# Money from 1672 to 1694: the years of change

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*I intended to post the fifth and sixth instalments of Helen Schofield's history of money yesterday, but actually only did the fifth. However, having now agreed with Helen and that at least one more instalment than expected is likely I will now post the sixth part as she wrote it here, because it is both quite long and important, with another two posts to come thereafter:*

***The 1672 Exchequer Stop***

At the Restoration when Charles II came into power he had to make a deal with Parliament. This deal was that he would receive revenue agreed by Parliament mainly through taxes and that the power to increase taxes in the future would rest with Parliament. Parliament didn't guarantee the revenue and right from the first year of Charles's reign there was a significant shortfall. Charles couldn't mint much in the way of extra money because there was insufficient bullion coming in also the knowledge that tallies could be created to top up spending appears to have been lost. We know this because interest started being paid on tallies (to Custom Farmers) as well Treasury Orders but even these tallies lost out to the Treasury Orders as a means of raising money. So Charles started borrowing heavily in order to balance the books but never caught up so much so that by the end of the year 1671 the interest on the borrowing was as much as the revenue. There were mitigating circumstances such as the Great Plague and Great Fire of London and Charles agreed two funding deals with Louis XIV one secret and one public. The public one was to help England join with the French to fight the Dutch. The secret one concerned Charles going public at some stage he was Catholic although no date was determined and converting England to a Catholic country. He sort of honoured this condition on his death bed! The secret funding went towards Charles's personal expenses.

So Charles was in serious trouble by the end of 1671 he was responsible for paying for the English army and navy out of the revenue but was in arrears on these payments. He was persuaded by Thomas Clifford to put a temporary stop on Treasury Order payments for a year. Clifford was blinded by his intense dislike for the gold-smith bankers' usury and clearly didn't care if he ruined them. Many of them were because their many creditors who'd deposited coinage and tallies with them were placed in the predicament of finding it difficult to recover these items let alone any interest payment due from the gold-smith bankers. Essentially a slow motion bank-run developed based on the fact if you couldn't honour your debts you went to a debtor's prison and many gold-smith bankers did!

So how was this all resolved? For 34 years uptil 1706 interest was paid sporadically on the Treasury Order debt but never at the original 6% interest rate. No principal was repaid! In 1706 the debt was rolled into the newly declared National Debt and the original principal revalued at 50%. Interest started to be paid on the debt on a regular basis at 3% a year. Milevsky has done compound interest calculations and figured out that after 34 years the effective investment return on the Treasury Orders was 0.01%! Now both for the gold-smith bankers and their deposit investors this outcome to say the least was outrageous not to mention the human misery this abuse of monarchical and parliamentary power caused. Basically trust in government was at an all-time low yet and the species based currency was continuing to fail in terms of meeting demand for use as a medium of exchange. Something had to give!

### ***The Bank of England 1694***

Let me start by saying that not all gold-smith bankers and not all wealthy merchants were caught out or destroyed by The 1672 Exchequer Stop some continued to have influence in Parliament and the Glorious Revolution of 1688 had strengthened Parliament's hand against monarchical powers. England was therefore faced with two problems it had to resolve shortage of medium of exchange in the economy and the need to sort out the financing of government activity with the monarchy still directing much of that activity. The latter was especially pressing since the French navy had defeated the English and Dutch navy in a naval battle off Beachy Head (near Eastbourne, Sussex) in 1690. England needed a navy to beat the French! What could be done? There were many proposals but the one that won out was a loan contract with the government that resolved various issues of trust. This was set up as a privately owned renewable charter company under act of Parliament that was to be called the Bank of England. It was a joint-stock company with limited liability. The initial capital subscribed was in the sum of £1.5 million. Not all of this needed to be subscribed at once and the capital sum could be increased to increase its money creation power. A large part of the original subscription was made in government issued tallies.

The bank was empowered to deal in bills of exchange, make loans on promissory notes, and lend on mortgages. Its borrowing privileges were not specified, however, it could take deposits on any terms as long as its liabilities did not exceed the amount of the government debt (which formed the bank's capital stock). The main promissory note the bank came to issue was the banknote. Whilst the banknote didn't have an interest rate specifically attached to each note Parliament hypothecated a stream of tax revenue to pay the bank's capital subscribers an 8% annual rate of interest return on the £1.5 million capital subscribed and an annual management fee of £4,000. The bank was not supposed to issue paper money in excess of its subscribed capital but it did particularly banknotes. Essentially the banknotes were issued to the government to augment specie money. The bank for its part had to convert its banknotes to specie money on demand it also had to provide settlement services for the private banks (Country Banks) that sprung into existence issuing their own local banknotes. It did this because as yet it didn't as yet have a monopoly on the issue of banknotes as legal tender that didn't come till early in the 20th century. The Exchequer for its part agreed to accept Bank of England issued banknotes for tax payment (I'm not sure how Country Bank issued banknotes were used to settle taxes despite trying to research it).

Important aspects of the loan contract with the government were asymmetric and, from a modern perspective, favorable to the government. For example, the loan contract was non-callable. That is, the Bank could not demand repayment early. Conversely, the government was given the option to prepay the loan and terminate the Bank's charter with one year's notice during the eleven year term of the charter. Subsequent charters held to this same general pattern, specifying the amount that the loan would be increased, the loan terms, and the length of time the loan/charter would be in effect.

Over time and particularly with the Royal Mint filling in the denominational gap below banknotes with lower valued coins this increased demand in the UK economy substantially. The unreliability of workers running up large credit tabs disappeared and the more reliable demand from improved currency circulation kicked off the Industrial Revolution in the country. Why should this be? It's really important to grasp that non-MMTer's when told more currency is being put into an economy than being retired from it through, taxation, etc. automatically assume productive capacity within an economy is static. This isn't so the extra demand created draws down inventory, increases the output of existing machinery, creates demand for more capital investment and encourages the growth of new competitive enterprises often with better productivity than the existing and importantly also creating brand-new products and services.

To bring this all round to full circle the 1694 private Bank of England loan contract agreed with the government was nationalised in 1946. What, however, changed considerably between 1694 and now was the growth of private sector banking creating currency from nowhere in very large quantity but all with the back-up, or safety net of government created currency and especially after the Bank of England had been re-nationalised (see GFC)!