VIII

BAGEHOT AND THE TRADE CYCLE

I

To the economic historian the unique position of the *Economist* in the lore of nineteenth-century Britain consists not only in the special information it contains, information often inaccessible elsewhere, but also in the fact that it surveys systematically, week by week, the changing aspects of a whole economy. Its interest, it is true, was heavily weighted towards the problems of the capital markets and foreign trade; but the flow of reports from agriculture, and from the coal, iron, engineering, and textile industries, was regular and progressively more detailed, and in them can be traced the changing forces which governed the position in the various labour markets. All the relevant variables can be followed, in greater or lesser detail.

It would have been inconsistent with the coherence the *Economist* brought to political and social affairs for these reports to have been left to languish discretely side by side. It was inevitable that the editors should draw from them some generalized view of the course of the economy as a whole, and some sense of the typical relations governing the interplay of events in the various markets. Any journal committed to the regular reporting of the events which concerned the *Economist* would become, perforce, a chronicle of the trade cycle. The *Economist*, however, was more than a chronicle. Out of its accumulated experience it developed a lively sense of the causation of events. Unlike the typical Lombard Street operator or Midland industrialist it was not freshly surprised and affronted by each succeeding cyclical crisis and depression. If the *Economist* was to make sense of the changing scene week by week, if the journal was not to be an inchoate compendium of odd facts and statistics, an analytic framework was required. The *Economist* was forced, in a sense, to tell its readers where they stood at any moment in relation to the trade cycle.[1]

[1] This, in effect, the *Economist* regularly did, in the opening issue of each year,

It would be surprising, therefore, if the nineteenth-century *Economist* did not generate for its own needs some kind of trade-cycle theory. It would be equally surprising, however, if that theory were to be, as a theory, either highly explicit or highly abstract. The good reporter—even if he is a philosopher—must conceal the fact; and it would be a great philosopher indeed who could place the events of a complex economy into their ultimate analytic perspective as they developed, in their full detail.

The trade-cycle theory that emerged in the *Economist* was thus pitched on an intermediate level of abstraction, close to the language in which economic affairs were conducted, close to the data that were readily at hand. The *Economist* permitted itself no empty boxes. It employed only those analytic terms that carried an operating meaning to its readers. The most abstract and complete rendition of an *Economist* trade-cycle theory—chapter vi of *Lombard Street*—is entitled, 'Why Lombard Street is Often Very Dull and Sometimes Extremely Excited'.

II

Bagehot's view of the trade cycle is worth examination for several reasons. It is, for one thing, better articulated than those of either James Wilson or of his successors, before 1914; and we have the benefit of a chapter in *Lombard Street* addressed explicitly to the subject. Further, it was under his guidance that the modern *Economist* largely took shape. Echoes of his views can be heard through the four decades between his death and 1914. Finally, the period of his régime, 1860–77, coincides with the culmination of mid-Victorian prosperity; and if we would contrast sharply the problems of two centuries it is better to look there than to the last quarter of the century, with its evident foreshadowing of the major economic issues of later days.

Bagehot, after two years of apprenticeship, became editor of the *Economist* in September 1860, succeeding his father-in-

and later (from 1864) in the annual *Commercial History and Review*. In its role as analyst, and thus prophet, the *Economist* maintained, however, a becoming humility: 'We do not like to be Prophets in the money market; it is an indication of immaturity to be sure of the future' (1862, p. 533).

law, James Wilson, who had died while serving as Financial Member of the India Council. He remained editor until his death in March 1877. His régime thus embraces fully one major trade cycle (1862–8) and most of a second (1868–79). He drew, further, on his own considerable business experience, as well as upon the then meagre literature of economic history. His views on the trade cycle developed, however, mainly from observation of the economic system whose movements he professionally knew and reported.

These views incorporate his special gifts of generalization. One never loses touch with the institutions Bagehot is describing, nor the human motives and actions which suffuse them. Few latter-day cycle theorists, even those who have explicitly dealt with the so-called 'psychological factors', have permitted themselves such a bland and relevant observation as: 'All people are most credulous when they are most happy.'[1] The easy interplay of persons, institutions, and theory in Bagehot's exposition makes the abstraction from it of a formal structure difficult, as well as something of a violation. Chapter vi of *Lombard Street* still makes fresh reading, as do the *Economist* files themselves.

Bagehot begins by noting the failure of mid-century political economists to deal adequately with the trade cycle.[2] He points simply to the central cause of that failure, a diagnosis most modern economists would endorse: 'Our current political economy does not sufficiently take account of time as an element in trade operations.' Goods, in an advanced economy, are produced for consumption at some future time by persons other than the producer. From this observation Bagehot adduces two basic elements in his theory: the interdependence of markets ('the partnership of industries') and the central role of expectations about the future,[3] operating through the institutions of credit.

[1] *Lombard Street* (ed. Withers, 1931), p. 151.

[2] The existence of broadly regular cyclical fluctuations was not universally accepted at this time. See, for example, the letters of 'A Political Economist', *Economist*, 1864, pp. 1577–8 and 1428–9. This correspondent directly challenges the conception of any systematic general movement in the economic system and regards crises as uniquely determined catastrophes.

[3] This tribute to the entrepreneur, quoted in the *Economist*'s memorial leader

Using the first of these tools he launches a lively account of the workings of the cumulative upswing and downswing of the cycle. He takes, by way of example, the effect of lean or abundant harvests—a likely detonating force—with their repercussions on the volume of spending for commodities other than foodstuffs; and he shows that they alone could set in motion a minor business cycle which might, however, require several years to work itself out, in each direction.

The second tool—expectations, and thus credit—is then introduced: 'Credit—the disposition of one man to trust another—is singularly varying'. It is the preponderant role of credit that Bagehot finds peculiar to Britain of the seventies when compared with the other Great Powers. When the general view of the future is optimistic, credit is good, commodities change hands more quickly, and the volume of production increases. Here the banking system plays a major part, bridging the gap between present and future.

The effect of good credit Bagehot regards as a cause of 'real prosperity'. False prosperity comes when capital flows to uses which fail to produce their expected yield. Here Bagehot calls on rich historical illustration, including Macaulay on the South Sea Bubble, to indicate the credulousness of happy people. The element of mania, which he finds present even in more modest booms, like that which ended in 1866, he places as a factor setting the stage for the crisis and slump.

But the mania is not *deus ex machina*. He shows it growing naturally, in a modern society, from real factors. The mild and general prosperity, caused by (say) a good harvest, increased consumer spending on non-foodstuffs, and an improvement of credit, brings forward idle savings eager for a good return. The forms of fixed investment which are

to Bagehot, reflects the large part allotted to expectations in his system (1877, p. 348): 'Men of business have a solid judgment, a wonderful guessing power of what is going to happen, each in his own trade; but they have never practised themselves in reasoning out their judgments and in supporting their guesses by arguments; probably, if they did so, some of the finer and correcter parts of their anticipations would vanish. They are like the sensible lady to whom Coleridge said, "Madam, I accept your conclusion but you must let me find the logic for it".'

thus encouraged—especially in the latter stages of expansion—take time to mature. In the short period, however, they make demands on the money market for working capital and upon the basic industries, which are already strained; Bagehot points especially to the relative inelasticity of the coal and iron supply. The consequent rise in prices and interest rates creates a situation different from that in which many medium- and long-run projects were undertaken, and one less favourable. The pressure exerted by 'the sanguine and ardent' against limited financial and physical resources creates a prosperity 'precarious as far as it is real, and transitory in so far as it is fictitious'.

This is the setting for crisis, the chief characteristic of which is a general loss of confidence and a desire to reduce commitments. The decline can be set in motion by a bad harvest, or a local crisis anywhere within the economy. The changed view of the future spreads out from the first impact, and the volume of activity, in industry and in the capital markets, declines.

The limitation of depression, and then recovery, flow smoothly in Bagehot's system from the description of crisis. Money cheapens as industrial and commercial demands fall off and commodity prices decline; credit improves as the 'remembrance of disaster becomes fainter and fainter'; 'quiet people continue to save part of their income in bad times as well as in good',[1] and the irritation of John Bull with 2 per cent. stirs the adventurous; finally a good harvest comes.

[1] *Lombard Street*, p. 143. Bagehot notes that, as between bad and good times, 'people of slightly varying and fixed incomes have better means of saving in bad times because prices are lower'. At another point, however, Bagehot comments on the tendency for savings to diminish during depression; although there is no doubt that the net result of movements on the supply and demand sides of the capital markets made for lower interest rates (*Economist*, 1869, p. 1). '. . . in a year of depressed trade the monied savings of the country are not nearly so great as usual . . . most people do not deny themselves their customary indulgences till they have ceased to save; they arrest their provision for the future before they change their customary life. The small savings decline before the tea and sugar duties decline at all.' As indicated below, it is a characteristic especially of Bagehot's writing in the *Economist* that he distinguishes consistently the forces determining, at any moment, the volume of intended savings from those determining the volume of investment. And he is quite aware of the significance of their partial independence.

The terms of this dynamic system are familiar and modern with two exceptions: the considerable role of the harvests and the absence of the Hamlet of current theories—the marginal productivity of capital.

With respect to the harvests, it appears to have been true of the whole period from 1790 to Bagehot's day that a good harvest was a necessary if not sufficient condition for the beginning of general and sustained recovery.[1] Bagehot depicts its operation through the volume of consumers' money incomes—assumed to vary less than foodstuff prices—available for the purchase of goods other than foodstuffs. It is possible that harvests in fact had their chief impact on the economy as a whole through the volume of food imports required, the pressure or easing of pressure in the money market, and thus on the rate of interest.[2] In any case, repeal of the Corn Laws or no, the harvests were still in Bagehot's day an important factor in the trade cycle, even if their part was permissive and contributory, rather than central.

The absence of any extended discussion of the productivity of new investment is, of course, itself significant; and it may be taken by some virtually to define the difference between the nineteenth-century cyclical problem and that of the inter-war years. The concept appears briefly in one passage as part of a capital market trilogy:[3] 'In most great periods of expanding industry, the three great causes—much loanable capital, good credit, and the increased profits derived from better-used labour and better-used capital—have acted simultaneously.' On the whole, however, Bagehot assumes, as he was indeed entitled to assume in the early seventies, that the opportunities for profitable private investment were ample, and that the worst that had to be dealt with was the relatively mild irregularity of the rate at which they were

[1] See above, pp. 50–52.

[2] This is explicitly suggested in the *Economist* leaders. See, for example, the discussion of the consequences of the poor harvest of 1860 (1861, pp. 1–3); also (1863, p. 1205)—'in spite of our excellent harvest, which is generally the most potent of monetary agents, it [i.e. the rate of interest] has not fallen'.

[3] *Lombard Street*, p. 143. As noted below, the scant attention given to investment opportunities characterizes the generalized discussion of the trade cycle in *Lombard Street* more than the *Economist* itself.

exploited in an economy where investment decisions were taken by individuals, acting under self-defeating common impulses.

III

The treatment in *Lombard Street* cannot, of course, be taken to represent fully either Bagehot's or the *Economist*'s view of the trade cycle. It is a useful starting-place, and it suggests the considerations the *Economist* of the sixties and seventies regarded as most relevant. Chapter vi was written, however, for a special purpose: to explain and to reinforce Bagehot's plea for the maintenance by the Bank of England of a larger gold reserve.[1] His trade-cycle discussion centres disproportionately on the significance of credit and on the part played by Bank and other capital market policy in determining the extent of its fluctuation.

Although they reflect the same crusade, the *Economist*'s leading articles, taken over the course of a full trade cycle, present a better balanced view. Bagehot became editor of the *Economist* late in 1860, close to the trough of the slump which followed upon the crisis of 1857. The bad harvest of 1860, and then the opening of the American Civil War, set back the gathering revival; and considerable editorial attention was given to an analysis of the relative stagnation.

In the period 1860–3, before recovery was clearly under way, a recurrent theme in the *Economist*, and one not fully developed in *Lombard Street*, was the relation between saving and investment.[2]

> The annual savings of the country, which some statistical writers are bold enough to specify, amount to many millions. By the most received computation—that of Mr. Porter—they amounted to £5,000,000 a month. It is only by a continually augmenting trade that this sum can be employed. Commerce

[1] *Lombard Street* has so long and honourably held its place as the classic description of the institutions of the City that it may not have been fully realized that its campaign for a larger gold reserve at the Bank had its roots in a particular analysis of the business cycle; and that the measure was regarded, by Bagehot at least, as a means of limiting the severity of crisis and depression. See below, pp. 174–5.

[2] The first of these quotations is from the *Economist*, 1862, p. 254; the second, 1860, p. 1; the third, 1862, p. 879.

must constantly extend itself in various directions, or a certain portion of the new capital will, of necessity, be unused.

The desirable and natural course is that year by year the inventive business talent of the country should open new fields sufficient to employ its new capital. In every year the new investments that are suggested ought to absorb the new capital that is saved.

But in 1862, with the market still depressed:

. . . we consider it exceedingly desirable that a considerable part of our spare English capital should just now be embarked in loans to foreign governments. We do not want the money; money in the open market is 2 per cent., and has been less; and foreign governments do want it.

Bagehot, patently, was using the conception of an equilibrium balance between savings and investment that would maintain an even prosperity. He did not define that equilibrium in terms of the full income flow as it is now conventionally defined; but he saw the cycle as arising from the fact that the decisions to save and to invest were taken by different sets of individuals, acting under motives that were not identical.

The major difference between Bagehot's analysis and that of modern economists is, however, his relative lack of concern about unemployment. The focus of his analysis is 'the value of capital':[1]

As we have often explained, an augmenting trade is necessary to a high, perhaps even to a fair, value of money. The savings of the country are constantly swelling the loanable capital to be disposed of, and, unless an increasing trade gives a new opening to our new resources, there will be a momentary superfluity, and a momentary depression in the money market in the value of capital for brief periods.

That Bagehot brings his analysis to bear upon unemployed money and low interest rates, rather than upon unemployed

[1] 1863, p. 533. It will be noted that implicit in this statement is the assumption that, without new investment opportunities, on an expanding scale, the value of capital would fall over long as well as short periods. There is enough here, and in similar references, to make one feel that it is only by fifty years in one direction and seventy in the other that Bagehot managed to avoid the accents of the Rev. Mr. Malthus, Lord Keynes, and Professor Hansen.

labour, is to be taken in part, of course, to reflect the concern of his subscribers. But there is little doubt that unemployment in the depression of the early sixties was relatively mild. The *Economist* was not simply the hard-bitten advocate of the mid-Victorian capitalist: with respect to the Nine Hours Movement it admitted the right of labour to wage an organized fight for a larger share in profits;[1] it emphasized the reality and measured the extent of the distress of the workers in the cotton districts during the famine caused by the American Civil War in its early days;[2] during the boom-time agitation of the trade unions, in 1865, it urged the case for organized labour as a means of equalizing otherwise disparate bargaining positions in the labour market;[3] it favoured the development of the co-operatives.[4] On the whole it seems fair to take the *Economist*'s lack of attention to general cyclical unemployment as properly indicating its lesser amplitude in the depression it was reporting.

The year 1863 was, clearly, a period of expanding prosperity, with its repercussions now felt strongly in the heavy engineering trades and the coal and iron industries.[5] The *Economist* recognized the widening effects of new enterprise, and correctly placed this phase of the cycle as part of the sequence, growing out of the good harvest and cheap money of 1861–2; but it was not complacent. The mood of optimism was bringing forward a spate of finance companies and banks. By February 1864, when the editors issued the first of the annual *Commercial Histories*, the *Economist*'s view of these

[1] 1860, p. 586. The *Economist* did not, however, believe that the reduction in the working day by one hour would result in a sufficient increase in efficiency fully to compensate the employer; but it was quite capable of regarding that outcome with equanimity.

[2] 1862, p. 479.

[3] 1865, pp. 1456–7. True to its political liberalism, however, the *Economist* also emphasized that the manner in which trade-union decisions were taken was not wholly democratic. It did not advance this as a general argument against the unions.

[4] 1862, p. 480.

[5] See especially 1863, p. 1246, 'Fluctuations in the Scotch Iron Trade'. This article traces, in some detail, the impact of business cycles on the iron industry, from the early forties on. It recognizes, in 1863, the relation between the contemporary prosperity of the iron districts and previous developments in agriculture and the markets for short- and long-term capital.

enterprises was already faintly jaundiced: 'Under any circumstances prudent observers will not fail to prepare for contingencies the exact date of which is alone uncertain.'[1] This theme had been elaborated in even greater detail in the opening leader of 1864:[2]

> Credit is the life of trade, but every sudden growth of new credit is always tainted with an admixture of evil. The late extensive credit has fortunately fallen upon a period of very prosperous trade—of trade stimulated by cheap food, and, therefore, we may hope that the alloy of evil may not be large. Still, some alloy general considerations warn us to expect, and what alloy there is, a long period of dear money, especially of oscillating dear money, will be sure to display and detect. On the whole, therefore, we anticipate that the year 1864 will be a serious though not an alarming year. Our trade will probably be very large and very profitable, but against this we shall have to set the possible consequences of a long period of dear money—the gradual detection of undue credit—and the gradual failure of any trade which such credit may have fostered or created.

The *Economist* could not be accused of leading its readers up the garden path.

The first of the anticipated failures came in September 1864, when the Leeds Banking Company went down. That shock, however, and concurrent difficulties caused by the bullion policy of the Bank of France, were successfully weathered. And 1865, with its revival of exports to the United States, was another good year. Beneath the growing tension of the capital markets, a general expansion in domestic and foreign enterprise, including a major shipbuilding boom, made for increased industrial output, higher wages, and a typical prosperity outbreak of trade-union expansion, with strikes for higher wages widely successful.

From late 1864, with their eyes firmly fixed on the middle future, the editors began to concern themselves with the developing financial crisis. In September 1864 the question of Bank policy with respect to the gold reserve was reopened:[3] 'The good of Peel's Act is that it alarms the Bank Directors; the harm, that it alarms other people also; the advantage,

[1] *Review of 1863*, p. 2. [2] 1864, p. 2. [3] 1864, p. 1195.

that it may prevent a panic; the curse, that if it does not prevent, it enhances it.' And in 1865 the case was vigorously put for a Bank rate policy that would discriminate between an internal and an external drain on the bullion reserve, a concept that lay behind Bagehot's recommendations for Bank action during crisis.[1] At the same time it noted 'the preliminary oscillation—the warning symptom—which suggested to every one under large liabilities the expediency of making preparation while there was yet time, and before the real crisis had set in'.[2] In the opening leader of the next year, the *Economist* expressed obliquely the hope that its message had been well read in the proper quarters: 'The management of the Bank of England has improved; they know that confidence is based on cash—that credit requires gold.'[3]

In May, however, 'like a spark falling on tinder', Overend, Gurney & Co. failed, giving rise to a panic 'more suitable to their historical than to their recent reputation'.[4] The Bank Act was suspended and the worst of the crisis was soon passed; but in London, the commercial centres of the provinces, and the industrial areas depression had set in. The *Economist* regarded the crisis of 1866 as having been generated in the credit system, rather than within industry or in the foreign balance:[5]

> . . . credit is an unsubstantial phenomenon; it is like a woman's reputation; the moment it is suspected it is gone. . . . The crisis of 1866 was in its essential character not a capital panic arising from an exhaustion of our actual resources, or a bullion panic arising from the excessive diminution of our national cash balance, but a malady of credit inhcrent in such credit.

In a limited sense this was obviously true: the failure of Overend, Gurney & Co. was decisive. But the condition of virtually full employment that had persisted over the previous year, the rapid rise of industrial prices in the months before the crisis, and the tension in the labour markets indicate a

[1] 1865, pp. 1266–7.
[2] 1865, p. 1026.
[3] 1866, p. 2.
[4] 1866, pp. 581 and 553, respectively.
[5] 1866, pp. 613 and 818. There can be little doubt that the crisis of 1866, as interpreted by Bagehot, strongly affected the formulation of his trade-cycle theory in *Lombard Street*, just as it reinforced his advocacy of a larger Bank reserve.

general background of instability in all the principal areas of the economy.

The *Economist*'s leaders of 1867–8, in the period of depression, follow much the same lines as those of 1860–3. The fall in interest rates came quickly, and in the depressed state of enterprise money hung heavily in the market:[1] '. . . for our present purpose, the cardinal fact is that our credit, which was last year so good as to raise the rate of interest by the ease with which it conducted money to those who could use it, is now so bad that it clogs up money in the hands of those who do not dream of themselves employing it.' There was, as well, considerable soul-searching of the kind that followed most nineteenth-century panics. For three long columns the *Economist* examined the 'Alleged Degeneration of England in Commercial Morality';[2] and it offered this observation to the already sorely tried country vicars, retired military gentlemen, and other amateur investors:[3] 'The fact is, that there is a real pleasure to the mind in slight pecuniary danger. It has the character of gambling and the delight of gambling; and to that temptation experience shows very quiet, grave-looking people are often susceptible.'

By modern standards, however, the depression was not severe. It was confined to business of an enterprise character: 'the optional business of the country so to speak'.[4] There was a 'regular continuance of profitable industry'; and this contributed a steady flow of savings to the institutions of the money market. The answer that was to be found to the pressure of 2 per cent., in the course of the subsequent five years, was clearly foreshadowed:[5]

> An old saving country like this ought to lend to new countries where there are no sufficient savings to employ. A new colony, with virgin soil, untouched mines, and a whole wealth of nature waiting to be used, ought to borrow if it can; an old country which has no fresh soil, and no untried opportunities, ought to lend if it can. We ought to send capital abroad, if we can do so safely. We shall thus get a good interest for our money, for virgin communities can pay better than others; we shall thus get better

[1] 1867, pp. 1–2. [2] 1868, pp. 1–3. [3] 1867, p. 1408.
[4] 1867, p. 1. [5] 1867, p. 141.

imports, for the capital we lend will raise produce for civilized countries, and very much for ourselves; and we shall augment our exports, for we can not have these new imports without paying for them.

In its opening leader of 1869 the *Economist* was able to note a tentative revival of confidence:[1] 'A really sound investment is now sure of fair attention; it will not be unreasonably pooh-poohed'; while the *Review of 1870* indicated 'constant and full employment for the working classes' in the textile industries.[2] With the ending of the Franco-Prussian War, however, the expansion took on a new and more intense character. Britain's export trade increased to record levels, responding to the booms in central Europe and the United States; while the export market was further supported by loans floated in London on behalf of numerous foreign enterprises and governments. An enormous trackage of railways was laid throughout the world, and capital facilities, in Britain and elsewhere, were overtaxed despite their extraordinary growth in the course of the expansion. Prices and wages rose astronomically in the coal, iron, and engineering trades—'the instrumental articles'—and, briefly, miners drank champagne.

IV

All this was explicable in the analytic terms the *Economist* had earlier developed, as was the crisis of 1873. The expansion of 1868–73 had been simply the greatest of the mid-century booms. In the years that followed, however, profits appeared to lose their resilience. As early as 1877, the year of Bagehot's death, the main problems of the Great Depression were apparent and had been defined:[3] a strong downward trend in prices and profits, increased foreign competition in the export markets, the intensive character of new investment opportunities.

In terms of public policy the *Economist* was to resume the battle of the early forties against the Protectionists. Having helped create the mid-century system, the *Economist* was not

[1] 1869, p. 3. [2] *Review of 1870*, p. 32; also p. 29.
[3] See especially *Review of 1877*, pp. 1–2.

likely to abandon it in the face of a frightened minority. Its recommendations continued to run in terms of unsubsidized efficiency and enterprise; and while the thirty years that followed 1873 lacked, for British entrepreneurs, the exhilaration of the two preceding decades, the opportunities proved sufficient to support a high average level of employment and a rising standard of welfare.

The *Economist* continued, however, Bagehot's vigorous campaign for a more responsible Bank of England policy. In general, it saw the trade cycle as an unfortunate but not insupportable process, deeply rooted in the basic procedures of the economy. The cycle's chief manifestation, from the *Economist*'s perspective, was the irregularity of profit margins, and that irregularity it was willing to accept as a toll for continued capitalism. It clearly recognized, however, that the Bank's part in the economy was not atomistic; and it believed that the interest rate and lending policy of Threadneedle Street could affect the duration of cyclical expansion and the intensity of the crisis and contraction. In a different context the *Economist* of the sixties and seventies was still preaching, and with little greater success, the lessons of social responsibility defined in the Bullion Report of 1810.

Bagehot wanted the Bank to keep during prosperity a larger gold reserve, and to respond sensitively, in its interest rate policy, to drains upon it, especially to drains abroad. In its lending policy the Bank was to preserve its high qualitative standards, avoiding the 'unsound' business of the market and thus serving somewhat to temper the general extravagance of expectations. When crisis came, however, the Bank was to assume a more positive role. Its reserve was the final rock on which credit might be preserved. Within the country lending on good security was to proceed on an open-handed basis. In this way a crisis might consist, ideally, in the weeding out of only those investments which were unsound. The subsequent depression would be shorter and less intense. Bagehot concluded his chapter on the trade cycle in *Lombard Street* by bringing the argument to this focus:[1]

Now too that we comprehend the inevitable vicissitudes of

[1] *Lombard Street*, p. 152.

Lombard Street, we can also thoroughly comprehend the cardinal importance of always retaining a great banking reserve. Whether the times of adversity are well met or ill met depends far more on this than on any other single circumstance. If the reserve be large, its magnitude sustains credit; and if it be small, its diminution stimulates the gravest apprehensions. And the better we comprehend the importance of the banking reserve, the higher we shall estimate the responsibility of those who keep it.

By a modification of Bank reserve and lending policy, then, Bagehot hoped to see the trade cycle converted into something approximating Prof. D. H. Robertson's 'slooms and bumps'. That represented the limit of centralized trade-cycle policy the *Economist* of the sixties and seventies would support. It is significant, however, that the condition which justified this advocacy was that Bank policy, consciously or otherwise, affected the interests of the community as a whole. As the decades passed, the application of that criterion was capable of justifying, without violation of the *Economist*'s liberalism, an expanding scope for centrally planned economic action.

V

For those burdened with problems of post-war economic readjustment, a glance at Bagehot's day may appear almost wholly irrelevant, evoking, at best, a certain envy and nostalgia. There are obvious senses in which the mechanisms of Britain's mid-century economy are, and have long been, inapplicable to our own day. We have abandoned almost beyond recall a flexible interest-rate policy, sensitive to short-run movements of bullion in and out of the central bank reserve. Foreign trade and foreign investment will be affected substantially, both with respect to volume and direction, by centrally taken decisions of national policy; even if the relation between 'sanguine and ardent' promoters and 'quiet grave-looking gamblers' persists on the level of chancelleries or within the various institutions of the United Nations. Domestic investment, and, more broadly, the allocation of all resources, will be more largely a matter of communal decision than it has been for several centuries, at

times of peace in the western world. The peoples will undoubtedly insist that a variety of services, formerly, in large part, a function of individual incomes, be systematically provided, at minimum levels, for all. In short, a generation facing issues which call for consciously conceived policy of great intricacy, which must blueprint vast administrations and readjust radically the techniques and terrain of political decision, may be tempted to look up only briefly from the drawing-boards at Britain of the sixties.

Although we would now apply different and perhaps stricter standards of social security and welfare, its economy had one virtue which justifies a certain amount of current attention: it worked. It gave a rising standard of life to a rapidly increasing population; it provided a tolerable level of employment; its mode of operation was not necessarily inconsistent with democratic development at home and with international peace.

The conditions of its success are familiar, and clear in Bagehot's writing, both in *Lombard Street* and the *Economist*. The growth of populations, the opening of new areas, and the application of new inventions and industrial methods, offered wide opportunities for investment; and these were exploited, with intermittent vigour, by persons and institutions, acting under the motives of private profit. A machinery was provided for setting the order in which potential new projects were undertaken; and the resultant sequence of development was adequately rational. Crude but effective means operated to expose errors in foresight and judgement and to cut the losses of individuals and the community. The system as a whole was sensitive to changes in taste, and to changes in knowledge. The accepted procedures of foreign trade and the exchanges prevented any nation from pursuing an international economic policy outside a fairly well-ordered framework. These remain the relevant criteria.

Founded on the rock of expanding investment opportunities, the required institutions grew with a minimum of central guidance or control. That fact, however, should not blind us to the combination of intelligence and spirit that infused their operation. The mid-Victorians believed in their

system and its future. They felt that the rules of the game, if followed, would yield benefits to themselves and to their neighbours; and in the sixties the game was sufficiently successful, and the rules sufficiently well kept, to give their vision vitality. It is only in later times that their slogans, when confronted with the facts, ring hollow.

Roughly from the crisis of 1873, a new set of influences altered the assumptions and changed the pattern. America and Germany emerged as major industrial powers, and the era of Britain's almost monopolistic railway building came gradually to a close. The physical frontier of America was reached by 1890. Increased powers of production and enlarged institutions for the mobilization of savings made for lower profit yields when they confronted the existing range of investment opportunities. The flexibility of commodity prices and money wages was compromised. Working, for the most part, in opposite directions, two great political forces began to affect the operation of the economy: the rise of the working classes as a political force, and the sharpening of national rivalries among a group of first-class powers.[1]

The operation of these forces, in the seventy years after 1873, shattered the institutions upon which the British economy of the sixties was based. Movement was made towards a new pattern. But even at times of greatest relative success—1896–1912, 1920–9—the compromise system failed to recapture fully the old confidence. The mid-century slogans, developed out of the battles of 1832 and 1846, with even deeper revolutionary roots in the preceding centuries, were employed defensively. The newer ideas, often formulated in remote terms, were only dimly reflected in measures of economic control and planning, and in action towards social security and welfare. Those who viewed

[1] As early as the *Review of 1879* the *Economist* noted the increasing diversion of resources to armaments (p. 2): 'In fourteen years the military expenditure of Europe has risen at the rate of 3 mill. a year, or from 117 to 160 mlns., and, as far as can be judged, will go on increasing with the same or greater velocity till arrested by some combination of three events, viz. (1) a decisive victory by one or more of the Armed States over the other, (2) the exhaustion of the means and patience of the unfortunate populations who bear the burden, or (3) (most unlikely of all) such a return of common sense as will produce a pacific policy.'

events from the older viewpoint were perennially fearful, the reformers fuzzy and frustrated.

Post-war developments will not, of course, end the days of compromise. The war has, however, both lessened many inhibitions to centralized action and it has stimulated productive energies. While the goals of peace are not as simple or as easy to define as those of war, there is a wide, if rough, area of agreement in Britain with respect to objectives; and the technique of planning in a politically democratic society is being generated cautiously day by day. It is possible, that in the decade after the war Britain may come near to resolving, in its ideas and institutions, conflicts which have sapped the vitality of the western world for some seventy years.

If this success is to be achieved it must, clearly, be grounded in a spirit of individual and collective enterprise as impatient of some newly defined '2 per cent.' as were the mid-Victorians. Bagehot's expression of that spirit speaks strongly over the intervening years:[1]

> The area for employing our capital being thus enlarged, the physical opportunities for it being augmented by science, the mental opportunities being increased by the growth of civilized organization and the improvement of individual intelligence, we must not expect to go back to the old times when capital was not employed, or was scarcely employed.

[1] 1865, p. 62.