages depend on theof the least fertile land, or least productivecapital; on the point which cultivation has reachedits downward progress — in its encroachments on the barren, and its gradually increased strain upon the powers of thefertile. Now, the force which urges cultivation in thiscourse, is the increase of people; while theforce which checks the descent, is the improvement ofscience and practice, enabling the same soil toto the same labour more ample returns. The costliness ofmost costly part of the produce of cultivation, is an exactof the state, at any given moment, of the race whichand agricultural skill are always running against each.

2. It is well said by Dr Chalmers, that many of the mostlessons in political economy are to be learnt at themargin of cultivation, the last point which the culturethe soil has reached in its contest with the spontaneousof nature. The degree of productiveness of this extreme, is an index to the existing state of the distribution ofproduce among the three classes, of labourers, capitalists,landlords.

When the demand of an increasing population for more foodbe satisfied without extending cultivation to less fertileor incurring additional outlay, with a less proportional, on land already in cultivation, it is a necessaryof this increase of agricultural produce, that theand price of that produce must first rise. But as soon asprice has risen sufficiently to give to the additional outlaycapital the ordinary profit, the rise will not go on stillfor the purpose of enabling the new land, or the newon old land, to yield rent as well as profit. Theor capital last put in requisition, and occupying what Drcalls the margin of cultivation, will yield, andto yield, no rent. But if this yields no rent, the rentby all other land or agricultural capital will beso much as it produces more than this. The price of foodalways on the average be such, that the worst land, and theproductive instalment of the capital employed on the better, shall just replace the expenses with the ordinary profit.the least

favoured land and capital just do thus much, allland and capital will yield an extra profit, equal to theof the extra produce due to their superior; and this extra profit becomes, by competition,prize of the landlords. Exchange, and money, therefore, makedifference in the law of rent: it is the same as we originallyit. Rent is the extra return made to agricultural capitalemployed with peculiar advantages; the exact equivalent ofthose advantages enable the producers to economize in theof production: the value and price of the produce beingby the cost of production to those producers who haveadvantages; by the return to that portion of agricultural, the circumstances of which are the least favourable.

3. Wages and Rent being thus regulated by the same principlespaid in money, as they would be if apportioned in kind, itthat Profits are so likewise. For the surplus, afterwages and paying rent, constitutes Profits.

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

There are two modes in which the Cost of Labour, which isrepresented (money being supposed invariable) by thewages of the labourer, may be increased. The labourer maygreater comforts; wages in kind — real wages — may rise.the progress of population may force down cultivation tosoils, and more costly processes; thus raising the costproduction, the value, and the price, of the chief articles oflabourer's consumption. On either of these suppositions, theof profit will fall.

If the labourer obtains more abundant commodities, only byof their greater cheapness; if he obtains a greater, but not on the whole a greater cost; real wages will be, but not money wages, and there will be nothing tothe rate of profit. But if he obtains a greater quantitycommodities of which the cost of production is not lowered, hea greater cost; his money wages are higher. The expensethese increased money wages falls wholly on the capitalist.are no conceivable means by which he can shake it off. Itbe said — it is, not unfrequently, said — that he will getof it by raising his price. But this opinion we have already,more than once, fully refuted.(1*)

The doctrine, indeed, that a rise of wages causes anrise of prices, is, as we formerly observed,contradictory for if it did so, it would not be a rise of; the labourer would get no more of any commodity than hebefore, let his money wages rise ever so much; a rise of realwould be an impossibility. This being equally contrary toand to fact, it is evident that a rise of money wages doesraise prices; that high wages are not a cause of high prices.rise of general wages falls on profits. There is no possible.

Having disposed of the case in which the increase of money, and of the Cost of Labour, arises from the labourer'smore ample wages in kind, let us now suppose it tofrom the increased cost of production of the things whichconsumes; owing to an increase of population, unaccompanied byequivalent increase of agricultural skill. The augmentedrequired by the population would not be obtained, unlessprice of food rose sufficiently to remunerate the farmer forincreased cost of production. The farmer, however, in thissustains a twofold disadvantage. He has to carry on hisunder less

favourable conditions of productivenessbefore. For this, as it is a disadvantage belonging to himas a farmer, and not shared by other employers, he will, ongeneral principles of value, be compensated by a rise of theof his commodity: indeed, until this rise has taken place,will not bring to market the required increase of produce. Butvery rise of price involves him in another necessity, forhe is not compensated. As the real wages of labour are byunaltered, he must pay higher money wages to his. This necessity, being common to him with all other, forms no ground for a rise of price. The price will, until it has placed him in as good a situation in respectprofits, as other employers of labour: it will rise so as tohim for the increased labour which he must now employorder to produce a given quantity of food: but the increasedof that labour are a burthen common to all, and for whichone can be indemnified. It will be paid wholly from profits.

Thus we see that increased wages, when common to allof productive labourers, and when reallya greater Cost of Labour, are always and necessarythe expense of profits. And by reversing the cases, we shouldin like manner that diminished wages, when representing adiminished Cost of Labour, are equivalent to a rise of. But the opposition of pecuniary interest thus indicatedthe class of capitalists and that of labourers, is to aextent only apparent. Real wages are a very different thingthe Cost of Labour, and are generally highest at the timesplaces where, from the easy terms on which the land yieldsthe produce as yet required from it, the value and price ofbeing low, the cost of labour to the employer,its ample remuneration, is comparatively cheap,the rate of profit consequently high. We thus obtain a fullof our original theorem that Profits depend on theof Labour: or, to express the meaning with still greater, the rate of profit and the cost of labour varyas one another, and are joint effects of the sameor causes.

But does not this proposition require to be slightly, by making allowance for that portion (thoughsmall) of the expenses of the capitalist, whichnot consist in wages paid by himself or reimbursed tocapitalists, but in the profits of those previous? Suppose, for example, an invention in theof leather, the advantage of which should consist init unnecessary that the hides should remain for soa length of time in the tan-pit. Shoemakers, saddlers, andworkers in leather, would save a part of that portion ofcost of their material which consists of the tanner's profitsthe time his capital is locked up; and this saving, it maysaid, is a source from which they might derive an increase of, though wages and the Cost of Labour remained exactly the. In the case here supposed, however, the consumer alonebenefit, since the prices of shoes, harness, and all otherinto which leather enters, would fall, until the profitsthe producers were reduced to the general level. To obviateobjection, let us suppose that a similar saving of expenseplace in all departments of production at once. In that, since values and prices would not be affected, profitsprobably be raised; but if we look more closely into thewe shall find, that it is because the cost of labour wouldlowered. In this as in any other case of increase in theproductiveness of labour, if the labourer obtained onlysame real wages, profits would be raised: but the same realwould imply a smaller Cost of Labour; the cost ofof all things having been, by the supposition,. If, on the other hand, the real wages of labour rose, and the Cost of Labour to the employer remainedsame, the advances of the capitalist would bear the sameto his returns as before, and the rate of profit would be. The reader who may wish for a more minute examinationthis point, will find it in the volume of separate Essays toreference has

before been made.(2*) The question is tooin comparison with its importance, to be furtherinto in a work like the present; and I will merely say,it seems to result from the considerations adduced in the, that there is nothing in the case in question to affectintegrity of the theory which affirms an exact, in an inverse direction, between the rate ofand the Cost of Labour. :. Supra, book iii. ch. iv. section 2, and ch. xxv. section 4.. Essay IV, on Profits and Interest.