John Law, Banker and Economist

1. Of recent years, the ferment of new ideas set in motion by Keynes has led to a number of attempts to reassess John Law's position, in some cases even with apologetic overtones, as if his rehabilitation as an economist and a banker was now overdue.

It is no accident if Schumpeter, in his History of Economic Analysis, has given prominence to Law's ideas, as a theoretician of cartelism and as an advocate of the view that the economy of a large country can be controlled by the manipulation of financial levers. And not by chance has Hirst continued, for over a score of years, to devote his learned researches to the exhumation of Law's works and has even held out hopes of supplying «une histoire appendiculée peut-être définitive du système», together with a «biographic détailée» of the Scotman's versatile figure (9).

In the meantime a detailed biography of Law, the «banker», has come out in Italy. It is by Magri who gives a workmanlike and well balanced overall picture of Law's life, works and writings (2).

Magri's study breathes a spirit of calm, unflurried objectivity. He portrays Law as «half revolutionary, half reactionnaire» and as «a chaotic mixture of good and evil, of genius and folly». This judgment, in contrast to the apologetic overtones referred to above, makes it even more essential to go deeper into the good and bad sides in his make up, to start the ball rolling again, will be my endeavour, in a discussion of several of Law's most characteristic thoughts and actions.

2. In John Law, as in most people, thought and action influence each other, since both are indissolubly intertwined. The «banker's» mistakes in practice can be traced back to the «writer's» mistaken conceptions. Conversely, the writer's vague, the present eagerness to enshrine and evaluate everything he wrote, is mainly due to his notoriety as the inventor of the «system». In reality, it cannot be said that, from the point of view of the history of economic theory (especially if interpreted in a Schumpeterian sense, as the history of analysis, theories and models), his voluminous writings subsequent to Money and Trade (1705) broke fresh ground, at least as regards money and credit (9). To grasp Law's thought, therefore, we may confine our attention to Money and Trade. And it may even be sufficient, and indeed more to the point, to consider only the two basic ideas, which, as we shall see, constitute the fabric of his thought and which crop up on almost every page.

By the same token, I do not feel that we shall be making a contribution to the more accurate understanding of Law's «originality» and «fertility» (2) if we attach overmuch importance to Law's defence, in that work, of an «ideal» currency with a constant purchasing power. The price revolution caused by the flood of precious metals from America had brought home the instability of the purchasing power of gold and silver, a point which had been stressed by Bodin in his well known Response to Malestroit (1668).

In the same vein, it is impertinent to enshrine «Law's» ideas in a way that is quite below in note (12) 10 p. 39.

3. Law's two main propositions may be deduced from the opening syllables of Money and Trade: firstly, his conception of the «influence» of money on the course and development of the economy and, secondly, his interpretation of the «nature» of money, i.e. what it is and what it can become.

As to the first of these points, it must be admitted that Law brings out very clearly whatever was living and vital in the mercantile economy of Money, 1705, pp. 24 sq. 209. In Studies in the Theory of International Trade, 1937, p. 65, Vossen has shown that the effectiveness of raising the value of money had been deduced as far back as 1725 by an Italian merchant in his tract on the monetary system (Queen Elizabeth to reform the coinage).

4. In chapter II of Part III of the Monetae Traite, in ss. 34 of the same Considerations and on p. 36 of Further Considerations respectively.

10. This may be illustrated by the typical example of Law's «classe» concerning the relation between the value of silver and that of silver which French society preferred to substitute in Gaul and to exchange for foreign currency. Its essence (in Terza delle Monete insignissime, op. cit., pp. 20-21) is that which might also be subsumed in the «Loch's classe», since Loch had already shown that it was impossible to fix that relation by law and in such a way that advantage be secured by the first day of the merchant (see Considerations, op. cit., pp. 107-108).

Thus, in the same vein, Law, in contending that the value of metallic money is not a purely conventional value imposed by the authorities (Considerazioni, Monete e Lavoro, op. cit., p. 166) ended up by taking the same line as Loch, who had in fact brought out that the «intrinsic» value of precious metals is influenced by their use as money, a use legislated by government (see Considerazioni, op. cit., p. 162).

Most of the authorities (see Considerazioni, op. cit., p. 107) was subsequently admitted by Law in his repeated references to the «added» value attributed to precious metals, perfectly known of their not in money. (The series of «imaginary value» created by Law, is to be found, every now and then in printing the «money» in Stone Considerazioni later than 1674. That Law's criticism was not a «sensation» had been appreciated by Piganiol in his name in the Italian translation of Loch's Considerazioni published by Bondi in 1751, cf. p. 12; Vol. I. In any case, the question of a long standing. It seems to me as well as in a history of Economic Analysis (1956) Stengler rightly links Loch's connection with that of Adam Smith.


(10) J. Lavo, Some Considerations of the Consequences of the Inconvertibility of Money and the Value of Money, 1901, p. 75.

(11) B. Cassone, La Moneta, 1793, p. 39.

(12) W. Prett, L'estornino, 1704, p. 9.

(13) S. Maccaroni, Le storie del buonista Law (The Strange Life of Banker Law), 1796.

(14) In the «Preludio» and the «Introduzione» to Law's Commodities, 1752, pp. 14 and 15.

(15) S. Maccaroni, Le storie del buonista Law (The Strange Life of Banker Law), 1796.
list outlook which he had absorbed. He showed that money is not just a mere "veil" but an essential element in the "basic" problems of the economy. And in so doing, he acquires a definitely modern touch, so much so that it has been possible to portray him as a "foreunner" of Keynes (12). For it is credit increases in the money supply not only with the change of trade but also with the change of production in all sectors through the creation of wider and more intense employment. This was enunciated by him dogmatically, as something beyond question. He tells us so, right from the outset: "As Money encreas'd, the Poor and Idle were employ'd, more of the Land was Labour'd, the Product encreas'd, Manufactures and Trade enprovd" (p. 14) (13).

And he goes on repeating this, almost on every page, up to the end. Law makes no bones about categorically affirming what is implicit in, or hinted at by, other writers in passing. There are no limits, as he sees it, to the beneficial influence of money. Not only at home, but also in international trade. And this is always brought about by a rise in employment. In domestic trade, there is no doubt that "an Addition to the Money...adds to the National Wealth, raises the country of a Number of Poor or Idle, proportioned to the Money added" (p. 16). And in the international field, too, "a greater Addition to the Money will imply yet more People, (12) By Dr. Parkinson in the opening essay in his 'Journals Keynesiani' under the heading of 'A Foreunner'; the modernity of Law's thought is in evidence, with the help of Jardine, we recall the main phases through which the system passed, but shows all the revised Law's works in the light of modern economics, and in particular of the latter Keynes, we shall be surprised to find, in works written two hundred years ago, the more to raise insights, arguments and deductions. And Jardine had pointed out, in the dedication to his essay in Monday's L Forecast, that the basis illustrations, from the monetary doctrine and institution study of the past, arguments, illustrations, problems and theories which the context of the flow of man's thought and action reproduces even today, are doubt with some additional complications, but yet substantially unchanged. (13) For in his 'Studies,' pp. 1, 2, 4, 5; Versus means that Law meant to attack the quantity theory. And Adam Smith also argues as much in his 'The Theory of International Prices,' 1776, where the writer states: "The quantity of the money, or, at least its raw material, is given in Law and Smith" (p. 128).

or the same People before employed to more Advantage, which, say not a greater or more valuable Export, will make a Balance due" (p. 18). So that "the effectual way to bring the Balance to our side is to add to the Money" (p. 159). And conversely, "without some addition to the Money, it is not to be supped that next years Export can be equal to the last; it will lessen as Money has lessen'd, a Part of the People then employ'd being now idle; not for want of Inclination to work, or for want of Employers, but for want of Money to employ them with" (p. 46). In these extracts from Law, and in many others, it is undoubtedly possible to detect "extremely up to date insights, arguments and deductions". But this does not seem to us to throw any light on the propositions enunciated by Law. On the contrary, it casts a shadow on the recent tendencies to which we have referred. We might even go further and argue that Law's merit consists in making it easier, by the primitive ingenuity of his reasoning, to identify those errors which it is hard to track down among the twists and turns of recent theories.

4. — One of Law's basic errors was to attach almost exclusive importance to what we would nowadays call 'income effects' (more specifically to the effects of increases in the money supply on the productive process generally as a result of full employment) and hence not to give due weight to the upward trend in prices linked with these increases in the money supply. This is so marked that he gives the impression of not being aware of, or even of meaning to contain, the embryonic "quantity theory" which was not only already in the air in his day but had been consciously formulated in England and elsewhere (14). Actually, Law was not unaware of, and even less did he contest, the main propositions of the quantity theory. Right at the beginning of"Money and Trade", he warns the reader that "Silver was lyable to a change in its value, as other Goods, from any change in its Quantity, or in the Demand for it" (p. 6). This is a point on which he harps in order to throw into the reader's face the mass influx of precious metals had forced down their value (pp. 86 et seq.). The singularity of his position consists rather in imagining that an increase, even an unlimited one, in the money supply could be absorbed by a parallel increase in the demand without giving rise to a considerable decline in its value, or, in other words, to a rise in prices. His error — "le gite du paradoxe" — to use Gallant's typical expression — hinges on his lack of understanding of the nexus between the extension of demand and the diminution in the value of money; that the expansion of demand to the extent that and in so far as it is not linked to an expansion in trade (or to an increase in need (liquidity), cannot but be connected with a rise in prices (15). It was precisely this lack of understanding which led him, quite logically, to assume that the increase in the quantity of money might exert its influence almost exclusively on the level of the rate of interest while the price level remained almost unchanged. And, given this position which, as we shall see, was entirely his, but entirely wrong, it was easy for him to prove that the effects of the increase in the quantity of money on the productive process might take the form of a continuous crescendo, conferring almost unlimited benefits on the course and on the growth of the economy. It need only be recalled that, even in his day, people were aware of the numerous advantages to be derived from a low level of the rate of interest wherein the mass influx of precious metals had forced down their value even then as the cornerstone of the economy. For if, at the time, people contested the possibility and desirability of effecting the reduction of the rate of interest (i.e. by legislation), they were not unaware, any more than they are today, of the advantages in question, both in the domestic and in the international fields. The only point at issue, then as now, was whether the lowering of the rate of interest was to be regarded as a cause or an effect of the progress of the economy and whether, in any case, the lowering could be effected and maintained by increasing the money supply.

5. — That is what Law had no hesitation in claiming (16). And in his day, other writers, including Locke, had the same standpoint. Locke, however, realized clearly that an increase in the quantity of money had repercussions not only on the level of the rate of interest but also on the level of prices (17). Whereas Law attributed far greater importance to the possibility of lowering the rate of interest by increasing the

(16) In a number of passages in Money and Trade (p. 68) and also in his Memorials sur les Bancs, December 1775 (at p. 21).

(17) This concept echoes his whole work as a proto-geometric of the main trends of the "quantity theory" (including the concept of the "equilibrium of circuits"). The dual effects of the variations in the quantity of money is explicitly brought out in some Considerations, op. cit.; in "money there are two effects in its influence which have hitherto been isolated by Jardine in Money and Commerce, op. cit., pp. 71 and 72.

In that speech, Thorstein added that, while "there might be no bounds to the demand for paper" (as for money in general) "the increasing quantity would overvalue the rise of commodities, and the rise of commodities require, and must justify, a still further increase. So that, in wishing to regulate the rate of interest, the increase in the quantity of money would be reduced between the expansion of the demand and the decline in the value of money. For he holds that, because the desire of more paper is almost always everywhere the same, to want twice very false (p. 56). And he uses the quantity theory (i.e. that only the quantity offered is enough to regulate and determine its value, without considering any proportion between its quantity and value (p. 79).
quantity of money, since, as we have seen, he started from the assumption that the increase in the money supply did not affect the price level.

In this respect, Law may rightly be regarded as a typical fore-runner of the recent "monetary theories" of the rate of interest and the price level, who make the same assumption as to the absence of effects on the level of prices and wages. Which, it must be admitted, was not always clear to the supporters of the extreme versions of these theories, on the strength of which politicians have embarked on some none too felicitous experiments in monetary policy such as that of "cheap money" (18).

In any case, after the recent debates on Keynes' theories, it can now be maintained that this neutrality is not existent, or, to be more precise, is somewhat precarious. That is to say, it lasts just as long as it does not have repercussions on prices and wages (19). And there is certainly no case for ascribing to Law the merit of having erected on such an unstable basis his conception of the continuous crescendo in the beneficial effects of the quantity of money on the employment of the "Poor and Idle" and, thence, on the course and growth of the economy. And still less can we see anything in Keynes' analysis of the influence of the money supply on international trade, since the balance of payments cannot fail to be unfavorably influenced by a trend in prices and wages resulting from the deliberate expansion of the money supply (20).

6. — Thus, his unsound approach, together with his misunderstanding of the connection between the extension of the demand for and the diminution in the value of money, gradually carried Law very long way in the direction of a "wonder-working" conception of the possibilities of developing the economy by a crescendo of employment in a constantly expanding productive process. A conception which, instead of being based on the "magic" of credit or, to put it more clearly, on the effectiveness of an organic and systematic diffusion of credit through sound institutions, rested almost exclusively on the expansion pure and simple of the quantity of money.

Bois in the essay "Of Interest" in Political Discourses, 1753.

It is also to be found in A. Serres (Wealth of Nations, Book II, Chapter IV) which refers to Law.

(18) Of course the knowledge that it was necessary to take into account the level of prices and wages as well was back then extremely recent, and the opposite assumption of those theories and still less among his critics. The fact that this is the Addissio's head of monetary theories of the interest rate has been demonstrated by Mountford in Equality Preference and the Theory of Investment and Money (Economica, 1941, reprinted in Buildings in Monetary Theory, 1950). The conclusion is that the dependence of the rate of interest on the quantity of money is explained only by the assumption of rigid wages function (20) already, as a matter of fact, strictly speaking, the long run rate of interest is determined exclusively by real factors (21).

(19) In this context, the following remarks by Moseman in Money, Credit and Commerce (1933, p. 597) in spite of Effzter's opinion to the contrary (in M. Keynes, The Classical, 1933) have again become extremely pertinent: "The new currency, or the increase of currency, goes, not to present persons, but to future ones. It increases the willingness of lenders to lend in the first instance, and lowers the rate of discount. But it afterwards raises prices; and therefore it tends to increase discount. This later movement is cumulative. Thus, a fall in the prevailing power of money tends, after a while, to raise the rate of discount and the rate of interest on long investments." A full demonstration of this point had been provided, over a century before, by Thurnov in Paper Credits, op. cit., p. 245, and even earlier by Tessier in Reflexions sur la formation et la distribution des richesses, 1756, parr LXXVII, and by the exposition of the dilemma and its consequences, 1767, pars LXXVIII, and by the exposition of the dilemma and its consequences, 1767, pars LXXVIII.

(20) Locke continues up to the idea of a "proportion", both in the domestic and the international sphere, in Some Considerations, op. cit., from p. 14 on, where he talks of a "certain proportion of money money for doing with such a proportion of trade", and on an epistle to p. 33. Where, after pointing out that it is impossible to estimate the quantity of money needed to trade, he goes on to state a "sensible" guess as to the limits within which the quantity should vary. Similar considerations had been advanced by Pierre in Quaestiones, op. cit., p. 59. Against this, Law, as noted by Jannacerca in Merchant and Laxness, op. cit., p. 59, does not believe that the quantity of money which a country needs can be calculated a priori. Which, as we see it, is ridiculous, especially given the fact that it is impossible to assess the exact amount of money necessary to sustain the economy, a fact which was well known already at the time.

(21) It is to be found at the beginning of Money and Trade, in the sense of the number of people to work proportioned to the quantity (p. 12) and in the opposite sense in the incomplete De la nature des hommes at July 1747, where he contends that if we go excessive from the wrong of an extraordinary emission of paper (p. 327) and later on, more specifically, that the "law's" bank appeared for a time to be an instrument of not overextending the demand for labor, and in augmenting the visible and bona fide property of the kingdom (p. 259, footnote).

as the driving force and indeed the only force capable of creating economic progress. So much so as to differentiate him from the mercantilist writers of the age, who, while attaching great importance to money (as the "blood") rather than as the "oil" of the body, were not as fully conscious of the need for a certain proportion between money and the other factors in economic life (ranging from population to international trade) and who even went as far as to lay down the limits within which the quantity of money might be considered appropriate for each country (21). As Law saw it, however, there is no room for the concept of an optimum proportion. Or, to be more exact, the very existence of such a proportion, which occasionally occurs (22) takes on quite a different meaning under his pen. In this connection his failure to understand the link between the extension of demand and the value of money comes into play. The optimum proportion for him is one that is derived from the total demand in full. And so, without realizing it, he makes it meaningless. For him proportion (if I may be pardoned a contradiction in terms) is unlimited proportion as much so that we are justified in saying that he lacks the sense of what is essential in economics: proportions and limits (23).

7. — The negative elements emerging from our analysis so far of the first point in Law's thought are also to be met with in the second characteristic feature, that is, in his conception of what money is and what it may be.

In this context, Law may be represented as in Schumpeter's History as — an "Ancestor of a Managed Currency" (24). And it is true that, with far greater mastery than so many other "planners" of new banks launched both before and after him, he demonstrated clearly the advantages of the adoption of a credit money and in addition foresaw the possibility and desirability of not anchoring that money to a given weight of metal. For that reason, he justified being credited with the merit of having initiated the theoretical discussion of pure "catalism", a discussion which, by its subsequent evolution, has made it possible to single out more precisely the "nature" and the "functions" of money (25). And also of having developed catalism to the highest degree of a growing logical complexity", to use the felicitous expression of Jannacerca (26), steering a course "among the concepts of money in account, imaginary money and ideal money", postulating...

(22) See Jannacerca in Merchant and Laxness, op. cit., p. 77.

(23) This is the title given, probably by Moseman, to one of the sections of the History, op. cit., devoted to Law (pp. 351-352).

(24) Arguing on the same lines, Stecher, in opposing catalism to circulated, takes it for granted that theoretical catalism is unattainable (in his History, op. cit., p. 189, note 9).

(25) In Merchant and Laxness, op. cit., p. 32.

(26) The goal of constant purchasing power was enunciated by Law only in Money and Trade and in any case was pur-
As is well known, Law was forced, in his subsequent schemes, to drop the plan for a Bank at Turin in 1711 to the first time his system was put into practice with the Banque Générale in 1716, to fall back on constant reference to a given weight of metal (the scudi di banco), i.e. bank ducats). In this way he covered the same ground as had been explored in so many other countries by the creation of a bank money. And he ended up in 1719 by sliding down the inclined plane towards the current monetary unit with a variable metal content (the livre de Tournois) when transforming the Banque Générale into the Banque Royale.

8. — Unfortunately, against these merits must be set his lack of appreciation (discussed earlier) of the role of proportions and limits, a deficiency which comes out not only in connection with the influence of the money supply on the course and growth of the economy, but also when he comes to consider what money can be. For he does not realise that the essential condition for the maintenance in being of a system of credit money, especially if not anchored by free convertibility to a given weight of metal, lies in the observation of certain proportions and appropriate limits to the issues of the money itself. In other words, he does not realise that credit money can completely replace metallic money only to the extent that the quantity can be regulated, i.e. limited in relation to demand in any given circumstances. In this connection, too, it is easy to discern his failure to understand the link between the extension of demand and the diminution in the value of money. By taking as a guiding principle for the issue of paper money the maintenance of the quantity of money at a level always equal to

and that, in any case, he defended criteria for regulating the money running counter to these principles, which were making headway even in his day. Indeed they had been adumbrated in writings with which he was familiar, such as those of Locke (39) and had also been applied in the experiment which he himself proposed to repeat (31).

9. — The same remarks go for the essence of the two basic points in Money and Trade as made when we discussed the secondary features. To paraphrase a famous dictum, it might be said that what is original in Law's thought is not fertile and what is fertile is not original. In any case, there seem to be no grounds for speaking of his a genus as an economist, a term used and abused when referring to Law. It only remains to be seen whether, although no genius in that respect, he was as a banker and whether the somewhat severe judgments, especially of economo bankers such as Thornton and MacLeod (32) ought not to be given a lower rating than the rather indulgent appreciations of the so-called original economists as Nicholson and Hare (33).

10. — One cannot honestly disagree with the latter for having presented some aspects of Law's work in a light or, rather, to be more specific, some aspects of his intentions as they emerge from his writings and in particular from the Mémoire on the Rétablissement du Commerce de Septembre 1772, in which he presented the notion of the system, its aims and structure (34). And, even if, in this respect, too, caution is indicated in attributing to Law merits of originality (35), it cannot be gainsaid that he had correctly sized up the gravity of the financial and economic situation of France at the end of Louis XIV's reign and that he realised the need to place the State Finance on a fresh and sounder basis and to have recourse systematically and on a large

scale dell'Economia, IV Settemb., 1905). (39) John Law's system, considered solely as a system of financial and industrial organisation, was a work of genius and had not been vitiated by an a priori principle, which was due to its exclusive interest; it would have brought to its author the sanguinary accusations (pp. 427). The "original principles" is identified by the same as that of the 1711 Bank, to which we will return, as the works of John Law's system which was soon ended because of its nature and its destruction (36). So that, lost for the extraordinary frenzy of speculation which burst out in Paris at that time, it is not improbable that he would have accorded, in spite of the many elements on a round of failure (p. 496). (30) According to Leuven in Les diverses monnaies et monnaies en France du XVI au XVIII siècle, 1940, the failure of the "system" has cast Law the malédiction of the contemporaries and the condemnation of the future of the silver and gold speculators. Meilleurs aimons, he is forced to choose between the illusion and the money which is for a while looking in his life (p. 28). (31) For the speech to the House of Commons from which we have quoted, Thornton thought himself sufficiently obliged to the explanation of Law's name in the same breath as the Bank of England Directors: "Unfortunately the name of Mr. Law and that of the present Directors of the Bank ought not to be associated with the total amount of the two establishments, or the comparative value of the person presiding over them, were the only subject for Consideration " (p. 745).

For his part, MacLeod, who is certainly no stickler for orthodoxy when it comes to credit, has leaned anything but conditioning like little towards Law whose name he has used, as "Lombard," to cite the various methods of handling considered unsatisfactory by him (in The Theory of Credit, op. cit., p. 113, and in The Theory and Practice of Banking, 1775, Chs. XII, XIII). (33) According to Nicholson, in John Law of Lawyers and the greatest speculative readiness in human money (Bills of

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10. — One cannot honestly disagree with the latter for having presented some aspects of Law's work in a light or, rather, to be more specific, some aspects of his intentions as they emerge from his writings and in particular from the Mémoire on the Rétablissement du Commerce de Septembre 1772, in which he presented the notion of the system, its aims and structure (34). And, even if, in this respect, too, caution is indicated in attributing to Law merits of originality (35), it cannot be gainsaid that he had correctly sized up the gravity of the financial and economic situation of France at the end of Louis XIV's reign and that he realised the need to place the State Finance on a fresh and sounder basis and to have recourse systematically and on a large
scale to credit rather than to the occasional expedients such as those which had hitherto been current. Nevertheless, if, instead of venturing to put the man in the dock, or rather the man's professed intentions, we concentrate on an objective examination of the system as it was actually put into effect by Law, we cannot but subscribe to the traditional judgment of the system as to quote Adam Smith's words — "the most extravagant project of both banking and stock-jobbing that, perhaps, the world ever saw." It is not really permissible to explain the collapse of the system by Law's "impatience" or by the fact that the age was not ripe for it (36). The collapse of the system was inevitable and would have come about sooner or later in any case as a result of its principles and of the course it took, since Law's assumptions in constructing and applying the system were simply wrong. Law's errors an economist could hardly avoid being translated into his failures as a banker.

10. — Moreover, as a banker, he not only put into practice the faulty conceptions developed in his writings as to the influence and nature of money, but, in his actions, fell into another basic error which was no less grave, although not expressed in his writings. For

(36) Law himself admitted that he would have been better advised to act "as a lender of money for a shorter time" ("Merci, Drouyn, op. cit., 50, 59, 130, 132, 137, 197, 240). And it was precisely because of the "stream of specie predominating" which appears to have been one of the main reasons for the collapse of the system according to his own and also his June comment in Merci à Monseigneur, op. cit., p. 155.

The suggestion that the crash was due to the "impatience of the times" is attributed to Drouyn and Schumacher. According to Drouyn, Smith's history shows Law acted out with incredible persistence the path which credit was to follow to become the driving force of industry in the modern world (in John Law, op. cit., p. 246). According to Schumacher, Smith's Banque Royale and the Compagnie des Indes, which was absorbed, failed because the colonial ventures combined in the latter did not, for the time being, prove to be the source of anything but losses. If these ventures had been successful, Law's grandiose attempts to control and to reform the economic life of a great nation from the financial angle — for this is what his plan eventually amounted to — would have looked very different to his contemporaries and to historians (in Editorial, op. cit., p. 300).

both in his works and his deeds he showed that he was steeped in a "working-man's" conception, in the former case as regards the effects of the expansion of the money supply and the possibility of satisfying an unlimited demand for money, in the latter case as to the possibility of using bank credits to the point of permitting the repayment of the principal in an expansion of real investments to be sustained to an unlimited extent and for an indefinite period by drawing on the credit of a national issuing bank.

Therein, in the last analysis, lay the originality of Law's system. What he had in mind was to carry out, in conjunction with the Compagnie des Indes, a gigantic investment plan which would not only have revived France's overseas trade but would have opened up immense stretches of the new continent. And the execution of this plan should have brought in sufficient profits to put the State's finances on a sound basis and to enrich, at the same time, both sovereign and subjects without calling for any sacrifices in order to effect the savings essential if the investments were to be carried out. For his purpose, he thought it was sufficient to rely on the credit of the Banque Royale, i.e. on a swelling flood of note issues. And, in fact, whereas the shareholders were asked to pay cash for only a ridiculously small part of their holdings, the Company itself was enabled to operate, without quantitative limitation, with the funds provided directly by the Bank through the typical "brainwave" of Law's whereby shares and notes were made interchangeable, and both put into circulation as money and, as being even preferable to gold. This brainwave which, more than any other statement or action of his, gives the measure of his alleged genius as a banker, enabled him to conceal the weaknesses of the system, i.e. the insufficiency of funds available for investment that had been noted when the Company made its first uncertain steps. But, in this way, the Company's real investments, instead of being fed by "voluntary" savings, linked to a rise in employment and a parallel increase in real income, were buttressed in the main by the volume of "forced" savings produced by the rise in prices and incomes brought about by the crescendo of note issues. But this forced loan could not in any case go on ad infinitum, since the gap between planned investments and the savings available inevitably widened as the inflationary spiral got under way.

11. — What we have said of Law the economist is also valid of him as a banker. His inability to grasp what any modern schoolboy knows cannot, of course, be held against him.

After so many decades of dull discussions, it is now common ground that credit can be created "out of nothing" by mere "confidence," since, on a given base of tangible goods, a credit pyramid may be erected the height of which will vary with the degree of "credit mobilisation" obtaining as between the immovable operators of the economic system, considered as producers and savers, and also as consumers. But there is also a fairly wisely held notion that this creation out of nothing, while exercising a prodigious influence on the process of income formation, especially if the "creation" takes place through the banks, is not enough of itself to sustain the real investments as a stable "counterpart" to them. As a counterpart to the real investments conceived of concretely as a "fund" of real goods, credits are needed which in their turn are linked to real savings, whatever their origin — whether they are the fruit of taxed income or bank loans, or the fruit of increased savings, even unforced ones, in that income. And there is no escape from this perennial, timeless necessity in running a bank, and still less in administering an issuing house. Even the credit granted by note issues may give stable support to real investments only insofar as they represent ("ex post" although not "ex ante") real savings.

It is understandable that, in his day, Law could not have realised all this very clearly.

Nevertheless, the people in charge of the main State banks from whom Law had taken his cue in working out his system had long had an intuition of this point. Not by chance and not without some justification had the banks in general (and especially the "deposit and clearing banks" in addition to the "circulation and discount" banks) been subjected to limitations in their operations by prohibitions and restrictions in the granting of credits. So much so that they were forced, or at least pretended to be forced, to observe restraints which turned out to be indefensible, even in the general interest (cf. the typical case of the Bank of Amsterdam). And what we said of Law in connection with monetary policy is also true of credit policy (since both fields are really inseparable parts of the same whole). It certainly does not speak for his alleged genius as a banker that the structure and development of his system were based on criteria incompatible with the principles which have now prevailed and which were already making headway in his time in the very experiments which he had set out to repeat.

12. — All things considered, then, we cannot but be perplexed when confronted of late with repeated attempts to rehabilitate Law.

Law's figure has too many sides to it that each of us may well form our own opinion of him. For my part, I find it impossible to share Harris's judgment, however authoritative, according to which [as already stated in footnote (33) to page 105] "les études les plus sérieuses qui lui ont été consacrées reconnaissent presque toujours une pensée de génie président à des conceptions grandioses, une habileté de tacticien et une compétence de réalisateur très peu communes." I would rather be tempted to see in him, to use Ouard's expression, a "gentleman adventurer" (37) or, to adopt the concluding expression of Magri a "gentleman financier".

And we should be particularly grateful to the critical appraisals of Law's work, which have helped us to understand the underlying realities that have been overlooked.
The Foreign Exchange Business of the Australian Trading Banks

Exchange Rates and Other Charges.

The trading banks' income from foreign exchange business is made up of three components. As dealers in foreign exchange they derive a trading profit by charging more for foreign exchange than they pay for it. As suppliers of credit they charge interest. And for some of their other services they charge commissions. With the exception of some commissions, however, all three types of charge are customarily compounded and quoted in one price, the cashed exchange rates for different kinds of transactions.

The basic exchange rate between the Australian pound and the pound sterling is the TT buying rate Australia on London, that is to say, the rate which an Australian bank will pay a customer for sterling for immediate delivery. This is the rate which economists have in mind when they speak of the exchange rate in connection with exchange rate policy. There has been such an exchange rate ever since financial market transactions began between the Australian colonies and England. But until 1900, it was not generally recognised as such. The Australian pound was not distinguished from the (British) pound sterling. The exchange rate quoted by Australian banks was regarded merely as the rate for the same currency in another place. London, and was therefore expressed by saying that sterling in London stood at so many pence premium or discount.

The operation of the sterling exchange standard ensured that the rate did not diverge greatly from par. The Australian banks fixed the actual rate, within the limits of gold export and gold import point, from time to time by consultation in accordance with the condition of supply and demand in the market which reflected movements in Australia's balance of payments.

The fiction that the Australian and British pound were one and the same currency had to be given up during the depression of the early nineteen-thirties. The deterioration in the balance of payments resulting from falling export prices and cessation of capital imports was such that the banks were unable to meet the demand for overseas exchange from their depleted holdings of London funds. At first, the trading banks, with the full concurrence of the Commonwealth Bank Board, preferred to ration exchange rather than raise its price. But when it became apparent that they were unable to control the market and were losing more and more business to an outside market,