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Institutions, Events and Theory


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Institutions, Events and Theory

A Comparison of the Monetary Policy Shifts of 1844/45 in England and Sweden.¹

Ḥåkan Lobell

Abstract

Monetary policy in England and Sweden were subject to transformations in 1844/45 that might be characterised as regime changes. We attempt to analyse the role of experience and current events in the process leading to theoretical disputes and regime change. We also compare the institutional setting and types of actors involved in the decision-making process. The results suggest that current events and past experience were important factors. The process can largely be characterised as error-learning and theory played an important role in determining the policy-choice. Institutional peculiarities and different types of actors in the two countries did not significantly alter the core outcome, but certain specific institutional characteristics.

Introduction

This paper explores the changes in monetary policy that took place in England and Sweden during the period starting from the resumption of specie payments in 1821 and 1834, respectively, up to and including the regime changes in England and in Sweden and 1844/45. The monetary regime introduced in England following “Peel’s Bank Act” in 1844/45 was an important milestone in the development of the modern monetary policy and came to characterize the system for a long time to come. However, the orthodox interpretation of the underlying theory represented a step back in a way,² and both countries witnessed a

¹ This paper is a revised version of a paper that was presented at the Fifth European Social Science History Conference, Berlin, 2004. Klang-Vänerklint, Lobell & Pettersson (2004). The research is funded by the Bank of Sweden Tercentenary Foundation.

² The act was sometimes seen as an attempt to apply “old” solutions, i.e. metallic currency, to new realities of an increasing role of banks and financial markets begged for changes in another direction.
theoretical as well as political tug-of war. A stricter deployment of rules and a quantity theoretical approach came face to face with one that was more adaptable and discretionary approach to monetary policy. In England these two approaches are normally referred to as the Currency School and the Banking School. We have, in another context, mentioned that the discussion and theorizing in both England and Sweden were concerned with relatively similar arguments. Yet, although institutions and experiences were different in many respects, similar regime 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 changed thinking influenced by current events and did the developments in the 1840s represent progress in economic theory? Or could the policy shift be seen as a case of “social learning”, in which the theoretical controversies were subordinate to a combination of current events and past experience?

The Theoretical Debate in England and Sweden

The English theoretical discussion on money and banking was rather quiet in the first decade following the resumption of gold payments in 1821. Most economists, except for some eccentrics and so-called Birmingham economists had accepted the bullionists’ (Wheatly, Ricardo, Lauderdale, Thornton and others) views of how the monetary system work and the role of the Bank of England. The debate began to be revived again during the 1820’s business cycles and gathered

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3 Lobell (2003).

4 It is a long-standing idea in the history of economic thought that the development of economic theory is influenced, or even dictated, by economic events. See e.g. Eagly (1968) or Skaggs (2000).

5 E.g. Jonung (1999) and Hall (1993). Hall and Jonung used the concept of policy learning slightly differently. Jonung started from exogenous macroeconomic disturbances and expressed the process more as a drawn out course of events with a sequence of policy shifts. Each shift was initiated by an exogenous disturbance that led to the crisis and each time there appeared something of the new theory, characterised as error-learning. Hall concentrated on an endogenous process by starting from a prevailing paradigm (Keynesianism) that was subjected to strains, anomalies, which to a certain limit could be solved within the paradigm by a little adjustment. When this limit was reached the policy tipped over, under dramatic forms, to something completely new (Monetarism). Nonetheless, both interpreted the development in terms of a sequence of short run learning processes.

6 The theoretical debates produced “more heat than light”, according to Viner (1934) p. 118.

7 Bullionism, in short, is the idea that notes must be convertible and covered by bullion, otherwise, banks may be tempted to issue notes excessively which causes inflation and agio.
momentum in the course of the monetary and financial crises of 1836-39. The participants formed camps that were afterwards called the currency school and the banking school.

The currency school represented an orthodox interpretation of the quantity theory and maintained that money was neutral in relation to the real economy and that changes in money stock – money stock (the currency) was defined as coins and/or notes – only affects the price level, and that the price level (the inverse of the value of money) was a purely monetary phenomenon. They also put forward Ricardo’s view that gold is exported only when it is profitable to do so, i.e. when inflation erodes the value of money that consequently has greater purchasing power abroad. A rise in the price-level and falling exchange rates could only be caused by an improper, “unnatural”, increase in money stock. 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 note issue. This so-called currency principle maintained that a mixed system with coins and notes should be designed so that it functioned as if it was a purely metal, coin system, which was automatically regulated, according to Hume’s *price specie flow mechanism*. The policy recommendation of the currency school’s leading advocates, Robert Torrens, J. R. McCulloch, G. W. Norman and Samuel Jones Loyd (Lord Overstone), was therefore that the Bank’s note issue should be tied more firmly to its gold reserves. They also considered that the private so-called country banks’ (i.e. provincial bank’s) note issues ought to be suspended because they could be as inflationary and destabilizing as the Bank of England.\(^8\)

The banking school opposed the proposals put forward by the currency school. Its representatives, the editor of the Economist James Wilson, the Russia merchant Thomas Tooke, the surgeon and banker John Fullarton, director of the Bank of England John Horsley Palmer and others 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 with prices and interest rates instead of metallic reserves. They have sometimes been referred to as inflationists since the principle was influenced by “*real

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\(^8\) Fetter (1965), Fetter (1980) and Viner (1934).
“bills doctrine” and the “needs of trade doctrine”, but most of them only wanted to maintain the status quo. They claimed that the gold standard, as it had developed by then (1830s), 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.  

The theoretical discussion in Sweden resembled to a large degree that of England described above. Classical economics, especially bullionism, made its breakthrough in Sweden at the beginning of the 1820s. A few concepts, left over from the 1810s, still flourished though. The so-called fund-theory (fondteorin) was a mixture of quantity theory and a theory of “trust”. Unlike quantity theory, the fund theory explained inflation and the emerging agio in 1808-1810 by claiming that note issues and silver exports resulted in an incorrect proportion between notes in circulation and the fund, the silver reserve. Diminished credibility for the Riksbank’s capacity to pay in silver would thereby erode the value of the notes. The policy implication was the same; namely that it was important to control note issuing.

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 currency school, Emil von Troil, J. P. Lefrén and others represented the orthodox position in Sweden, while the Swedish variant of the banking school, Bernhard Rosenblad, David Frölich and others were more pragmatic opponents of an orthodox application of the bullionist theory rather than advocates of alternative theories (real bills doctrine, law of reflux, etc). They maintained that the value of money (price level) and exchange rates could not be viewed as monetary phenomena excluding every other factor. They were opposed to letting the external silver flows, which were normally determined by conditions outside the Bank’s control in a small country like Sweden, determine the Riksbank’s note issue and lending. Instead, they advocated letting the Bank’s board of directors work in a preventive/restrictive manner during
upswnings and at the same time be given the means to relieve the business community in recessions.

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

**England**

The Bank of England resumed specie payments in 1821, but otherwise continued its activities more or less as usual.\(^{12}\) A boom at the beginning of the 1820s was followed by a recession, which in turn developed into a serious financial crisis with extensive suspensions of payment and bank runs in 1825. The Bank of England was initially subjected 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 flow in. The directors decided that the positive external balance allowed the Bank to be “bold enough” to expand credit and note issues substantially during the most intense phase of the crisis. This immediately put a brake on the liquidity crisis in the money market and the bank-run, seemingly without causing either price rises or an outflow of bullion. At the resumption in 1821 monetary stability had been promised, but during the crisis in 1825 it was shown that this was not always possible. Two important lessons were learned from the events in 1825. The one was that the crisis had been preceded by a large increase in note issue by the Bank of England and country banks, which caused inflation, speculation and crisis. The other was that if the exchange rates and external balance were favourable, when a financial crisis threatened, the bank could issue notes without causing inflation.\(^{13}\)

During the latter half of the 1820s the Bank of England took a further step towards increased deployment of rules that was partly built on the experiences of 1825. The policy rule, which came to be known as Palmer’s rule, meant that the Bank would hold a metallic note-coverage of 1/3 to 2/3 in securities in normal times. The idea was that securities were to be held constant and that the notes in circulation could vary with the metallic reserves. In cases of adverse external balance and falling exchange rates, the Bank of England was to restrict lending and withdraw notes immediately. In cases of financial crises and internal

\(^{12}\) “…..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.

\(^{13}\) Clapham (1944) pp. 102-107, Maclaren (1858) pp. 163-164.
drains the Bank had the possibility of deviating from the rules to relieve the money market.  

The banks’ suspended payments during the 1825 crisis aroused strong opinion against the private banks’ note issues and notes in general. However, no complete suspension of country bank note issues was implemented. The government reacted in 1826 by prohibiting the issuing of notes with a denomination lower than £5, and after discussions with the Bank of England, by letting the Bank establish branches in the countryside and increase the spread of these notes.

Another monetary shock occurred in connection with political unrest on the continent in 1830. External as well as internal flows halved the Bank of England’s bullion reserves from £10 to 5 millions. What was remarkable was that the crisis was not noticed much in England. The outflow of bullion in 1830 had, however, been accompanied by similarly large withdrawals of notes, which at least the currency school’s advocates later interpreted as the covariance between notes and bullion, explaining why the monetary shock passed almost unnoticed.

The English parliamentary investigation of the Bank of England, in connection with the renewal of the Bank’s charter in 1832, disclosed that the Bank had not applied Palmer’s rule consistently. The Bank’s officials had, moreover, difficulty explaining how the Bank’s commercial activity weighed against its special role as “central” bank. The investigation led to only a few measures, mainly abolition of the Usury laws. The Bank charter was renewed in 1833 and the country banks could continue issuing notes.

The English economy suffered yet another serious recession and crisis in 1836 – 1839, when the Bank of England’s bullion reserve was very close to running dry. It became clear to many that the Bank’s instrument did not work. During the worst phase of the crisis it attempted to dampen gold exports by raising the minimum rate of interest, but the market rates increased even more, which immediately worsened the domestic run to the Bank and intensified the gold outflow. Eventually, help was sought in France to save the Bank and convertibility, which in certain circles were regarded as humiliating.

The element of arbitrariness in the monetary policy that characterized Palmer’s rule was thoroughly discredited by the experiences of 1836–1839. The Bank of England was criticized for its note issues and too expansive credit policy, which worsened the inflation in the economic upswing and that its countermeasures contributed to a deepening of the crisis as soon as the economy slowed

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14 Horsefield (1953) p. 114.
15 Clapham (1944) p.170.
down. Obviously, something had to be done and it was in this phase that 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 strict, simple rules. Many of the directors and the members of the governing council of the Bank of England, the Court, had never fully accepted Palmer’s rule and had been uncomfortable with the discretionary policies of the rule for a long time.

The Bank Charter Act of 1844\textsuperscript{16} implied that the Bank of England was to be divided into two sections, the Issue department and Banking department. The Issue department was allowed to issue notes up to a total of £14 without gold coverage. All note issues above that limit had to be fully covered. No new note issuing permission was given to other private banks. The intention was to gather note issuing under one roof and to tie it to the bank’s gold reserves. The law prescribed that the Issue department had to cut down its note issuing and credits at the first sign of drains regardless of the cause.\textsuperscript{17}

In certain ways the 1844 Bank Act in England was a regime shift. The target “the needs of trade” became totally subordinate to the goal of currency stability and it was a hard blow to free banking as the Bank of England was given increased monopoly on note issuing. The system became formally strictly regulated and was a first blow to the development of the lender of last resort function that had just begun. Afterwards, under the influence of new crises, the system was shown to allow deviations and changes in practice. Since the idea was that the control of the “currency” was to be wholly automatic, there were no special rules associated with the banking department’s business transactions. “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”.\textsuperscript{18}

The experiences of 1825 and 1836-39 made several of the leading experts in England, especially J.R. McCulloch and Robert Torrens, change their opinions in favour of the currency principle and simple deployment of rules.\textsuperscript{19} At about the same time Thomas Tooke changed his stance in the opposite direction, which was due to the fact that he had analysed long price and money stock series and come to the conclusion that empirical evidence for the currency school’s fundamental theoretical connection did not exist. Some bankers began to

\textsuperscript{16} “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.”
\textsuperscript{17} Fetter (1965) p.185.
\textsuperscript{18} Whale (1953) p.127.
\textsuperscript{19} O’Brien (1965).
prefer rule-based policies since they, at least judging by the correspondence between the London bankers John Carr Glyn and Langton in the 1830s, were dissatisfied with the unpredictability of the Bank of England’s actions, for example, its 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, while the industrialists in Manchester, and Cobden, among others, seemed to support Peel.20

Compared to Sweden there was, as John Clapham, J.K. Horesefield and Frank Fetter have taken up, a distinctive feature in this process. The discussion was conducted mainly outside the party political sphere in parliament, even though the Parliamentary Political Economy Club probably was an important forum for an exchange of views regarding this issue. It was likely that the Bank of England’s directors and members of the governing assembly, “the Court”, were the important actors. Clapham showed that the formulation and implementation of the Bank Act was decided in talks between Robert Peel and the Bank of England’s representatives William Cotton and John Benjamin Heath. Peel’s Bank Act has occasionally been interpreted as an orthodox expression of a purely theoretical approach.21 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 policy in England during much of the period from resumption in 1821 until 1844.22 J.K. Horsefield accounts even more explicitly for the existence of a sequence of events where the directors of the Bank of England revised their perceptions of how the monetary system operates and how it should be organized. Both held, in our opinion, 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”.23 On the whole, Horsefield described a learning process in which every crisis from the end of the 1700s and onwards was brought about by changes in the regulatory system that controlled the Bank of England’s actions. 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

21 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.
22 Clapham (1944) p. 163.
23 Horsefield (1953) p. 125.
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.”24

Something similar had also applied to earlier changes in the 19th century. 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”.25 According to Clapham and others, the Bank of England directors were a strong lobby group that influenced Peel and the other politicians to a considerable extent. The discussion in parliament before legislation mostly resembled a formality and was of low quality and boring.26

**Sweden**

In many ways conditions were different in Sweden. The financial and banking system differed substantially since England already possessed a widespread and integrated system of bankers, note-issuing country banks and bill brokers. A law for private banks was passed in 1824 in Sweden, and note-issuing provincial joint stock banks began to emerge in 1830.27 Six banks existed in Sweden while England harboured hundreds of note-issuing banks and joint stock banks in the early 1840s. The position of the Bank of England in the centre of a large financial system, together with the emergence of modern style business cycles, made the system vulnerable to internal drains and bank runs. This was a smaller issue in Sweden. Instead, the external adjustment and external drains were the source of most concern, typical of what one may expect in a small trading nation.

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24 Horsefield (1953) p. 115.
26 Clapham (1944) p. 170ff.
27 Three private so-called discount companies (discont-verk or discont contour) were established in Sweden between 1803 and 1810, but all three failed in 1817.
Ownership conditions and the relation to the state were other prominent differences. The Riksbank was controlled by the Riksdag. The Bank of England was privately owned. We have already mentioned that Horsefield and others dismissed the idea that the currency theory’s policy was fobbed off onto a reluctant Bank of England. Apparently the Bank’s directors sometimes learned from experience and were influenced by theories (e.g. Palmer). Alternatively, they continually attempted to escape from the “unwanted burden of monetary management” by following a set of “simple and automatic rules” (e.g. Cotton & Heath). The Riksbank had no intentions of avoiding the responsibility of monetary management. On the contrary, the dominating concept was that it was the Bank’s principal task, ahead of extending credit, supporting business activity and being the state’s financier. In any case,”simple and automatic rules” were introduced into the Riksbank’s regulatory system at about the same time as in England.

Also in Sweden there was an opposition to a monopolistic Riksbank. More important though was probably the conflict between the Crown and the Riksdag. The constitution RF § 72 decreed that the Riksdag should alone administer the Riksbank without intervention from the King or government. Karl XIV Johan demanded influence nonetheless, which had repercussions for the process towards resumption in 1834, mainly through delaying it. Still, the acute conflict was eventually settled and the Riksbank’s business remained under the Riksdag’s unrestricted control. The conflict continued though. Even if the royal power and the government were excluded from influencing the Bank, they still managed to obtain for themselves the right to charter private banks that were outside the Riksdag’s influence. Hence the stalemate.

The Riksbank resumed specie payments considerably later than the Bank of England. The former took the decision to implement resumption in 1823, but legislation only came in 1830 and it was not before September 1834 that specie payments were resumed. The paper

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28 The Riksbank’s predecessors started in 1661 as a note issuing private bank, 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).

currency riksdaler banco was devalued to 2 2/3:1 against riksdaler silver specie as compared to the relation 1:1 before the suspension in 1809.

In 1834 the standing committee on banking proposed new rules for the Riksbank’s activities and measures to “maintain the value of coins”. The principles behind the proposal were to keep the monetary value stable by stipulating a lowest silver reserve, and to allow notes to vary with the silver reserve. In the event of rising foreign exchange rates and threatening external silver outflow the Bank was to withdraw banknotes, by contraction of credit if necessary. According to Riksbank historian David Davidson the bank regulations (bankoreglementet) had a preventive dimension. The issue of banknotes was to be restrained with the aim of preventing inflation, exchange rate increases and agio. The Bank, which was by far the single largest credit market institution in Sweden at the time, was provided with a well-defined ceiling for credit and government lending was suspended, all with the intention of securing the monetary value and convertibility. Several participants in the debate referred to the suspension of silver payments in 1809, which was seen as a state bankruptcy in that it could not meet its commitments, i.e. notes at a fixed rate. Thus, Swedish monetary policy was to a larger degree designed along the lines of the currency principle as far back as in 1834 (even if the theoretical reasons were partly different).

When the proposal was discussed in the Riksdag there were, however, on the one hand those who wanted to introduce strong links between the Riksbank’s silver reserves and banknote issues and on the other those who wanted to give the board of governors more room to manoeuvre and preferred not to fix an exact connection. The debate resulted in certain changes in the regulations, which thereby did not become as restrictive as in the original proposal. Securities did not always have to be held constant. The Riksbank was given unlimited possibilities of making advances against goods, gold and silver. The contraction of credit, with the aim of maintaining the proportion between notes and silver, was only to be used after all other means were tried.

In 1819, most likely influenced by the discussions and decisions on resumption in England, 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 were passed through parliament in 1830.
The discussions centred on the formulation of the bank regulations in 1834 references were often made to experiences from the 1700s and suspended payments in 1809. Much time was given to a discussion on whether the resumption of 1776 was “successful”. Moreover, the English experiences of dealing with crises in 1825 were often cited, the knights and nobility had access to the English bank charter investigation of 1832 and some members of the Riksdag knew Palmer’s rule. The memory was neither short nor limited to Sweden.

In 1837 an international crisis had repercussions in the form of reduced export demand in Sweden. Exchange rates rose and silver was exported to a relatively large extent (Figures 2 and 3). The Riksbank’s analysis was that it was a matter of a temporary adverse balance of trade and, in full agreement with the prevailing regulations; the only measure was to suspend silver purchases.\textsuperscript{31} The general consensus was that the automatic-regulatory forces would work, and above all that foreign trade would improve and lead to a revival of exports. In 1838 the exchange rate turned downwards and the foreign silver purchases could be resumed. The crisis and the substantial outflow of silver and gold from England in 1839 resulted in a sizeable inflow of silver via Hamburg into Sweden. The lesson of the events in 1837 was that the system appeared to work, which probably is the reason, why very few proposals to change the bank’s regulatory system were made in the Riksdag sessions of 1840/41.\textsuperscript{32} The Riksdag’s auditors, however, came to the conclusion that the Riksbank would thereafter need to buy silver after temporary outflows. The auditors criticised the rule allowing the Riksbank to order silver through private entrepreneurs for cash payments in advance. It was a costly business for the state and only favoured the entrepreneurs. The Riksdag reacted by taking up a new rule stating that the Riksbank would carry out its own purchase and import of silver.

Another and more serious series of monetary shocks in 1841-43 drained the Riksbank’s metallic reserves by more than a half over the course of a couple of years. An international recession and two very special circumstances, namely a substantial silver export to Finland and arbitrage with Spanish piaster, giving rise to even more extensive silver exports.\textsuperscript{33} The Riksbank’s Board of Directors (bankofullmäktige) was

\textsuperscript{31} Silver could only be bought when the rate was under or at par.
\textsuperscript{32} See Davidson (1931) p. 80.
\textsuperscript{33} After the war and transition to Russian dominance in 1809, Finland held on to the old Swedish coin system. On 18 November 1841 the Russian government increased the authority of and reorganised the Bank of Finland into a National Bank. A little later the Finnish government announced that all Swedish notes were to be taken out of circulation. The years 1841 to 1843 therefore saw a substantial export of silver destined for Finland, with 1.6 million rdr silver specie (or about 4.4 million rdr bko). The Swedish silver became
uncertain as to how the nature of the situation was to be interpreted and what had to be done. To begin with the board did what was done earlier, i.e. suspended silver purchases because of the exchange rate and waited. However, the Riksbank continued and even increased its advances against goods so the bank notes in circulation were in principle unchanged. The dramatic silver drain and a violation of the legal limit to issue notes created considerable consternation regarding the Riksbank’s capacity to maintain its coverage of banknotes. The metal outflow did not decrease however, and it was decided that measures had to be taken, thereby putting an end to the passive behaviour. Half-hearted attempts were made to reduce notes in circulation in accordance with the regulations, i.e. the proportion between the silver reserve and stock of bank-notes was to be restored. The bank tried to take up loans on the domestic market via the National Debt Office (Riksgäldskontoret), which gave at most meagre results. Thereafter attempts were made abroad with the same meagre results. In the late autumn of 1843 the situation began to improve. The foreign exchange rates began to fall and the Riksbank could order silver again. The private banks on the other hand were subjected to drains of Riksbank notes, when these were demanded for further exchange at the Riksbank for silver that was to be exported. The private banks were often forced to suspend lending directly (partly due to interest rate restrictions), which contributed to monetary tightening, as well as to strong public indignation.

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. In autumn 1843 the King requested a report on the iron export prospects and currency situation from finance secretary Munthe, who explained that the notes in circulation had diminished so much that “Under such a monetary situation there is likely to appear a difficulty, which leads to reduced use and import of foreign goods, and, consequently, in its time contributes to the restoration to equilibrium of payments in foreign places”. He added that if the harvest was good and exports increased, silver would come flooding into the country. But if the opposite occurred: “As a consequence of unlimited advances against iron in the bank, its metallic

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bullion reserves for the newly constituted Finnish National Bank. Another great outflow was due to 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 sold these for 122 á 125 Sk bko, while they were bought for 3 1/6 á 3 1/4 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.

Skogman (1846) II p. 81-83.

assets could become mostly iron instead of silver”. The report expresses very well the crisis-atmosphere and concern for the continued existence of the silver coins. The report indicates that it was regarded as a serious problem when the bank advanced credit and released notes to the stretched iron industry in a situation of considerable silver drain.36

However, it was obvious to many an opponent of the currency principle that the reasons for the substantial outflow of silver lay outside the Riksbank’s control. Pamphlet writers often pointed out that the silver drain was caused by factors beyond the reach of the Riksbank. Anyway, the unfavourable external balance was the explanation that won most approval and the cause was sought in the regulations of the Riksbank. Thus, a growing number of members of the Riksbank board of directors and the Riksdag drew the conclusion that a strict application of the currency principle and the deployment of rules would better be able to remedy the silver reserves and secure convertibility for the future. However, the Riksbank historian and economist David Davidson had difficulties tracing the basic thoughts behind the new regulatory framework, but found that understandable since “the result had emerged from the decisions of four estates. Furthermore, the Riksdag was dominated by two powerful parties, of which one first and foremost wanted to provide for the elasticity of the Riksbank’s lending operations, while the other considered the creation of entirely secure guarantees for the maintenance of monetary stability to be the most important matter”.37 Davidson then turned to the lesson learning from the previous crisis but found no clear explanation, even though the speakers in the Riksdag often referred to what the lessons of the crisis was supposed to imply in terms of changes in the regulatory framework for the Riksbank.38 Thus, the changed concept was most probably also influenced by the development of events in England.39

The Riksbank regulations were changed in the Riksdag session of 1844/45. The central difference was, as Davidson pointed out in particular, that the monetary policy was changed from being preventive to repressive. In future the contraction of credit was to be the means to be used first in cases of drains, instead of being the last resort as the

36 Skogman (1846) II p. 97.
37 Davidson (1931) p. 117.
38 See e.g. Davidson (1931) p. 118.
39 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.”
bank regulations prescribed, the aim of which was to get the notes in circulation to vary with silver reserves.\footnote{Davidson (1931) pp.120f. 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 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. Thereby, it was thought that foreign bills could be used instead of silver, and buying silver could be avoided after recessions/export decreases. In this way 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 purchases of silver.}

In the 1844/45 Riksdag session a law for note issuing joint stock banks was formulated and adopted to replace the obsolete law of 1824, which did not regulate the private banks’ note issues. New banking legislation had been proposed in the Riksdag sessions of 1834/35 and 1840/41. King Karl XIV Johan, however, had blocked the proposed laws. During the first half of the 1840s there was a strong opinion in the Riksdag against note issuing banks, and even the King changed his opinion with regard to private note issuing and was ready to cooperate with the Riksdag. This opinion was based partly on the view that note issues were a threat to monetary stability and resumption, and on dissatisfaction with the cutting off of credit during times of silver exports experienced in 1841-1843. The law was very restrictive. It required e.g. fifty founders, all with unlimited liability, and a large part of a basic fund of 1 million riksdaler banco was to be deposited. The King died, however, and the successor to the throne, Oscar I, again 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 banks, with the restriction that small notes would be gradually prohibited.\footnote{Ögren (2002) pp. 76-79.}

Since experience of note-issuing private banks was limited in Sweden, arguments were willingly borrowed from foreign sources, mostly Scottish, English and North American.\footnote{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.}

Leading participants sometimes reacted on crises in a way that can be interpreted in terms of short run learning processes in the 19th century too. At times, though, their memory seemed stretched relatively far.
back. They frequently referred to the events in the 17 and 1800s, not least to those of 1809. They did not restrict themselves to experiences in Sweden but instead showed great knowledge of the English course of events quite far back in time.

Concluding Remarks

We can thus conclude that the agenda was highly determined by current events. The process in England can quite clearly be characterised as trial-and-error, i.e. a kind of policy learning. There is less evidence of short-run policy learning in Sweden, though. The process between resumption and policy change was much shorter in Sweden and we may note 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. References to not least the English experience were frequent at the time.

It is hard to derive the true mix of ideas and processes behind the Swedish regime shift in 1844/45. English experiments were used in Sweden as a compromise 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, as Eagly has claimed in the case of the 1700s bullionist controversies in Sweden and England. The discussions produced, as Viner once concluded, “more heat than light”\textsuperscript{43} and were more instrumental, concerning monetary policy instruments and the choice between rules 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 if we compare this with Sweden, with its Diet of Four Estates and its strong

\textsuperscript{43} Viner (1934) 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). Besides, strong exogenous disturbances were required for the regime change to be implemented. 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 less such narrow reasons in Sweden, which might suggest that monetary theory and foreign influences played a larger role.

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