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Published in:
Social Science Spectrum

2018

Document Version:
Förlagets slutgiltiga version

Link to publication

Citation for published version (APA):
Lobell, H. (2018). Institutions, Events and Theory: A Comparison of the Monetary Policy Reforms of 1844/45 in England and Sweden. *Social Science Spectrum*, *4*(4), 165-178.

Total number of authors:
1

Social Science Spectrum ISSN 2454-2806
Vol. 4, No. 4, December 2018, pp. 165-178

Institutions, Events and Theory: A Comparison of the Monetary Policy Reforms of 1844/45 in England and Sweden.[1]

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Abstract

The paper analyses the role of ideas, past experience and crises in the process leading to theoretical and political disputes and the changes of monetary and banking policy in Sweden in 1844/45. It also analyses the role of institutional settings and types of actors involved in the decision-making process. A comparative approach is deployed. Policy changes at the time in the poor and peripheral Sweden is contrasted with the well-known developments in England. The results suggest that current events and past experience were important factors. Purely theoretical considerations played a somewhat lesser role in determining the policy-change. Institutional peculiarities and country characteristics did not significantly alter the core outcomes, but certain specific features. Probably an influx of ideas, policies and experiences from England also influenced policy choices in the case of Sweden.

Keywords: Institutions, events, theory, monetary policy

"You never want a serious crisis to go to waste. [...] This crisis provides the opportunity for us to do things that you could not before." (White house Chief of Staff Rahm Emanuel in an interview with the *Wall Street Journal*, November 19, 2008.)

I. Introduction

Why do economic policies change? The recent financial crisis and subsequent crises of varying magnitude in Europe between 2008 and 2014 has so far mostly led to amendment of existing policies and not to more fundamental, or paradigmatic, changes. However, historical institutionalism emphasizes discontinuities in the historical development of institutional change and policy making. Rare but fairly regular appearances of *critical junctures* or *punctuated equilibriums* in connection with financial- and economic crises are key features of more far-reaching policy changes and institutional change. These rather rare events are normally separated by more stable periods, characterized by incremental institutional change or *normal politics*.[2]

How are policy changes of different magnitude carried through? In a widely recognized study, Hall (1993) proposed a typology of policy learning. Policy changes are seen as the result of social learning in which changing economic conditions play an important role by influencing actors and inducing different levels of urgency.[3] The typology applied to changes in economic policies has been further elaborated by Oliver and Pemberton (2004). Both Hall and Oliver/Pemberton treat the economic disturbances that drive economic policy changes as exogenous.[4]

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[1] The research was funded by the Bank of Sweden Tercentenary Foundation. The author wants to thank my colleagues, Lars Pettersson and Neelambar Hatti for valuable comments.

[2] See e.g. Hall (2009) or Capoccia and Kelemen (2007).

[3] Policy changes in the 1960s and 1970s were described as first and second order changes, in which specific instrumental policy targets and policy instruments were adjusted without altering the fundamentals of economic policy. The highest level is a type of paradigmatic transitions such as the radical policy change from "Keynesianism" to "monetarism" in Britain during the period 1970−1989. Such paradigm transitions concern fundamentals, while first and second order changes are a sort of "science as usual". Third order changes are preceded by a long-lasting accumulation of "anomalies" that undermines the existing paradigm until its authority has been grinded down.

[4] Hall (1993) and Oliver and Pemberton (2004).

The paper deals with an episode famous for the battle of ideas between the so-called currency and banking schools preceding the Bank Charter Acts of 1844. The policy change in 1844 was an important milestone in the development of modern monetary policy and represents a high tide of 19th century monetary and gold standard orthodoxy, which came to influence policies for very long time – perhaps even until today in the early 21st century.[5] This paper attempts to link the role of the development of ideas with processes of social learning related to current events and past experience. It explores the developments of monetary policies that took place both in England and Sweden during the period, starting with the resumption of specie payments in 1821 and 1834, respectively, up to and including the policy changes in 1844 and 1845. The orthodox interpretation of the underlying theories represented a step back in a way, and both countries witnessed theoretical as well as political tug-of-war.[6] A stricter deployment of rules and a more abstract theoretical anti-discretionary approach came face to face with views that advocated more adaptable and discretionary approaches to monetary management and policy. In England these two approaches are normally referred to as the Currency and Banking Schools.[7] However, the discussion and theorizing in both England and Sweden were concerned with relatively similar arguments.[8]

This paper follows a comparative approach. Policy discussions and changes in the poor and peripheral Sweden are analysed by contrasting it with the well-known developments in England. The two North-Western European countries were quite different at the time. England was in the midst of the industrial revolution and economically becoming the most important country in the world. Sweden, on the other hand, was in comparison an extremely poor, much smaller and peripheral country. The Swedish population was about one eight of the United Kingdom and its real GDP only about one twelfth.[9] Yet, although institutions and experiences were different in many respects, similar policy changes were accomplished in both countries. How did the institutional conditions differ in England from that in Sweden and what conclusions may be drawn from this? To what degree was the changing thinking influenced by crises and economic downturns in the two countries, representing anomalies and undermining the present monetary order leading to policy change?

II. The Theoretical Debates in England and Sweden

The English theoretical discussions on money and banking was rather quiet in the first decade following the resumption of gold payments in 1821. Most economists had accepted the bullionists' view of how the monetary system works and the role of the Bank of England.[10] The debate began to be revived again during the 1820's business cycles and gathered momentum in the course of the monetary and financial crises of 1836-39. The participants formed camps that came to be known as the currency school and the banking school.

The currency school represented an orthodox interpretation of the bullionist position. The basic idea was that the supply of precious metal should determine the level and change in money stock in an economy under a specie or bullion standard, such as the gold standard. It did not matter that money stock consisted also of bank notes and deposits. These ideas were based on the claim that money was neutral in relation to the 'real' economy and that changes in money stock, the

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[5] See Skaggs (1999) or Goodhart and Jensen (2015).

[6] The theoretical debates produced "more heat than light", according to Viner (1937) p. 118.

[7] See e.g. Viner (1937), Fetter (1965), Skaggs (1999) or Arnon (2010) for overviews.

[8] Klang-Vänerklint, Lobell and Pettersson (2004), Lobell (2019).

[9] UK and Sweden compared here. Data from Maddison (2001) Tables A1-a and A1-b, pp. 183-184.

[10] Bullionism, in short, is the idea that notes has to be convertible and covered by reserves of bullion, otherwise, banks may be tempted to issue notes excessively which causes inflation and agio (i.e. a discount between bank notes and bullion). Among prominent bullionists one could mention John Wheatly, David Ricardo, Francis Horner and Henry Thornton. (See Laidler (2000), Hendrickson (2018).)

'currency', only affects the price level. Thus, the price level (the inverse of the value of money) was seen as a predominantly monetary phenomenon. The school therefore maintained that excessive note issuing and ensuing inflation were the primary sources of prevailing monetary instability in the shape of rising exchange rates, agio and subsequent gold export and/or domestic drains of coin and bullion. The Bank of England and country banks were consequently blamed for printing paper money without being covered by corresponding changes in the stocks of specie or bullion.

The currency school criticised the current policy of the Bank of England as it appeared from the parliamentary investigation in 1832. The main flaw, as they saw it, was that changes in the Bank of England's gold reserves were not accompanied by corresponding changes of the Bank's stock of bank notes in circulation. This so-called *currency principle* stated that a mixed monetary system with coins, notes and credit should be designed so that it functioned as if it was a purely metal money system, which was thought to be automatically regulated partly by international flows of specie and bullion, resembling David Hume's *price specie flow mechanism*. The policy recommendation of the currency school's leading advocates was thus to tie the Bank of England's note issuing more firmly to its gold reserves. They also argued for the suspension of private country banks (i.e. provincial banks) issuing of banknotes because it was assumed to be as inflationary and destabilizing as that of the Bank of England.[11]

The banking school opposed the orthodox analyses and policy proposals made by the currency school. Its most important representatives were ardent supporters of the gold standard, but they disagreed with the currency school when it came to the definition of money, the analysis of the monetary system and how the Bank of England and bank system ought to be regulated. The *Banking Principle* – if indeed there is reason to talk about a single such principle – maintained that banks should be free to let notes vary instead of being tied to holdings of silver and gold. It was believed that this position has sometimes been referred to as inflationist since the principle was influenced by the "*real bills doctrine*", "*law of reflux*" and the "*needs of trade doctrine*",[12] but most of the writers only wanted to maintain the *status quo*. They claimed that the gold standard, as it had developed at the time of the parliamentary investigation of 1832, with an ever increasing element of fractional reserve banking, did not operate in the manner envisaged by the currency school. A mixed system should not be made to operate as if it was something other than what it is in reality.[13]

The theoretical discussion in Sweden resembled to a large degree that in England described above. The emerging ideas of British political economy gradually became more widely known among policy makers in Sweden in the 1820s. However, there had been an independent development of monetary thinking because Sweden had been struggling with stabilising paper money and maintaining currency convertibility for about a hundred years by then.[14] A few concepts, fairly uniquely Swedish, still flourished though. The so-called fund theory (*fondteorin*) was a mixture of quantity theory and a theory of "trust". Unlike the quantity theory, the fund theory explained inflation, rising exchange rates and emerging agio by claiming that excessive note issuing and silver exports can cause an imbalance between bank notes in circulation and the so-

[11] Fetter (1965), Fetter (1980) and Viner (1937).

[12] It was believed that a bank which issues new paper by discounting bills based on "real" trade transactions cannot cause inflation, since, put simply, such note issue merely satisfies a demand for money. Any over-issue of banknotes will return to the issuing bank according to the so-called law of reflux which had been put forward by Adam Smith and was embraced by anti-bullionists and the banking school. (Laidler (2000), Humphrey (1998)).

[13] Laidler (2000), Cassidy (1998). It is worth noting that White (1984) considers most of those who so far have been regarded as belonging to the banking school instead belonging to a free banking school that wanted to preserve a free and automatic working of the banking system where private banks would have the right to issue notes. The successful Scottish banking system lacked a note issuing central bank and was cited by free banking advocates as an example of a functioning free bank system.

[14] See e.g. Eagly (1968).

called "fund", i.e. underlying specie and bullion reserves held by the national bank. Therefore, it was thought that diminished credibility for the national bank, the *Riksbank's*, capacity to pay in 'real money', i.e. exchange bank notes with silver currency, had eroded the value of bank notes compared with silver currency and foreign currencies based on silver during the course of events preceding the suspension of specie payments in 1809. However, the policy implication was the same, namely that it was important to restrict the total amount of paper money in the country relative to reserves of specie and bullion.

A debate was conducted in the *Riksdag* in 1834, where the lines of demarcation were similar to those between the currency and banking schools. The Swedish advocates of the 'currency principle' represented the orthodox position, while members of a Swedish variant of the banking school were more of pragmatic opponents of the orthodox application of the bullionist theories rather than advocates of alternative theories (real bills doctrine, law of reflux, etc.). They maintained that the value of money (price level) and foreign exchange rates could not be viewed as monetary phenomena excluding every other causes. They were opposed to letting the external flows of money, which were normally determined by conditions outside the *Riksbank's* control in a small, trading country like Sweden, determine the Bank's note issue and lending. Instead, they advocated letting the Bank's board of directors act in a preventive/restrictive manner during economically favourable times and at the same time be given the means to relieve the business community in recessions.

III. The Monetary Events and Debates in Sweden and England 1821-1844

The Bank of England resumed specie payments in 1821, but otherwise carried on its activities more or less as usual.[15] A boom at the beginning of the 1820s was followed by a recession, which in turn developed into a serious financial crisis with numerous suspensions of payment and bank runs in 1825. The Bank of England was initially subject to a double drain, i.e. in terms of both internal and external outflows of gold, but the exchange rates improved in autumn 1825 and gold began to pour back in. The directors decided that the positive external balance allowed the Bank to be "bold enough" to considerably increase lending and issuing of notes during the most intense phase of the crisis. This immediately put an end to the liquidity crisis in the money market and the bank-runs, apparently without causing either rising prices or outflows of gold. Monetary stability had been promised prior to the resumption of specie payments in 1821, but during the crisis in 1825 it became evident that this was not always possible.

Two important lessons were learnt from the events in 1825. The first was that the crisis had been preceded by increased note issuing by both the Bank of England and the country banks, which was thought to have caused inflation, speculation and crisis. The second was that if the exchange rates and external transactions were in balance, when a financial crisis threatened, the bank could relieve the money markets by issuing bank notes and extend credit without causing inflation.[16]

During the latter half of the 1820s the Bank of England took another step towards increased deployment of rules, which was largely based on the experiences of 1825. The new policy rule, which came to be known as the Palmer rule, suggested that the Bank would hold about half of its metallic reserves as securities in normal times. The intention was to let securities be held constant and to allow notes in circulation vary with the metallic reserves only. In cases of adverse external balances and falling exchange rates, the Bank of England was expected to confine lending and

[15] "…..to say openly that the Bank was trying to control the banking system, let alone to manage the general business situation, would have evoked laughter if not indignation: the thing to say was that the bank was modestly looking after its own business….and that it harboured no pretensions of controlling anything or anybody." Schumpeter (1953 (1994)) p. 696.

[16] Clapham (1944) pp. 102-107, Maclaren (1858) pp. 163-164.

withdraw notes immediately. In cases of domestic financial crises and internal drains of coins and bullion the Bank was allowed to depart from this strict rule to instead relieve the money market.[17]

The wave of suspended payments by private banks during the 1825 crisis provoked a hostile public opinion against private bank note issuing and bank notes in general. However, it never got as far as to banning banks and bank notes. Instead, the government reacted in 1826 by prohibiting the issuing of notes with a denomination lower than £5. Moreover, the Bank of England was allowed to establish branches in the country to increase the circulation of its bank notes in competition with country banks.

In 1830 another monetary crisis occurred in connection with political unrest on the continent. Outflows of gold coins and bullion both abroad and domestically halved the Bank of England's reserves from £10 to £5 million. What was remarkable was that the crisis was not much noticed in England. The outflow of bullion in 1830 had, however, been accompanied by large withdrawals of notes, which the currency school advocates later claimed was the explanation of why the monetary shock had passed almost unnoticed.

The parliamentary investigation of the Bank of England, in connection with the renewal of the Bank's charter in 1832, disclosed however, that the Bank had not applied the Palmer rule consistently. The Bank's officials also had difficulties explaining how the Bank's commercial activity weighed against its special role as "central" bank. Nevertheless, the investigation led to only a few measures, mainly the abolishment of the Usury laws which had restricted the levels of interest rates. The Bank charter was renewed in 1833 and the country banks were allowed to continue issuing bank notes for the time being.

The English economy suffered yet another serious recession during 1836–1839. The subsequent monetary and banking crises led to further difficulties for the Bank of England. In the late 1830s the bank's bullion reserves were even feared to be close to running dry. It became obvious to many observers that the rules were flawed and that the bank's devices did not work. During the worst phase of the crisis the Bank attempted to dampen gold exports by raising the minimum rate of interest. However, market rates increased even more, immediately worsening the bank run and intensified the domestic drain of bullion of specie, which the public wanted to hold as secure assets during crisis. Eventually, relief was sought in the old rival France to save the Bank of England and maintain currency convertibility, which in certain circles was regarded as humiliating.[18]

The element of arbitrariness in the monetary policies that characterized the Palmer rule was thoroughly discredited by the experiences during 1836–1839. The Bank of England was criticized for its monetary expansions and overly expansive credit policies, which were thought to have worsened inflation during the proceeding prosperous economic conditions and that its countermeasures had contributed to descendent into crisis as soon as the economic activity slowed down. Many believed something needed to be done and the debate between the experts in the currency and banking schools took off. The experience of the crisis and drain in 1839 may be said to have tipped the balance in favour of the currency principle and its policy prescriptions consisting of strict, simple rules. Moreover, many of the directors and the members of the governing council of the Bank of England, the 'Court', had never fully accepted the Palmer rule and had been uncomfortable with the prescribed discretionary policies for a long time.

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[17] Horsefield (1953) p. 114. The Palmer Rule was named after the governor of the Bank och England, John Horsley Palmer.

[18] Clapham (1944) p.170.

The Bank Charter Act of 1844[19] inferred that the Bank of England was to be divided into two sections, the *Issue* department and *Banking* department, separating the bank's monetary and commercial activities. The Issue department was allowed to issue notes up to a certain amount without gold coverage. All note issues above that limit had to be fully covered. No new permissions to issue bank notes were given to other private banks. The intention was to gather all issuing of bank notes under one roof and to tie it firmer to the bank's gold reserves. The new act prescribed the Issue Department to cut down its note issuing and lending at the very first sign of outflows of coin and bullion regardless of cause.[20]

In some ways the 1844 Bank Charter Act in England represented a policy shift. The target, "the needs of trade", became completely subordinate to the goal of currency stability. It was also a hard blow to free banking as the Bank of England was granted with increased note issuing privileges. The new rules also threatened an emerging development of a lender of last resort function.

Afterwards, however, under the influence of new crises, the system in practice allowed major deviations. Since it was thought that the control of the "currency" would be fully automatic, there were no special rules associated with the Banking Department's business transactions. Thereby, according to Whale, "The freedom which the Act left to the Bank in the conduct of its banking business included the freedom to run it as a central bank".[21]

The experiences of 1825 and 1836-39 leading up to the policy shift, had caused several leading experts in England, most notably McCulloch and Torrens, to change their opinions in favour of the currency principle and deployment of simple rules.[22] However, about the same time, Tooke changed his stance in the opposite direction, which was due to the fact that he had been analysing long series of money and prices and had come to the conclusion that empirical evidence for the currency school's fundamental theoretical relationships did not exist.[23] Nevertheless, even some bankers began to prefer rule-based policies since they were dissatisfied with the unpredictability of the Bank of England's actions, for instance a sudden refusal to discount bills drawn on joint stock banks during the crisis in 1837. Other interest groups were divided on the issue. Among others, industrialists in Birmingham, the home of anti-bullionist Attwood, were opponents of the currency principle, whereas industrialists in Manchester, including Cobden, seemed to support the proposals.[24]

Compared to Sweden, there was, as Clapham, Horsefield and Fetter have emphasised, a distinctive feature to this process. The discussion was conducted mainly outside the sphere of political parties in parliament, even though the Parliamentary Political Economy Club probably was an important forum for an exchange of views on the issue. It is instead likely that the Bank of England's directors and members of the governing assembly, 'the Court', were very important actors. According to Clapham, the actual formulation and implementation of the Bank Charter Act of 1844 was decided in talks between the Prime Minister Robert Peel and the Bank of England representatives William Cotton and John Benjamin Heath.

[19] "An Act to regulate the Issue of Bank Notes and for Giving to the Governor and Company of the Bank of England certain Privileges for a limited Period."

[20] Fetter (1965) p.185.

[21] Whale (1953) p.127.

[22] O'Brien (1965).

[23] Tooke (1838-40).

[24] See Collins (1972) and Cohen (1998).

Robert Peel's Bank Charter Act has occasionally been interpreted as an orthodox expression of a purely theoretical approach.[25] However, it is not difficult to find other interpretations. For example, Clapham used phrases such as "uncertainty" and "trial and error" to describe the development of monetary and bank policies in England during much of the period from resumption in 1821 until 1844.[26] Horsefield accounts even more explicitly for the existence of a sequence of events where the directors of the Bank of England repeatedly revised their perceptions of how the monetary system operates and how it should be organized. Both held a view in which pure theory played a secondary role. It was a matter of "an attempted solution of certain definite difficulties, and not a mere application of a priori theory".[27] On the whole, Horsefield described a learning process in which every crisis from the end of the 1700s and onwards brought about changes in the regulations of the Bank of England policies. The actors were to a large extent the Bank's own board of directors, who were driven not by theoretical principles, but by a willingness to "be tied to the mast"; to obtain a set of rules that could give the bank administration a feature of automatic regulation.

> "Thus, during the whole period from 1810 or earlier to 1844 or later, the Directors cherished a delusion that their proper policy could be condensed into a simple and automatic rule […] Always fruitlessly seeking for an easy escape from the unwanted burden of monetary management, which their eighteenth century predecessors knew could not exist; and being repeatedly disappointed in their simple-minded hopes; the Bank did little more for forty years than flirt with fundamental fallacies in hopes of avoiding that active responsibility for currency control.."[28]

According to White, the directors must have been "more than happy to have the government applied the rules of the currency principle to them: For years they had been searching for a simple nondiscretionary rule that would govern their circulation in such a way as to insulate the bank from public criticism of its monopoly".[29] According to Clapham, the Bank of England directors comprised a strong lobby group that influenced Peel and other politicians to a considerable extent. The discussion in parliament mostly resembled a formality and was of low quality and essentially boring.[30]

Conditions were in many ways different in Sweden. A somewhat less important difference was that Sweden was on silver standard while England was on a gold standard. However, the formal financial and banking system differed substantially since England already possessed a widespread and integrated system of bankers, note-issuing country banks and bill brokers, while in Sweden only a small number of bank companies and only very little trade in domestic bills of exchange existed. A decree allowing private banks was passed in 1824 in Sweden, and note-issuing provincial joint stock banks began to emerge in 1830.[31] Only six banks existed in Sweden while England had hundreds of note-issuing banks and joint stock banks in the early 1840s. The position of the Bank of England at the centre of a large financial system, together with the emergence of modern style business cycles, made the system vulnerable to internal drains of coin and bullion coupled with bank runs. This was a lesser issue in the much smaller Sweden. Instead, the influence of international recessions and financial crises and external flows of coin and bullion were the source of most concern, typical of what one may expect in a small trading nation. Moreover, as

[25] "Peel's Bank Act has always seemed to me exceptional in English legislation because it did not represent an attempt to deal piecemeal with the immediate practical problems […] but gave effect to a clear-cut theory…". Whale (1953) p. 126.

[26] Clapham (1944) p. 163.

[27] Horsefield (1953) p. 125.

[28] Horsefield (1953) p. 115.

[29] White (1989) p. 77.

[30] Clapham (1944) p. 170ff.

[31] Three private so-called discount companies (*Discont-Verk*) were established in Sweden between 1803 and 1810, but all three failed in 1817.

mentioned earlier, domestic monetary expansions causing domestic inflation and overconsumption were also believed to endanger monetary stability and had to be prohibited.

Ownership conditions and the relation to the state were other noticeable differences. The *Riksbank* was controlled by the *Riksdag* while the Bank of England was privately owned.[32] It has already been mentioned that Horsefield and others dismissed the idea that the currency principle was imposed on a reluctant Bank of England. Apparently the Bank's directors sometimes learned from experience and were influenced by theories (e.g. Palmer rule). Alternatively, they continually attempted to escape from the "unwanted burden of monetary management" by following a set of "simple and automatic rules". It was more or less the opposite in the case of Sweden and it's publicly controlled national bank. The *Riksbank* had no intentions of avoiding the responsibility of monetary management. On the contrary, the dominant view was that it was the *Riksbank*'s principal task; ahead of extending credit, commercial activities and being the state's financier. In any case, similar 'simple and automatic rules' were implemented into the *Riksbank*'s regulatory system at about the same time as in England.

There was an opposition against a monopolistic *Riksbank* also in Sweden, calling for a decentralized system with more private bank companies. However, a conflict between the Monarch and the *Riksdag* over the influence over banking and monetary policies in Sweden probably delayed resolution of the issue. The constitution RF § 72 decreed since 1809 that the *Riksdag* should alone administer the *Riksbank* without any interference from the King or the government. The King, Karl XIV Johan, nonetheless demanded influence, which had repercussions on the process towards resumption of specie payments in 1834 and the development of banking. The acute conflict was eventually settled and the *Riksbank* remained under the control of the *Riksdag*. However, even if the Monarch and his government were excluded from influencing the *Riksbank*, they still managed to keep for themselves the exclusive right to charter private banks. Hence the stalemate.[33]

The *Riksbank* resumed specie payments much later than the Bank of England. The *Riksdag* already had decided in 1823 that specie payments should be resumed whenever practical, but legislation came only in 1830. It was not until September 1834 that payments of silver actually were resumed. The paper currency *riksdaler banco* was devalued considerably to 2 2/3:1 against *riksdaler silver specie* as compared to the relation 1:1 before the suspension in 1809.[34]

In 1834, the Standing Committee on banking proposed new guidelines for the *Riksbank* defining its main purpose to "maintain the value of coins" (the term "coins" referring to both metallic and paper currency, or "paper coins"). The basic idea was to maintain monetary stability

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[32] The *Riksbank's* predecessor was founded in 1661 as a note issuing private bank called *Palmstruch's Bank* or *Stockholm Banco*. However, the bank failed after only 7 years and the operations was taken over by the state in 1668 and bank notes soon became general means of payment. The *Riksdag*'s control over the national bank in Sweden was even reinforced during the upheaval in 1809 when the *Riksdag* obtained full sovereignty over the bank, thus excluding the crown. A result of the constitutional clash between the *Riksdag* and the King was that the rivalry over the influence over the Riksbank largely delayed the resumption of specie payments and the development of banking legislation in Sweden. By resumption in 1834 Sweden had had long experience of note issuing and convertibility problems. The Riksbank suspended specie payments in 1745, 1789 and 1809, and after periods of a paper standard resumed specie payments in 1776, 1803 and, as mentioned, 1834. See Andreen P G (1961) and Nilsson G B (1981).

[33] See e.g. Nilsson (1981), Andreen (1961) pp. 304ff. and Montgomery (1934) pp. 23-28.

[34] In 1819, most likely influenced by the discussions on resumption in England, the prominent politician and government representative Fredrik Wirsén proposed a plan to resume payments at the current exchange rate and agio, i.e. to devalue the riksdaler banco against the riksdaler specie from 1:1 to 2.5:1. In the following parliamentary session of 1821/1822 a committee investigated the plan and proposed resumption with devaluation as soon as possible. However, the committee decided that the Riksbank needed to strengthen its silver reserves before resumption, since it was feared that the bank did not hold enough silver reserves to avoid a run for silver. Moreover, the King, Karl XIV Johan, obstructed the move towards resumption and demanded both "full restitution" and to have a say in monetary matters. The silver reserves were moderately improved and the conflict with the King was resolved when the resumption and Riksbank Acts passed through parliament in 1830.

by stipulating minimum silver reserve requirements and to link the stock of bank notes to the silver reserves. In the event of rising foreign exchange rates and threatening external silver flows, the Bank was advised to withdraw banknotes, even by contracting public lending if necessary.

According to *Riksbank* historian David Davidson, the bank regulations (*bankoreglemente*) also had a preventive dimension.[35] The issue of banknotes was to be restrained with the aim of preventing inflation, rising foreign exchange rates and agio between bank notes and silver.

The national Bank, which was by far the single largest credit market institution in Sweden at the time, was provided with well-defined ceilings for lending and government lending was suspended altogether, all of which were intended to secure the stability and convertibility of bank notes.

Several members of the committee explained the urgency of updating the regulations with reference to the experiences of the suspension of silver payments in connection with war and upheaval in 1809. The suspension of the riksbank convertibility of bank notes with silver at a fixed rate in 1809 was perceived more or less as state bankruptcy in that the national bank could not meet its commitments.

Swedish monetary policy was to a large degree roughly designed in line with the currency principle already in 1834. When the proposal was discussed in the *Riksdag* there were, however, some who sought to impose even tighter links between the *Riksbank*'s silver reserves and note issuing while others instead wanted to give the board of governors (the executive body) more flexibility and preferred not to fix an exact relationship. The debate resulted in somewhat more relaxed regulations compared to the original proposal. Securities was not always required to be held constant and the Bank was allowed to provide advances against the collateral of goods, gold and silver without any limitations. The contraction of lending, with the aim of withdrawing bank notes in order to maintain the determined reserve proportion between notes and silver, was accepted only to be applied after all other means had been exhausted.

During the *Riksdag* discussions in 1834, references were often made to experiences from the 18th century and the misfortunes leading to the suspended payments in 1809. There was e.g. much discussion on whether a resumption of specie payments in 1776 had been "successful" or not. Moreover, the English experiences of dealing with crises in 1825 were cited as well. It is evident that members of the Estate of Knights and Nobility as well as the estates of the Clergy and the Burghers had ready access to the English theoretical discussions, policy debates and the bank charter investigation of 1832; some members of the *Riksdag* seem to have had very detailed knowledge of the Palmer rule. The influences were thus neither short-sighted nor limited to Sweden.

In 1837 the international crisis led to falling export demand in Sweden. Foreign exchange rates rose and relatively large quantities of silver was exported. The *Riksbank* board of directors estimated that it was a matter of a temporary adverse balance of trade and, in full agreement with the prevailing regulations, that the only necessary measure was to suspend silver purchases.[36] There was a consensus that the automatic-regulatory forces should be left to work, and, above all, that foreign trade conditions eventually ought to improve and revive exports. In 1838 the foreign exchange rates returned to parity and foreign silver purchases could be resumed.

The lesson of the events in 1837 was mainly that the system appeared to be working, which probably is the reason why very few proposals of changes in the bank regulations were proposed

[35] Davidson (1931) pp. 48-50.

[36] Silver was only allowed to be purchased and imported when the foreign exchange rate was under or at mint parity.

during the *Riksdag* sessions of 1840/41.[37] The *Riksdag* auditors, however, noticed that the *Riksbank* needed to actively buy and import silver after temporary adverse external balances and subsequent silver outflows. It was considered to be costly for the state and only favouring entrepreneurs, thus partly repeating a long-lasting view that 'speculators', or 'agioteurs', were conspiring against the state through foreign currency-, specie- and bullion transactions. The *Riksdag* reacted by establishing a new rule stating that the *Riksbank* singlehandedly should carry out its purchases and imports of silver bullion from foreign financial and commercial centres, primarily Hamburg during this period.

Another and more serious series of monetary shocks occurring in 1841-1843 drained the *Riksbank*'s metallic reserves by more than a half over the course of just a couple of years. An international recession combined with two very special circumstances, namely a substantial silver export to Finland and arbitrage with Spanish piaster, gave rise to even more widespread silver exports.[38] The *Riksbank*'s Board of Directors (bankofullmäktige) became increasingly uncertain how to interpret the situation and what measures should be taken to counter the precarious currency situation. To begin with the board reacted according to the established rules, i.e. suspended silver purchases because of rising exchange rates and waited for the external conditions to improve. However, the *Riksbank* continued and even increased its advances against goods so the stock of bank notes in circulation principally remained unchanged. As the adverse external balance lingered on for several years, the ensuing silver exports finally led to a violation of the legal limits for notes issuing, creating considerable consternation among the public and leading policy makers regarding the *Riksbank*'s capacity to maintain coverage and convertibility.

Ultimately the *Riksbank* started to act by imposing austerity measures intended to restore internal and external balances and prohibit further drains of specie and bullion. Half-hearted attempts were made to reduce notes in circulation in accordance with the regulations, thereby attempting to restore the silver reserves and re-establish the stock of bank notes in circulation accordingly. Initially, the *Riksbank* fruitlessly tried to reduce the stock of bank notes and net lending by obtaining loans on the domestic market via the National Debt Office (*Riksgäldskontoret*).[39] Thereafter, attempts were made to borrow abroad, but with poor results because of the depressed state of the international money market. Instead, the *Riksbank* was relieved by improving international economic conditions in late autumn of 1843. Foreign exchange rates soon started to improve and the *Riksbank* could begin purchasing and importing silver again. The private bank companies, on the other hand, were subject to considerable pressure for some more time. They were often forced to respond to liquidity pressure by directly suspending lending, which contributed considerably to monetary tightening, as well as to much public indignation.[40]

The lessons learnt from the crisis in 1842-43 are more difficult to interpret, apart from the fact that the prevailing regulations were generally regarded as jeopardising convertibility and monetary stability. It was increasingly seen as problematic that the *Riksbank* continued advancing credit and releasing bank notes in situations of considerable silver exports, even though such

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[37] See Davidson (1931) p. 80.

[38] After the war and transition to Russian supremacy in 1809, Finland held on to the old Swedish monetary system. On 18 November 1841 the Russian government increased the authority of and reorganised the Finnish National Bank and shortly after the Finnish government announced that all Swedish notes were to be removed from circulation. Therefore a substantial influx of bank notes from- and export of silver destined for Finland took place between 1841 and 1843, amounting to about 1.6 million *rdr silver specie* (or about 4.4 million *rdr bko*). Another significant source of silver exports was arbitrage in Spanish piaster. These coins could be sold at a profit via Hamburg to Asia where they were in demand as a means of payment. The Riksbank held a considerable stock of Spanish piaster and sold these for 122 to 125 *Sk bko*, while they were bought for 3 1/6 á 3 ¼ florins (about 153 *sk bko*) in the Dutch East Indies and 56 á 60 pence (about 150 *sk bko*) in Kanton, Manila and Singapore. Davidson (1931) p. 205, Skogman (1846) II pp.76-78.

[39] Skogman (1846) II p. 81-83.

[40] Ögren (2003) p. 76. Usury laws, among a number of circumstances, prevented the banks from effectively using interest rates as credit rationing instrument by the 1840s.

actions could be motivated by relieving - or at least not exacerbating – an already difficult domestic economic situation. More and more decision-makers leaned towards the currency principle, i.e. to let notes vary "naturally" with silver reserves and automatically trigger certain monetary and credit market policies.

At the same time, however, many opponents of the currency principle realised that the reasons behind the substantial outflows of silver lay outside the *Riksbank*'s control. Nevertheless, the currency principle offered explanations that seemed most convincing and the causes of the instability were sought in the regulations of the *Riksbank*. A growing number of members of the *Riksbank* board of directors and members of the *Riksdag* drew the conclusion that a strict application of the currency principle and a strict deployment of rules would better remedy the silver reserves and secure convertibility and monetary stability in the future. However, it might be suspected that much of the new ideas and perceptions were most probably also influenced by the debates and impending regulatory changes in England.[41]

The *Riksbank* regulations were altered during the *Riksdag* session of 1844/45. The crucial difference was, as Davidson pointed out in particular, that the monetary policy was being transformed from preventive to repressive. The new *Riksbank* regulations stipulated that credit contraction should be the measure to be first to be employed in cases of drains of specie and bullion, instead of being the last resort as the bank regulations previously had prescribed. The aim was to get the notes in circulation to vary with silver reserves, thus resembling the currency principle to a higher degree.[42]

In practice, however, and similar to England, the new regime was never applied with the automatism and stringency as intended by the legislators and proponents of the currency principle.[43]

What is remarkable is that at the same time as the currency principle (in Sweden labelled the "metallic system") was given full impact in the regulations, a change was, in principle, carried out in the opposite direction. The *Riksbank* was being authorised to hold a foreign exchange portfolio and bank deposits in Hamburg as a substitute for a part of the silver reserves and to establish a function for foreign exchange market operations. It was thought that foreign bills could be used instead of silver, and buying silver could be avoided after recessions/export decreases. Thus the *Riksdag* achieved a thinning out of the metallic reserves, which definition-wise could be said to have been the beginning of a specie exchange standard. The introduction of the exchange reserves and market operations was initiated by the *Riksdag*'s auditors and can be attributed to the experiences of silver outflows and costly 'repurchases' of silver.

Similar to England during the first half of the 1840s there was growing resentment in Sweden as well against note issuing private banks. Even the King changed his opinion with regard to private note issuing banks and became less reluctant to cooperate with the *Riksdag* on this issue. The hostile opinion was based partly on the view that private bank note issuing was to a large extent to be blamed for monetary instability and thus posed a threat to convertibility. Their self-imposed credit contractions during the crisis in 1841-1843 was another source of public dissatisfaction.

The new proposal was very restrictive. New private bank charters were advised to require e.g. fifty founders, all with unlimited liability, and a large part of a basic fund of 1 million *riksdaler*

[41] Davidson (1931) pp. 114-117. See also Skogman (1845) II, p. 103. "…the proposed plan was partly a summary of measures, as proposed in this country, and partly a copy of the system Sir Robert Peel had recently introduced in connection with England's banking."

[42] Davidson (1931) pp.120f.

[43] Ögren (2012), Ögren (2017).

banco to be deposited. However, the King died, and the successor to the throne, Oscar I, blocked the law that the *Riksdag* had passed. The new King instead used a loophole in the constitution to formulate a law in 1846, which preserved the prevailing system of note issuing private banks, with the restriction that small notes would be gradually prohibited.[44] Since the experience of note issuing private banks was limited in Sweden, arguments were willingly borrowed from foreign experience, good and bad, mostly Scottish, English and North American.[45]

Hence, leading actors sometimes reacted on crises in a way that can be interpreted in terms of trial and error learning processes also in 19th century Sweden. Furthermore, it was frequently referred to the events in the 1700s and early 1800s in the discussions, not least to those from the suspension of specie payments in 1809. They did not restrict themselves to experiences in Sweden; instead they demonstrated considerable knowledge of the English – and other countries - course of events, both current and quite far back in time. There was an ability to learn and, though reluctantly, to implement foreign ideas if current urgencies so required.

IV. Concluding Remarks

The policy agenda was largely determined by primarily adverse current events. The process in England can quite clearly be characterised as trial-and-error, i.e. a kind of social learning. There is some evidence of short-run error learning in Sweden. The increasing sense of urgency was paving the way for policy changes and adverse events were in many cases perceived of representing anomalies in current policies. The process between resumption and policy change was much shorter in Sweden and it may be noted that short-run learning processes were complemented by more long-run ones. Not least the Swedish participants at the time frequently referred to events and processes that lay relatively longer back in time. The resumption in 1776 and the financial and monetary convulsions during and after the events of 1808-1809 were frequently used as examples in discussions on financial and monetary matters.

Moreover, in Sweden the learning process was not restricted to Swedish experiments. Not least, references to the English experience as well as ideas and theories were frequent at the time. English experiments and influences were used to reach compromises between competing interests and ideas. It would not be very bold to suggest that the influences, regarding both theory and policy, largely occurred in the direction from the larger, leading country England to the peripheral Sweden. It is doubtful, though, if the controversies in either England or Sweden contributed to add much depth to monetary theory, in contrast to what Eagly has claimed in the case of the 18th century bullionist controversies in Sweden.[46] The discussions appeared to have produced, as Viner once concluded in the case of England, “more heat than light”,[47] also in Sweden and were more instrumental, concerning monetary policy instruments and the choice between rule based- and discretionary policies.

A good hypothesis is that the somewhat different ways of theorising reflect the differences in the economic and political realities in Sweden and England. The “Anglo-Saxon model” with its two-party system, and with organised interests given a relatively weak position in the exercise of power, made cross changes in the economic policy possible, even those that were to a great deal inspired by new theory, at least compared with Sweden, with its Diet of Four Estates and strong

[44] Ögren (2003) pp. 76-79.

[45] However, some maintained that it would be wrong to base the design of a Swedish banking system on the experiences of England and the USA, since they had a “faulty organisation or more correctly a total lack of a system”. For Sweden to terminate private note issuing banks on the basis of currency stability and apply the currency school’s analysis to Swedish conditions would be an “indigestion of foreign ideas, I have always taken the freedom to regret”. Frölich (1840) p. 46.

[46] Eagly (1968).

[47] Viner (1937) p. 118.

organised interests. The Swedish *Riksdag* decision-making power was largely built on compromises and coalitions, with the nobility, the burghers, the clergy and the peasantry – all having “a say” in important issues. Moreover, the tendency was strengthened by a still influential and ambitious Crown, which sometimes was in coalition with some other influential interest groups. Many interest groups had to be brought together if a regime shift was to be implemented. Hence, stalemates could easily arise (such as the unresolved private bank issue after 1844). Accordingly, strong exogenous economic disturbances were necessary for the policy change to take place. The Swedish tradition of decision-making, built on compromises between privileged interest groups, has deep roots.

What about the different composition of actors, stakeholders and arenas in the two cases? If the shareholders of the Bank of England, a private company, played such an important role, why did the public servants and politicians in the *Riksbank* arrive at the same conclusions? Participants in the process wanted change for very narrow reasons: The Bank of England wanted to get rid of responsibility if something went wrong. Such interests apparently had influence at the time. But there were fewer such narrow or instrumental reasons in the Swedish case, which might suggest that monetary principles, political considerations and not least foreign influences played a larger role.

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