

James Wilson and the 1847 Crisis

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On 2 September 1993 *The Economist* celebrated its one hundred and fiftieth anniversary. It recalled particular aspects of the life of its founder and first editor, James Wilson, as well as the principles which inspired his work as a journalist — principles which *The Economist* has for so long adhered to. Yet there is no mention of Wilson's political opinions even though such opinions were influential in the debate between the Currency School and the Banking School which went on in the mid-nineteenth-century decades.

James Wilson largely supported the arguments advanced by Tooke and Fullarton's Banking School. These attacked the 1844 Bank Act which had regulated the functions and the structure of the Bank of England and fixed rules for banknote issue. Although Wilson never undertook to write a theoretical essay on the money problem, he did set down his ideas in a series of articles about the 1844 crisis and its causes, which he published in *The Economist*.

Nonetheless the best contemporary account of the crisis is that of Morier Evans, who produced a major essay narrating the course of events.¹ It is no coincidence that nearly half the essay was devoted to an examination of the years 1844-46, or the time of what the author called the "railway mania". Effectively the last few months of 1844 and all of 1845 and 1846 witnessed a steadily intensifying boom in the construction of new railway lines. Assisted by very low interest rates (2 to 2-1/2 percent) in the first half of 1845, speculation grew at an

¹ D. M. Evans, *The Commercial Crisis 1847-1848*, London, Letts and Steer, 1848.

alarming pace. "Between the month of May and June the increase of speculation was fearful. The papers teemed with advertisements unrestricted to the limits of ordinary announcements. Columns scarcely sufficed to give the world a knowledge of each scheme. Lists of provisional committee-men which in the beginning of the year had seldom exceeded a dozen or twenty names now, extended their length to ten times that number. Earls and Marquises struggled with London capitalists and rustic Landowners to add attractiveness by the sanitation of their names"². The speculative mania showed no signs of waning over the summer. For the first three quarters the rise in railway share prices amounted to 60 percent. In September alone 457 projects for new lines were submitted for Parliament's approval, bringing the total for the first nine months to 1,035.

In October the Bank raised the discount rate to 3 percent. The stock exchange lurched and railway shares plummeted. In November the market interest rate went up to 4-1/2 percent and the Bank of England raised its minimum rate to 3-1/2 percent. The *Times* published figures showing that while the capital invested in completed railways amounted to 48 million pounds, over 6 million was in lines under construction and £59 million had been deposited for new projects. It was further calculated that to complete those currently under construction, £61 million would be needed, and another £507 million to execute those projected. On November 17 the *Times* wrote "But if six million a year has been a difficulty, and twenty-two millions a year is almost a four times greater difficulty, what are we to say to the enormous — the stupendous — the infinite sums, if infinity can be summed up, — that appear in our synoptical view? Here we have 1,428 railways, with an estimated capital of £701,243,208 with a deposit of £49,592,816. Take away £140,000,000 for railways completed, or in progress, exclude the most extravagant items, such as the £40,000,000 for "Coke's National", and divide the remainder by ten — can we add a tenth of the vast remainder? — can we add £50,000,000 to the railway speculation we are already irretrievably

² *Ibidem*, 5.

embarked in? *We cannot*, without the most ruinous universal, and desperate confusion".³

In April 1846 Prime Minister Sir Robert Peel informed Parliament that in 1844, 37 new railway projects had been authorized, with capital of £17,987,000; in 1845 the number of railway bills passed had been 118, with authorized capital of £60,484,000; and that at the moment of his message 519 bills were before Parliament, for a total capital of £304 million⁴.

The market was calmer in 1846, and share prices declined, but although investments in railways in progress and in newly-approved railroad projects considerably thinned out compared to the avalanche of applications, they continued to influence the capital market heavily. For several more years the railroad boom of 1845 would keep drawing the bulk of the capital available for investment, and this distortion underlay the government's concern, as expressed by Peel and faithfully reported by Evans.

The year 1847, then, as Evans wrote, did not begin with rosy prospects; "Severe as had been the crisis growing out of the prodigal patronage bestowed upon railway enterprise, its effects, in its first stage, were limited, contrasted with the baneful influence it subsequently exercised in conjunction with other powerfully operating causes, upon the trade and credit of the country at large (...). But if in this respect all present danger was supposed to have passed, the subsequent remarkable increase in the amount of railway calls, the payments, which it was anticipated, would have to be made for imports of foreign corn and the countinuous decline in the exchanges — were circumstances which tended to create apprehensions as to the course of events in 1847"⁵.

Calls payable on railways amounted to £6,150,000 in January, £1,400,000 in February, £3,508,000 in March, £4,314,000 in April, £3,400,000 in May, £3,200,000 in June, £5,300,000 in July,

³ *Ibidem*, 20-21.

⁴ *Ibidem*, 23.

⁵ *Ibidem*, 23.

£2,280,000 in August, £4,160,000 in September, and £3,760,000 in October. Over the first ten months of the year, then, railway investment had amounted to £37,472,000, or about four fifths of the estimated total savings of the United Kingdom.

This made the financial market extremely vulnerable for the entire year. In addition, starting in January there was a growing balance-of-payments deficit, owing to massive grain imports in the wake of 1846's poor harvest. Between the first week of January and the first week of March, the Bank of England's bullion stock dropped from £14,950,000 to £11,590,000. The Bank had already raised the discount rate to 3-1/2 percent on 14 January then to 4 percent on January 21.

After these January measures, however, the Bank passively observed developments in the capital market. We shall see that afterwards this was generally deplored. Even at the time, however, it did not escape criticism. *The Economist* of 3 April wrote: "It is impossible to look at the Bank accounts, from week to week, to observe a uniform and rapid current in one direction, to see the bullion, and with it the reserve of notes, rapidly sinking, while an eager demand exists for discounts and advances, as is best shown by the weekly increase of securities, and to observe the value of the public funds, and of stocks of all kinds rapidly falling, without feeling an increasing apprehension that a period of pressure is not far distant: of this however, we should be much less apprehensive, did we only see the Bank of England pursuing that only course which, while it could not avert a difficulty, would at least materially modify it when it arrived. We must confess the policy of the Bank is entirely beyond our comprehension, to permit so rapid a decline in its means, without using any measures to check it, or avert the threatening difficulties. It was on the 21 January that the rise took place in the rate of discounts to 4 per cent. Since that time, up to the present week no steps except the sale of about £767,247 of securities, seem to have been taken by the directors for their own safety".⁶

⁶ *Ibidem*, 53.

It was not until April 15 that the Bank undertook some sharply restrictive measures, limiting discounts of bills and raising the rate to 5 percent. In the ensuing weeks, there were signs of greater order. But despite the improvement in the Bank's accounts, there remained a climate of uncertainty and difficulty, of which the most evident symptom was the persistence of a market discount rate of nearly 6 percent. In May and June exports of gold to America diminished, and gold began to return to the Bank of England. "With July commenced another drain of specie to America.

There were also the railway calls (4,300,000 English, and 1,000,000 foreign) in gross, 5,300,000; and another instalment on the Irish loan. These demands with the repayment of advances to the Bank, granted as usual during the six weeks prior to the discharge of the dividends, again created a scarcity of money, and a sensible increase of difficulty was felt. Between the 26th of June and the 31st of July, such had been the change in the appearance of affairs, that the stock of bullion in the Bank had declined to 9,200,000 and the reserve to 3,700,000".⁷

In August the Bank raised the discount rate to 5-1/2 percent on two-month bills and 6 percent on three-month bills. By now, however, the market rate was between 7 and 8 percent. The first failures came in August, in London and Liverpool, mainly in the grain trade. In September, however, some major commercial firms failed, and the list of bankruptcies soon lengthened dramatically, spreading to Manchester and Glasgow and severed foreign branches. At this point the Bank could not avoid returning to a limitation of discounts like that tried out in April. "At the end of September it was manifest that the crisis was increasing in its intensity; that the measures adopted by the Bank, instead of alleviating the pressure, further augmented it; and that such was the spreading distrust consequent upon the failures which had already occurred, that no hope of relief was apparent"⁸.

The pressure intensified in October, and this time the wave of failure struck several large country and London banks, a good number

⁷ *Ibidem*, 59.

⁸ *Ibidem*, 74.

of foreign merchants, and stock-brokers. "When these disclosures were therefore made, and the complete incapacity of the mercantile interest to struggle through their difficulties was rendered apparent 'confusion became worse confounded' and no hope and no assistance being looked for from the Bank, utter despair prevailed in all quarters. The 'week of terror' previous to the issue of the Government letter will long linger in the remembrance of those who witnessed its career".⁹

Evans's essay emphasized five key elements in the crisis.

There was the enormous speculation in railway shares in 1845, which flooded the capital market for the next two years and provoked a capital shortage.

To this was added the capital drain of the balance-of-payments deficit from the latter part of 1846 through the first half of 1847.

It was the Bank's slowness in intervening, which allowed the situation to turn dangerous in February and March. The April measures produced only temporary relief (lasting through May and June), and partial at that, as the capital market was still under heavy pressure.

The improvement in the balance of payments was not enough to relieve a financial market in which the pressure of railway investment continued to cause a shortage of capital for trade.

The commercial failures of August triggered a new phase in which lack of liquidity, failure of confidence, and the Bank's restrictive stance made capital supplies even more uncertain.

On 25 October the First Lord of the Treasury, J. Russell, and the Chancellor of the Exchequer, C. Wood, sent a letter to the directors of the Bank of England urging them "in the present emergency, to enlarge the amount of their discounts and advances upon approved securities" and recommending raising the discount rate to 8 percent.

The situation improved immediately, and confidence in the market was restored. In November, notwithstanding the continuing wave of failures, a lowering of the market rate of interest

⁹ *Ibidem*, 82.

demonstrated that liquidity was growing. On 24 November the Bank lowered its rate to 7 percent, and in December share prices and consols improved, together with a marked improvement in the Bank's accounts. The discount rate was lowered to 5 percent.

Chancellor Wood, S. Jones Lloyd, the Lords Committee, the Governor of the Bank of England himself, and Thomas Tooke all referred to the influence of the speculative excesses of railway fever in the crisis, which is a good indication that the perception of an inverse relation between the volume of investment and the capital required for day-to-day economic activity was widespread. The first to elaborate fully on this idea was James Wilson, founder and first editor of the *Economist* of London. He was joined in 1848 by J.H. Milner and John Stuart Mill.¹⁰ Wilson developed his argument in a series of articles in the *Economist* in the spring of 1845 and in the first half of 1847¹¹: Wilson sought to explain the events of 1847. As early as October 1846 he had noted an emerging distortion in the economy. Against total income that he estimated at £65 million, Parliament had granted new railway construction permits totalling £75 million in 1845 and £110 million in 1846¹². Were this programme to be even partially realized there would have to be a massive conversion of floating capital into fixed capital. This would drive up interest rates and simultaneously cause a rise in commodity and import prices. To these unpropitious conditions was added the unexpected harvest failure of 1846.

As we have seen, the Bank's response was inadequate. It failed to raise the discount rate promptly, and it did not stop funding the capital market by its very open-handed discounting policy. In

¹⁰ A recent critique of James Wilson's thesis is given in H. M. Boot, "James Wilson and the Commercial Crisis of 1847", *History of Political Economy*, XV, 1983, 567-583. D. T. H. Milner, *On the Regulation of Floating Capital and Freedom of Currency*, London: Smith, Elder, 1848; Id., *Some Remarks on the Bank of England, Its Influence on Credit*, London: Smith, Elder, 1849.

¹¹ J. Wilson, *Capital, Currency and Banking*, London: The Economist, 1847.

¹² *Ibidem*, 17.

Wilson's view, when there is a drain of capital overseas or a substantial conversion of circulating into fixed capital, bank deposits are withdrawn, and unless the banks put pressure on the market their reserves diminish and their solvency is threatened. Wilson argued that as long as the causes of the capital shortage were not removed, both high interest rates and the pressure on the capital market would persist.

Since the reserves of the Bank of England declined by more than £6 million and bullion holdings by nearly that amount in the first four months of 1847 and since there was a corresponding increase in advances of £4 million while the volume of notes in circulation nevertheless remained constant, Wilson reasoned that what the market wanted was not more notes (i.e. currency) but more capital. Thus when the Bank discounted bills of exchange and gave out banknotes, these were immediately exchanged for bullion and exported to pay for goods, and the shortage of capital made it impossible to produce¹³. A restrictive stance on the part of the Bank, by contrast, would have constrained the consumption of commodities and thus limited the need for circulating capital.

The *Economist's* weekly reports on the money market demonstrate a remarkable consistency of analysis. On 6 March, commenting on the "increasing tightness of money" and the railway companies' problems in raising funds, it predicted that in the months to come their need for money would cause a rise in interest rates. On 13 March the figures released by the Bank of England showed a substantial drain of bullion and reserves. The *Economist* called for a rise in the rate of interest. On 3 April, having noted that railway shares prices and consols were dropping and that the Bank had still not increased the interest rate, Wilson did not hide his disapproval. "We must confess the policy of the Bank is entirely beyond our comprehension". And further, "We have never hesitated to express our warm approbation of the policy of the Bank when it appeared to be directed by wise principles, but we must own we are totally at a loss to conceive on what grounds the

¹³ *Ibidem*, 123-140.

directors have stood still and seen these changes going forward without an attempt to check them”.

On 10 April, after a week of plunging bullion holdings and reserves (now amounting to barely over £4 million) and a tardy rise in the discount rate to 5 percent, the *Economist* reiterated its dissatisfaction with the Bank's course. After the crisis had climaxed in the next two weeks, with reserves reduced to £3 million, the magazine observed that the Bank of England was engendering great uncertainty by retaining a nominal rate of 6 percent but discounting in practice at 7 or 8 percent. Once the crisis was weathered, in May, the *Economist* immediately expressed an ebullient optimism.

On 5 August the fair financial weather seemed to cloud over. That difficult market conditions continued is indicated by the fall in reserves to just over £4 million, an increase of £400,000 in private securities and a comparable fall in bullion, the raising of the discount rate to $5\frac{1}{2}$ percent, and the drop in railway share prices. Yet the comments of the *Economist* in September and October did not betray excessive apprehension over the troubles of the financial market. The news of the first major failures (including the company of the governor of the Bank of England, who resigned) was reported but not given particular prominence.

On 9 October Wilson published a long article reporting on the sudden deterioration of the situation. The extraordinary pressure registered that week was blamed on the behaviour of the Bank of England. In September and October the Bank eased credit, extending advances to bills that it had previously excluded and lowering the discount rate to 5 percent. This generated a rise in discounted bills of more than £3 million and a new decline in reserves to £4 million.

The consequences of this imprudent policy, in Wilson's opinion, were dire. «During the early part of September, the greater facilities offered by the Bank in making advances, induced them to enter into more extensive exchange transactions: loans were received from the Bank on securities and foreign bills were purchased at better rates than they had previously obtained, and capital was thus sent abroad, leaving a fair profit to those who entered into these transactions. But

when the loans became due, the former indiscretion of the Bank had then the effect of closing the most certain avenues, to the conversion of securities, and enormous sacrifices, ten times greater than any profit derived in the interim, have been submitted to during the last few days to fulfil engagements becoming due. The enormous amount of the sacrifices made in London and Liverpool during the past week are a most unprofitable result of the temporary additional facilities afforded by the course which the Bank has pursued since the 2nd of September”.

Then, when the Bank did decide to change its stance, it was too late. As the situation precipitated, Wilson wrote again in the *Economist* of October 16: “While at the present time there is a great scarcity of available and floating capital, nothing could be more easily proved than that this scarcity is not referable to any existing restriction upon the issue of notes, or that the removal of those restrictions, would, in fact, keep a larger amount in circulation as long as the same denomination of notes was adhered to. It is not a question to what extent the Bank shall advance its capital and that of the depositors who intrust it to their care, but what reserve they shall keep to secure the payment of their liabilities”.

Wilson had the figures to show that while discounted bills had increased by more than 4 million, banknotes had expanded by just 100,000, which meant that the bulk of the notes issued had been returned to the Bank. Wilson maintained that an imbalance had arisen between the market’s need for circulating capital and its capacity to supply it. Only by raising its price (i.e. the discount rate) could the Bank achieve a drop in the demand for discounts and an influx of capital from abroad.

Wilson could thus proclaim his supreme indifference to the suspension of the Peel Act, which many were now urging. If the market did not want banknotes, the authorization to issue more of them would be quite useless; the market would not take them up. What the market wanted was to be able to discount bills of exchange when it was necessary. A guarantee of this facility would put an end to the requests for discounting bills that in ordinary circumstances would

simply be held onto; and more important, it would mobilize circulating capital that was being kept in reserve against all contingencies.

What the market was asking for, in Wilson's opinion, was an expansion of circulating capital, and the suspension of the Peel Act would be able to bring capital back into circulation, as was to happen within a few days.

James Wilson replaced the term «credit» as the fullest expression of the monetary functions with that of «floating capital». In his view, only the money commonly used by the public in the exchange of goods can be considered currency in circulation. That part of the money stock in the hands of merchants and bankers that is used for investment is capital, capital taken out of circulation either permanently or temporarily .

Elaborating on this idea, Wilson offers several criteria for distinguishing between fixed and «floating» or circulating capital. First, its use: if the capital is employed in the improvement of land, the construction of buildings or housing, or the improvement of manufacturing, if in general the investment yields a credit or an interest, it is fixed capital; if it is used for the purchase of raw materials and the payment of wages, it is circulating capital.

Even more important, however, is the distinction between the functions of the two types of capital in the production process. Fixed capital consists in labour employed to expand capacity, while circulating capital is used for the actual production of commodities.

Wilson then deals with the transformation of circulating capital into fixed capital. For this is possible only insofar as a part of the labour assigned to the production of commodities for everyday use is saved and shifted to increasing fixed capital. «It is therefore, not difficult to see, that it becomes a most essential thing to the continued prosperity of a country, that its *floating* capital, on which the continued reproduction of commodities of every-day use depends, as well as the continuous employ of labour, should not be withdrawn from those necessary purposes, and converted into fixed capital, in a greater degree than the surplus accumulation of the country, after

