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Between the ‘Bank screw’ and ‘affording assistance’. Rules, Standards, and the Bank Charter Act of 1844

Keywords: Money, Rules and Standards, Bank of England, Bank Charter Act 1844

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This article explores a dilemma at the centre of the monetary order: how to counter inflation eroding the value of money and simultaneously allow bank-created credit to meet the needs of an expanding economy. Building on recent scholarship on the history of money, this article analyses the Bank Charter Act of 1844 and the financial crisis of 1847 to reveal a response to this dilemma which continues to shape the modern context. That response puts its faith in ex ante restrictive measures in a bid to limit the discretion of the monetary authorities and cultivate financially prudent behaviour. Yet the history of the mid-nineteenth century exposes the challenges faced by those who enforce such rules, challenges which tie the mid-nineteenth century to the post 2008 reforms in both the US and the Eurozone, and reveal the on-going force of the dilemma: that simultaneous desire for both expansive credit and sound money.

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INTRODUCTION

A little reflection makes it appear a monstrous proposition that ... the conduct of so important a branch of finance as the paper circulation of the State should be intrusted, without any control, to twenty-four irresponsible merchants [the directors of the Bank of England], to whom power is thus given which affects more or less the property of every subject of the realm.¹ (Samson Ricardo, 1837).

I attribute the whole pressure of the last year [1847] to the positive restriction placed upon the Bank [of England] by the Act of 1844; if that restriction had not been in existence ... when the public required a further issue to supply notes and coin withdrawn from circulation, I believe there would have been nothing like the distress occasioned.² (Horsely Palmer, 1848).

The ‘monstrous proposition’ feared by Samson Ricardo was the Bank of England’s discretion over the creation of paper money. The ‘positive restriction’ identified by Horsely Palmer was the Bank Charter Act of 1844, the very legislation enacted to curb the discretion Ricardo saw as ‘monstrous’. Ricardo and the other critics of the Bank of England (‘BoE’), including the so-called ‘currency school’ of monetary theorists, pointed to the BoE’s discretion over money creation as one example

¹ S. Ricardo, *Observations on the Recent Pamphlet of J. Horsely Palmer* (London: Charles Knight, 1837) 37.

² Testimony of H. Palmer, *First Report from the Secret Committee on Commercial Distress* (HC, 1847-48, 395-VIII) Q. 2205.

of the ‘vast powers wielded by that establishment’³ which left other banks ‘wholly at [its] mercy’.⁴ The Act of 1844 countered such vast powers by forcing the BoE to back its paper note issue with reserves of gold. To its supporters that made the Act an ‘indispensable ingredient’,⁵ one which provided holders of paper money with security by countering ‘caprice and arbitrary action’ on the part of the BoE ‘uncontrolled by any legal limit’.⁶

Yet, between 1844 and 1866 the government suspended the Act during financial crises on three separate occasions. Each suspension responded to concerns that the Act was too restrictive, concerns Palmer was not alone in holding. Others chided the ‘rigid inflexible spirit’ of the Act,⁷ referring to it as a ‘straight-waistcoat’⁸ that ‘unjustly restricts the banking business of the country’⁹ and leaves commerce ‘cramped and paralyzed’.¹⁰ According to the currency school’s arch-opponent and leading figure in the rival ‘banking school’, Thomas Tooke, the strict enforcement of the Act led to ‘ridiculous ... lamentable catastrophe’.¹¹

³ W. Clay, HC Deb vol 95 col 587 2 December 1847.

⁴ R. Peel, HC Deb vol 75 col 861 13 June 1844.

⁵ Testimony of J. G. Hubbard, *Report from the Select Committee on Bank Acts* (HC, 1857, 220-X) Q. 2351.

⁶ *ibid*, Q. 2463.

⁷ E. S. Cayley, HC Deb vol 92 col 247 30 April 1847.

⁸ Lord Ashburton, *The Financial and Commercial Crisis Considered* (London: John Murray, 2nd ed, 1847) 9.

⁹ Editorial, ‘The Present Position of the Issue Department of the Bank of England’, *Bankers’ Magazine*, October 1847, 469.

¹⁰ Editorial, ‘The Foreign Exchanges and Our Home Currency’, *Bankers’ Magazine*, July 1844, 226.

¹¹ T. Tooke, *History of Prices* (London: Longman, 4th ed, 1848) 318.

This encounter between constraints and flexibility captures a dilemma which cuts to the core of the monetary order. Money creation by commercial banks is central to that order. Banks create money by extending credit to others in the form of a promise to pay in the state's currency. So leveraging the state's currency is a hugely dynamic arrangement because it allows the credit system to respond to the needs of those capitalists these banks deem of sufficient creditworthiness.¹² But it is also a fragile arrangement because the credit advanced is a bet on future productivity.¹³ From that fragility follows one half of the dilemma. Should those who create the state's currency extend support to commercial banks? To refuse to do so raises doubts about the viability of these banks and about the viability of the credit they create. In the absence of such viability Palmer's 'distress' and Tooke's 'ridiculous ... lamentable catastrophe' follow: contractual counterparties go without payment; manufacturers sell assets to keep creditors at bay; wage earners are laid-off. And yet, although extending support to commercial banks counters this distress, it also reveals the flip-side of the dilemma. Where the monetary authorities can create money at will, what is to stop these authorities from doing so to benefit special interests or the whims of those in power? And where that money creation outpaces the resources of an economy, inflation will undermine incomes and spending power and so will 'affect more or less the property of every subject of the realm'. How,

¹² See J. Schumpeter, *The Theory of Economic Development* (1911, Cambridge, Mass: Harvard University Press, Eng tr, 1936).

¹³ C. Desan, *Making Money: Coin, Currency, and the Coming of Capitalism* (Oxford: OUP, 2015) 428.

then, should we protect the value of assets denominated in the state's currency? Is it necessary to constrain those who create money to stabilise the value of money?¹⁴

One response to these questions directs central banks to maintain price stability, including, for example, the Federal Reserve Bank in the US and the European Central Bank (ECB).¹⁵ To whom they may lend is also curtailed: section 13(3) of the Federal Reserve Act (FRA), constrains the ability of the Federal Reserve to act as a lender of last resort; Articles 123 and 125 of the European Treaty on the Functioning of the European Union 2007 (TFEU) limit the capacity of the ECB to support public debt. And yet the dilemma facing the monetary authorities—how to engineer sound money and, simultaneously, safeguard the viability of credit creating banks—persists. As the events

¹⁴ This dilemma between constraints and flexibility is another way of capturing the tension between discipline and elasticity described by Perry Mehrling in *The New Lombard Street: How the Fed Became the Dealer of Last Resort* (Princeton: Princeton University Press, 2011). Mehrling draws inspiration from Hyman Minsky's famous Financial Instability Hypothesis, see H. Minsky, 'The Financial-Instability Hypothesis: Capitalist Processes and the Behavior of the Economy' in C. P. Kindleberger and J-P. Laffargue (eds), *Financial Crises: Theory, History and Policy* (Cambridge: CUP, 1982) 13. Others who explore the consequences that follow from this dilemma in the modern context include M. Ricks, *The Money Problem: Rethinking Financial Regulation* (Chicago: The University of Chicago Press, 2016), H. S. Scott, *Connectedness and Contagion: Protecting the Financial System from Panics* (Cambridge, Mass: The MIT Press, 2016), and K. Pistor, 'A Legal Theory of Finance' (2013) 41 *Journal of Comparative Economics* 315.

¹⁵ See Federal Reserve Act 1913, s 2A (as amended by 12 U.S.C. 225a) and Statute of the European Central Bank, Article 2.

of 2008 unfolded these constraints gave way to flexibility as the public authorities in both jurisdictions opted to rescue banks and sovereigns.¹⁶

Building on Christine Desan's 'constitutional approach to money',¹⁷ this article analyses the Bank Charter Act of 1844 and the financial crisis of 1847 to reveal a common response to this dilemma which ties the mid-nineteenth century to the modern context. That response builds on the close connection between constraints and the advantages typically associated with formal rules. Ideally, rules signal, with clarity and precision, the content of obligations before actions take place. The aim of such *ex ante* measures is to prevent harmful conduct from occurring by changing the behaviour of the authorities and of those who might turn to the authorities for support. The post-2008 reforms in both the US and the Eurozone offer examples of this type of preventative legal measure, a point to which this article returns in a later section. So too does the Bank Charter Act of 1844, a piece of legislation characterised by scholars as 'perhaps the first attempt to introduce central banking 'rules''.¹⁸

¹⁶ For an overview of these events in Europe, see K. Tuori and K. Tuori, *The Eurozone Crisis: A Constitutional Analysis* (Oxford: OUP, 2014), and for the US, see P.A. Wallach, *To the Edge: Legality, Legitimacy, and the Responses to the 2008 Financial Crisis* (Washington D. C: Brooking Institute Press, 2015).

¹⁷ C. Desan, 'The Constitutional Approach to Money: Monetary Design and the Production of the Modern World' in N. Bandelj, F. F. Wherry, and V. Zelizer (eds) *Money Talks* (Princeton: Princeton University Press, 2017) 109, 112. See also J. K. Moudud, 'Analyzing the Constitutional Theory of Money: Governance, Power, and Instability' (2018) 31 *Leiden Journal of International Law* 289.

¹⁸ M. Smith, 'On Central Banking 'Rules': Tooke's Critique of the Bank Charter Act of 1844' (2003) 25(1) *Journal of the History of Economic Thought* 39, 39. Others who make the same point about the Act include D. Laidler, 'Economic ideas, the monetary order and the uneasy case for policy rules' (2017) 54 *Journal of Macroeconomics*

Under the influence of the currency school's ideas, the Act of 1844 sought to secure the value of money by adding credibility to the BoE's commitment to the gold standard. It did so through a rule which fixed the creation of BoE notes to flows of gold: when gold left the country the BoE was unable to create additional BoE notes. One objective of that legal measure was to change the behaviour of the BoE. With its note issue capped, the Act encouraged the BoE to recognise the increased value of its remaining notes by raising the rate at which it swapped these notes for bills of exchange – a move characterised at the time as turning the 'Bank screw'.¹⁹ The normative appeal of the Act followed from this limited note issue because, with fewer notes available, the Act discouraged the BoE from 'affording assistance to the mercantile world'.²⁰ With the BoE short of the necessary quantity of notes to afford such assistance, the 'mercantile world' too would have to adjust its behaviour by learning to take care of itself, even if that left many merchants and bankers without security and exposed to the threat of insolvency.

12; G. Campbell, 'Government Policy during the British Railway Mania and the 1847 Commercial Crisis' in N. Dimsdale and A. Hotson (eds) *British Financial Crisis since 1825* (Oxford: OUP, 2014) 12; and C. R. Whittlesey, 'Rules, Discretion, and Central Bankers' in C. R. Whittlesey and J. S. G. Wilson (eds), *Essays in Money and Banking in Honour of R. S. Sayers* (Oxford: Clarendon Press, 1968) 252.

¹⁹ For examples of contemporaries using this phrase, see *Bankers' Magazine*, June 1844 and July 1844; E. S. Cayley, HC Deb Vol 92 col 245 30 April 1847; J. M. Knott, *The Bank of England Charter Act, 1844, and the Manchester Commercial Association* (London, 1855) 3.

²⁰ R. Peel, *Speeches of the Right Honourable Sir Robert Peel in the House of Commons, May 6th and 20th, 1844, on the Renewal of the Bank Charter Act* (London: John Murray, 1844) 75.

As a response to the monetary dilemma, *ex ante* preventative rules are almost compelling. In theory at least, adherence to rules sees the authorities favour the long-term benefits of sound money over superficially attractive, but ultimately short-sighted, support for special interest groups. Supporting interests such as those of commercial banks is short-sighted because it arguably serves only to encourage the financially reckless behaviour that leaves banks dependent on public support. Tying the hands of the authorities pushes in the opposite direction: it disciplines commercial banks by shielding the authorities from demands for short-term, expedient fixes. By so doing, it seeks to turn those who might call for public support into rational businesses and consumers, prudently planning and faithfully transacting their business without fear of money losing its value. Without strict adherence to the rules, however, these changes in behaviour are less secure: if the rules might be suspended or circumvented, why behave differently?

As the three suspensions of the Act of 1844 suggest, *ex ante* rules, credible commitments²¹ and ‘ideal monetary rules’²² perhaps promise more than they can deliver. To work out why, this article draws on the classic debate in legal theory and in monetary theory regarding rules and standards. Recent scholarship contributing to that debate has tended to indicate the limits in practice of the

²¹ The literature on credible commitment mechanisms is inspired by F. Kydland and E. Prescott, ‘Rules Rather than Discretion: The Inconsistency of Optimal Plans’ (June 1977) *Journal of Political Economy* 473, and further developed by M. Bordo, *The Gold Standard and Related Regimes: Collected Essays* (Cambridge: CUP, 1999). In this literature, tying the hands of the authorities is necessary to combat time-inconsistent policies. Without the credible commitment, the authorities may be inconsistent over time by deviating from their preferred, pre-announced long-term policy to satisfy short-term interests.

²² Bordo, *ibid*, 5.

distinction between rigid, clear rules and elastic, discretionary standards. This article seizes on the collapse of the dichotomy. Although the Act of 1844 is the quintessence of a rule-bound regime, during the crisis of 1847 a degree of discretionary judgement smoothed over its hard edges. That discretion is revealing. It reveals decision-makers responding to events unanticipated by those who designed the rules. Furthermore, it reveals the limits to rules as a means of channeling behaviour: accidents happen; the future is uncertain; incentives are complex; and crises are systemic. Strict enforcement downplays these phenomena because credibility depends on rigid application. Yet, how credible is a rule the benefits of which do not outweigh its costs? The dynamics of a financial crisis—contractual defaults and asset fire sales spread harm far and wide—add to the burden of the calculation. Whatever the rule-applier decides, the process itself shows rules blurring into discretion, and that takes us back to the dilemma at the centre of our monetary order, namely how to both support commercial banks and discipline them.

This article is structured around six main sections, as follows. The first section situates the dilemma explored in this article within the broader historical scholarship on money by introducing Christine Desan's 'constitutional approach to money'. The next section reviews the scholarship in legal theory on the debate between rules and standards. Guided by the tendency of rules and standards to converge, the third and fourth sections turn to the particular legal regime put in place by the Bank Charter Act of 1844 and the way that regime responded to the simultaneous need to secure both stable money and viable banks. The fifth section explores the re-emergence of discretion in a context where the Act's supporters had hoped to curtail situation specific judgement through clear, rigid rules. The final main section traces a number of threads connecting the story of the Act of 1844 and the crisis of 1847 to the events of 2008 and suggests that the challenges faced in the

1840s remain relevant today given the direction taken by the post 2008 reforms in both the US and the Eurozone.

THE CONSTITUTIONAL APPROACH TO MONEY

Christine Desan's constitutional approach to money challenges what others have labeled the orthodox approach to money. In the orthodox account people discover rather than create money and the money that they discover evolves in response to market forces, emerging from private barter as an instrument 'inaugurated to ease exchange in the mists of time'.²³ In Desan's account, by contrast, instead of discovering it 'societies engineer money',²⁴ which requires that they invent ways of orchestrating the creation of liquidity through work that 'is constant and collective' and 'involves both public initiative and individual decision-making'.²⁵ Money then is 'a project that relates participants one to another and each to the group, defining authority and distributing resources as it operates'.²⁶

²³ Desan, n 17 above, 112.

²⁴ *ibid.*

²⁵ *ibid.* See also R. Kreitner, 'Legal History of Money' (1996) 8 *Annual Review of Law and Social Sciences* 415, 424.

²⁶ C. Desan, 'Theorizing Money in Three Dimensions' in C. Desan (ed), *Re-theorizing Liquidity: Money, Credit, and Capital Dynamics* (Philadelphia: University of Pennsylvania Press, forthcoming) as quoted in Kreitner, *ibid.*, 425.

The manner by which money ties participants to one another and to the group helps to explain, rather than merely identify, money's functions as a unit of account, means of exchange, and mode of payment. A community could mobilise resources by compensating those who provide goods and services in-kind, paying soldiers with chocolate bars for example. Alternatively, that community could issue a token—a stamped piece of metal or an engraved piece of paper—in return for the goods and services. By singling out that token as a mode of settling debts owed to the community (such as taxes, fees, and fines) the community creates demand for the token across all members of the community. As Desan puts it, the public authorities 'spend by allocating units [tokens] for the kind of goods they need from people and tax back units [tokens] in the same measure'.²⁷ Through this process of tax and spend, resources are mobilised and the community creates a unit of account.

The community is the common creditor shared by all of the community's members. Since all of the community's members need to obtain the tokens accepted by the community to cancel taxes, fees and fines, members have an incentive to accept these tokens to cancel debts owed by one member to another. When members of the community write up and settle their IOUs using the tokens issued by the community, these tokens start to operate as a medium of exchange. Furthermore, the token will start to operate as a mode of payment when, as Desan puts it, the public authorities 'set their unit apart from all others by privileging its use as the only enforceable way to

²⁷ Desan, n 17 above, 113.

pay: if public tribunals recognize the official unit alone as the way of settling debts and other obligations, it will become the means of choice'.²⁸

That the creation of money requires a relationship between the collective and each of its members does not, however, tell us much about the details of that relationship. As Desan explains, 'Every engineering challenge identified above – taxing and spending to create a commensurate unit, supporting money's private use as a medium, enforcing it as a mode of payment – can be institutionalized in different ways and by different actors'.²⁹ Sovereigns might issue money directly, or they might delegate its creation to commercial banks. At times the issuer of paper money commits to convert the token into a precious metal, thereby giving the holder of the paper a type of collateral. At other times the issuer's commitment is to convert into the currency of another polity. Regardless of the specific design, the presence of political authority remains a constant. Those authorised to act on behalf of the group engineer the monetary order, and by so doing make difficult political choices over which interests to protect and which to leave vulnerable.

²⁸ *ibid*, 114.

²⁹ *ibid*, 115.

Desan's constitutional approach to money is part of a broader tradition of scholarship which asserts that money is intimately wrapped up with political authority.³⁰ But Desan, in the words of one reviewer of her work, also 'expands the limited theoretical interventions' of this tradition into 'positive, empirical claims by telling the story of [English and] British money through law from the fall of Rome to the eighteenth-century financial revolution'.³¹ In fact, Desan's historical account ends where this article begins, with the nineteenth century gold standard. In keeping with the overall argument of her recent work, Desan captures the public authority underpinning the gold standard as a system of monetary governance.³² By so doing, she also asks us to confront the distributional consequences which follow from its design. As Desan explains, '[t]he monetary order known as the Gold Standard was the vehicle for compromise'.³³ Those who designed it recognised the economic 'dynamism' made possible by bank created notes and demand deposits and so 'accepted bank currency as an important part of modern exchange'.³⁴ Yet the architects of the gold standard also tied the creation of domestic money to international flows of gold, 'to

³⁰ See, for example, G.F. Knapp, *The State Theory of Money* (1905, London: Macmillan, Eng tr, 1924) and L.R. Wray, *Modern Money Theory: A Primer on Macroeconomics for Sovereign Monetary Systems* (Basingstoke: Palgrave Macmillan, 2012).

³¹ A. D. Edwards, 'The American Revolution and Christine Desan's New History of Money' (2017) 42(1) *Law & Social Inquiry* 254.

³² In his book *The Making of Modern Finance* (Abingdon: Routledge, 2014), Samuel Knafo makes a broadly similar argument by showing that that the gold standard extended, rather than restricted, the power of the state over money by, for example, centralizing the note issue and fashioning modern central banking.

³³ Desan, n 13 above, 404.

³⁴ *ibid*, 399, 404.

commerce outside of national borders'.³⁵ They did so 'as a means to test and secure its value',³⁶ and used ideas drawn from David Hume—ideas to which we return in a moment—to justify their chosen arrangement.

The compromise identified by Desan captures the dilemma at the centre of the monetary order: that simultaneous desire for both expansive credit and sound money. With that dilemma in the background, this article brings to the foreground the details of the specific monetary regime designed by those who acted on behalf of the British polity in the mid-nineteenth century. That regime was a product of legal engineering, with the Bank Charter Act of 1844 central to the edifice. Built into its design was a possible solution to the monetary dilemma, one which attempted to stabilise the value of money by disciplining commercial banks. Implementing that solution entailed the allocation of legal entitlements, which called forth further decisions over whether to define these entitlements *ex ante*, through rules specifying legal outcomes in advance, or *ex post*, through standards specifying outcomes after actions have taken place and in light of situation specific facts. As we will see, the architects of Britain's mid-nineteenth century monetary order had a strong preference for rules and, indeed, the Act of 1844 is frequently referenced as a clear example of a rule bound regime.³⁷ To add depth to this article's analysis of that regime, the next section turns to the classic debate in legal theory and monetary theory regarding rules and standards.

³⁵ *ibid*, 410.

³⁶ *ibid*.

³⁷ See references at n 18 above.

THE CONVERGENCE OF RULES AND STANDARDS

As an example of a rule, consider Britain's decision in 1819 to return to the gold standard by restoring the convertibility of BoE notes into gold at the will of the note-holder. That decision put in place a rule which fixed the price of one ounce of gold at £3, 17s, 10 ½d. BoE note-holders now knew in advance of presenting notes to the BoE that they were entitled to a fixed amount of gold in return. To those who favoured such a rule, fairness, efficiency, and accountability then followed. Convertibility promoted fairness by entitling all BoE note-holders to a fixed amount of gold without distinction or favour. It promoted efficiency by adding stability to the value of the currency so that the commercial community could trade with certainty and predictability. It also promoted accountability by encouraging the BoE to balance its creation of notes against its reserves of gold rather than create notes subject only to its own sense of prudence.

As a point of contrast to rules and their alleged advantages, we find standards accompanied by counter-advantages. As an example of a standard, consider section 11 of the Bank of England Act 1998, which specifies that an objective of the BoE today is 'to maintain price stability'. The Act does not define 'price stability', however, fairness, efficiency, and accountability often follow from the absence of precise definitions. The task of determining 'price stability' is delegated to what many believe to be the expert judgement of the BoE's Monetary Policy Committee (MPC), which exercises its discretion in response to prevailing conditions and in reaction to contingencies as they happen. Such an arrangement allows the MPC to promote fairness by adapting monetary policy in response to, say, unfavourable employment trends. It enhances efficiency by giving the MPC scope to counter the harm caused by an over- or under-valued currency. The arrangement

also upholds accountability because the MPC's decisions are subject to oversight by the Treasury and parliament.

As these examples suggest, 'patterned and stereotyped'³⁸ arguments characterise the rules versus standards debate.³⁹ Rules promote certainty but are rigid and inflexible; standards promote flexibility but are open to manipulation. Rules treat all equally without fear or favour but fail to secure justice in particular circumstances; standards respond to the needs of the moment but fail to treat like situations alike. Given these back and forth movements, how might we explain the choice between rules and standards, between their respective vices and virtues? One explanation emphasises the influence of 'competing values such as certainty or flexibility, uniformity or individualization'.⁴⁰ Another suggests that rules and standards provide certainty in different circumstances: rules where actions are simple and stable, standards where 'the type of action to be regulated is complex, changing and involves large economic interests'.⁴¹ Or perhaps the

³⁸ P. Schlag, 'Rules and Standards' (1985) 33 *UCLA Law Review* 379, 380.

³⁹ Such 'patterned' arguments also characterise the scholarship on rules and discretion in monetary theory. A sample of the key texts includes: H. C. Simons, 'Rules versus authorities in monetary policy' (1936) 44(1) *Journal of Political Economy* 1; J. B. Taylor, 'Discretion Versus Policy Rules in Practice' (1993) 39 *Carnegie-Rochester Series on Public Policy* 195; J. Viner, 'The necessary and the desirable range of discretion to be allowed to a monetary authority' in L. B. Yeager (ed.) *In Search of a Monetary Constitution* (Cambridge, Mass: Harvard University Press, 1962) 244.

⁴⁰ Schlag, n 38 above, 399.

⁴¹ J. Braithwaite, 'Rules and Principles: A Theory of Legal Certainty' (2002) 27 *Australian Journal of Legal Philosophy* 47, 75. In a similar vein, see L. Kaplow, 'Rules Versus Standards: An Economic Analysis' (1992) 42 *Duke Law Journal* 557.

explanation follows from enforcement strategy: a clear, strict rule facilitates deterrence by helping the rule enforcer to prosecute rule breakers; but where the rule enforcer's strategy involves 'negotiation, advice, education, and compromise', a less rule-like approach may be appropriate.⁴²

A further, well-known explanation advanced by Duncan Kennedy suggests an association between rules and standards and the competing political visions of individualism and altruism.⁴³ Individualism in the sense used by Kennedy entails self-reliance and a clear separation between one's own interests and the interests of others; altruism, by contrast, entails sharing and sacrifice for the benefit of one's community. Kennedy's point is that arguments for rules resemble those favouring individualism and arguments for standards resemble those favouring altruism. Kennedy, however, fails to explain the logical necessity for the connection between form and substance, rules and individualism, standards and altruism because, as Mark Kelman puts it, 'there simply is *no* connection'.⁴⁴ Perhaps though the connection between rules-individualism and standards-altruism is less a necessity and more a tendency, one with the capacity to inform as well as to mislead. As we will see later in this article, the Act of 1844 is a clear example of a rule, one that its supporters justified by invoking the norms of self-reliance and individual responsibility. They did so in opposition to a standard, one that gave the BoE discretion over money creation, discretion that the BoE frequently used to 'afford assistance' to others for the benefit of the community.

⁴² J. Black, *Rules and Regulators* (Oxford: Clarendon Press, 1997) 29, referencing R. Baldwin, 'Why Rules Don't Work' (1990) 53 *The Modern Law Review* 321.

⁴³ D. Kennedy, 'Form and Substance in Private Law Adjudication' (1976) 89 *Harvard Law Review* 1685

⁴⁴ M. Kelman, *A Guide to Critical Legal Studies* (Cambridge, Mass: Harvard University Press, 1987) 56. Emphasis in original.

But, though informative, analysing the Act of 1844 as a clash between rules-individualism and standards-altruism misleads as much as it reveals. It misleads because it emphasises a difference of kind rather degree, rules *versus* standards, either one or the other. Why not rules *and* standards, as a series of continua comprising configurations of both?⁴⁵ A number of legal scholars have identified such a possibility, that we view rules and standards less as black-white, bright-line ‘Platonic essences’⁴⁶ confronting each other in ‘polar opposition’,⁴⁷ and more as ‘real world phenomena’,⁴⁸ coloured in shades of grey, as a ‘choice among points on a spectrum with rules at one end and standards at the other’.⁴⁹ If such a possibility has merit, the architects of a monetary order face the challenge of achieving the ‘right balance’ between rules and standards, of weighing up the trade-offs between the advantages of rules and the advantages of standards in the hope that each may prove effective when ‘combined in such a way that each tries to compensate for the limitations of the other’.⁵⁰

However, even where the monetary order’s architects reject ‘rules versus standards’ and embrace ‘rules and standards’, these architects may face a further challenge, that of rules converging with

⁴⁵ M. Horwitz, *The Transformation of American Law, 1870-1960* (Oxford: OUP, 1992) 199.

⁴⁶ M. Coenen, ‘Rules Against Rulification’ (2014) 124 *The Yale Law Journal* 644, 652

⁴⁷ C. R. Sunstein, ‘Problems with Rules’ (1995) 83 *California Law Review* 953, 961-2.

⁴⁸ Coenen, n 46 above, 652.

⁴⁹ R. B. Korobkin, ‘Behavioral Analysis and Legal Form: Rules and Standards Revisited’ (2000) 79 *Oregon Law Review* 23, 25.

⁵⁰ Black, n 42 above, 24.

standards, and vice versa. To see this blending of rules and standards, notice that the application of rules tends to require judgement calls and the application of a standard often sees decision-makers operating as if constrained by rules.⁵¹ Consider again the examples from above. On its face, the convertibility of BoE notes into gold is a simple and transparent directive. Its prescription takes the form of ‘if this, then that’.⁵² If the note-holder presents a note to the BoE, then the BoE must transfer a fixed amount of gold in return. The ‘trigger’—the presentation of the note—sets in motion a pre-specified response from the authorities. Often the response really is straightforward: the presentation of the note, the transfer of the gold. Sometimes, however, the response is not straightforward, because rules do not determine their own application. As Frederick Schauer explains, ‘a rule [does] not indicate whether its strictures should be taken as conclusive or subject to the making of exceptions should the result indicated by the rule itself appear to the interpreter or applier as unpalatable’.⁵³ The great virtue of rules is their rigidity. Yet this very virtue becomes a vice when rule-appliers confront emergencies or other contingencies which differ from the expectations of rule makers.⁵⁴ Such situations erode the rigidity of the rule: the applier of the rule must now exercise judgement to decide whether to uphold the rule even though so doing will result

⁵¹ Many legal theorists have noticed this blending of rules and standards. See, for example, Coenen, n 46 above, 653; Korobkin, n 49 above, 30; F. Schauer, ‘The Convergence of Rules and Standards’ (2003) *New Zealand Law Review* 303; Sunstein, n 47 above, 953. Many monetary theorists have identified the same phenomenon. See, for example, J. Bibow, ‘Reflections on the current fashion for central bank independence’ (2004) 28 *Cambridge Journal of Economics* 549, 551; and Whittlesey, n 18, 252.

⁵² Schlag, n 38 above, 381. See also W. Twining and D. Miers, *How to Do Things with Rules* (Cambridge: CUP, 5th ed, 2010) 90-91.

⁵³ Schauer, n 51 above, 313.

⁵⁴ D. Kennedy, ‘Legal Formality’ (1973) *The Journal of Legal Studies* 351, 380.

in unjust or absurd consequences. In 1797, the authorities in Britain had to make exactly this judgement call. Should they maintain the convertibility of BoE notes into gold at a fixed price of £3, 17s, 10 ½d? Or should they suspend convertibility given the ongoing hostilities with France? In the event, the authorities chose the latter course. But the point is this: even when confronted with a simple and transparent rule, the authorities still had to exercise judgement.

Although exceptions turn rules into standards, it is often also true that decision-makers with discretion act as if bound by rules. Recall the Bank of England Act 1998 which gives the BoE the objective of securing price stability. The advantage of a legal pronouncement such as this is the flexibility it gives to monetary experts to respond to unforeseen contingencies. But the objective of securing price stability fails to specify how the monetary authority will conduct monetary policy. Constrained only by a vague objective, what is to stop the monetary authority from adopting random, ad hoc policies or from becoming vulnerable to popular sentiments and interest group manipulation?⁵⁵ Monetary authorities nonetheless tend to argue that their approach to working under a standard such as ‘price stability’ tends to be structured and systematic rather than random and ad hoc. Such a structure might take the form of a predetermined plan which weighs reported inflation and economic growth against targets for economic growth and inflation. When inflation is above target, the monetary authority increases interest rates; when growth is below target, the monetary authority lowers interest rates. Either way, the authority reacts to the trigger—the gap between reality and the target—with an automatic rule-like response, and by so doing

⁵⁵ These fears underpin the ‘credible commitment mechanism’ approach. See n 21 above.

attempts to promote stable prices.⁵⁶ Other less automatic, more flexible responses are also possible.⁵⁷ The point to note is the degree of overlap between standards and rules. Despite starting with a firm line between rules and standards that line soon loses its sharpness amidst debates over the degree of discretion held by decision-makers.

THE BANK OF ENGLAND'S 'OPPOSITE AND INCONSISTENT DUTIES'

This section continues to explore the theme of the blurred boundary between rules and standards, and does so by using another example of a standard—the BoE's monetary policy of the 1830s—which came to take on rule-like characteristics. This approach to monetary policy is known today as the so-called 'Palmer rule', after the Governor of the BoE at the time, Horsely Palmer.⁵⁸ Although the Palmer rule showcases the convergence in practice of rules and standards, its perceived inadequacies as a means of constraining the BoE's powers over money creation also

⁵⁶ The predetermined plan described here roughly corresponds to the so-called 'Taylor Rule.' See Taylor, n 39 above.

⁵⁷ See, for example, B. S. Bernanke and F. S. Mishkin, 'Inflation Targeting: A New Framework for Monetary Policy?' (1997) 11(2) *The Journal of Economic Perspectives* 97.

⁵⁸ Horsely Palmer (1779-1858) was the Governor of the Bank of England from 1830-1833 and the Deputy Governor of the Bank of England from 1828-1830. He became a Director of the Bank of England in 1811. See J. K. Horsefield, *The Opinions of Horsely Palmer, Governor of the Bank of England, 1830-33* (1949) 16 *Economica* 143, 150-52.

explain the desire that led many to put their faith in clear, rigid rules such as the Bank Charter Act of 1844.

Our starting point for understanding the Palmer rule and its relationship to the Act of 1844 is the framework drawn from David Hume, which provides the rationale for a gold standard monetary regime.⁵⁹ Working under the assumption that gold is the only money, Hume's classic model tells us that when gold flows into a country, the money supply increases and that money finds its way into the pockets of the general population who then spend more on goods and services. Following this increase in demand, goods and services increase in price. As these goods and services increase in price, they become less competitive relative to cheaper goods and services elsewhere in the world that have not seen the same price increases. The inflow of gold that led to an increase in prices will then reverse itself as gold flows overseas to take advantage of the cheaper goods and services found there. Domestic prices then start to decline before the whole process repeats. Hume's conclusion is that this monetary system based on gold self-adjusts automatically provided governments do not meddle in the flows of gold that settle the balance of payments between countries.

⁵⁹ D. Hume, *Essays, Moral, Political and Literary* (1752), Book II, Essay V, 'On the Balance of Trade.' For commentary on Hume's ideas on money, see D. Vickers, *Studies in The Theory of Money, 1690-1776* (New York: Augustus M. Kelly, 1968) Chapter 11.

Matters become more complex when paper money is introduced into the model. For the theory to continue to apply in this context, the notes issued by the monetary authority must increase and contract in proportion to the flows of gold into and out of the country. Assigning the note-holder the right to have the note converted into gold on demand is one device for holding in-check the creation of paper money. It does so through a rule of the type that we saw earlier: the presentation of the note triggers the transfer of gold. But note a proviso: the monetary authority, such as the BoE, can only honour its obligation to convert the note on demand provided its reserve of gold is sufficient to cover the size of its note issue. This proviso is crucial because it, in effect, allows a simple and transparent rule to morph into a standard. The right of the note-holder is only secure provided the BoE judges carefully the extent of its note issue, so as to maintain an appropriate ratio of notes to gold reserves. But therein lies the problem. How ought the BoE to judge an appropriate ratio of notes to reserves?

Horsely Palmer fashioned rule-like guidelines to help the BoE make this judgement call. Palmer's guidelines recommended that, when gold was just about to leave the country, the BoE should divide its assets into a gold reserve equal to one-third of its note and deposit liabilities, and interest earning securities (such as government debt and bills of exchange) equal to two-thirds of these liabilities. Thereafter, the BoE should hold its securities at a constant level and allow its note and deposit liabilities to vary in response to inflows and outflows of gold. Courtesy of these rule-like guidelines, Palmer provided the BoE with a predetermined plan. In response to a trigger—inflows and outflows of gold—the BoE ought to hold its securities constant and allow its note and deposit liabilities to vary in line with its reserve of gold.

In practice, however, the BoE struggled to adhere to Palmer's rule-like guidelines. According to the leading figure of the currency school of monetary theorists, Lord Overstone,⁶⁰ the BoE struggled to do so because it was unable to resolve the dilemma between its 'opposite and inconsistent duties'.⁶¹ On the one hand, the BoE issued banknotes that it was duty bound to convert into gold on demand. On the other, the BoE also performed other banking activities, such as discounting bills of exchange, which merchants and other bankers believed the BoE ought to continue to perform during moments of commercial pressure.⁶² By providing such accommodation even though gold was flowing overseas—as the BoE had done during the crises 1825-26, 1837, and 1839—the BoE increased its holding of bills of exchange even through Palmer's guidelines

⁶⁰ Samuel Jones Loyd (1796-1883) was a banker who on his elevation to the peerage in 1850 became Lord Overstone. The currency school refers to the group of writers in the late 1830s and early 1840s who sought a means of ensuring that a paper currency behaved in the manner called for by Hume's model. For an overview of nineteenth century monetary theory, see A. Arnon, *Monetary Theory and Policy from Hume and Smith to Wicksell: money, credit, and the economy* (Cambridge: CUP, 2011).

⁶¹ S. Jones Loyd, *Reflections Suggested by a Perusal of Mr. J. Horsely Palmer's Pamphlet* (London: Pelham Richardson, 1837) 48. In addition to the dilemma described in this section, much of the contemporary debate on the BoE's practice in the 1830s focused on the distinction between bank notes and bank deposits. Palmer treated these two types of liability as equally important. Currency school thinkers such as Overstone privileged bank notes over bank deposits, and criticized the BoE in the 1830s for failing to counter the fact that, when people exported gold from Britain, the BoE's note issue did not contract to the same extent because some of the reduction in the BoE's liabilities fell on the deposits it held for the public.

⁶² On this tension between the BoE's responsibilities, see J. Clapham, *The Bank of England: A History* (Cambridge: CUP, 1945), 162-4; F. Fetter, *Development of British Monetary Orthodoxy, 1797-1875* (Cambridge, Mass: Harvard University Press, 1965), 258; T. Alborn, *Conceiving Companies: Joint-stock politics in Victorian England* (London: Routledge, 1998) 55; and G. Ingham, *Capitalism Divided* (London: Macmillan, 1984) 236-7.

recommended maintaining these securities at a constant level. This inconsistency compelled Overstone to conclude that the BoE's note issuing function and its banking function were not only 'perfectly distinct from each other, but in many respects of so conflicting a nature, that it seems hardly possible that the administration of the two can be safely confided to the same hands'.⁶³ As Overstone's fellow currency school member, Robert Torrens,⁶⁴ put it,

If they [the directors of the BoE] could be prevailed upon to attend with strictness to their essential duty of regulating their issues by the course of the foreign exchanges, they would never be called upon to perform the superfluous duty of watching over and supporting commercial credit.⁶⁵

In the 1830s, however, the BoE tended to watch over and support commercial credit on so many occasions that Overstone described Palmer as 'standing upon piles of Bank Notes and supporting with Atlantean shoulders broad the vast fabric of Commercial Credit'.⁶⁶ Convertibility was not suspended but, as Overstone argued,

⁶³ Jones Loyd, n 61 above, 43.

⁶⁴ Colonel Robert Torrens (1780-1864) was a Royal Marines officer and later an MP. His son, also Robert Torrens, introduced the Torrens system of land registration.

⁶⁵ R. Torrens, *A Letter to the Right Honourable Lord Viscount Melbourne* (London: Longman, 1837) 44.

⁶⁶ Lord Overstone to G. W. Norman, 3 April 1837 in D. P. O'Brien, *Correspondence of Overstone*, volume I (Cambridge: CUP, 1971) 223.

Unless the paper-circulation of the country be regulated by a fixed rule, not fitful and capricious in its operation, but constant and invariable, its convertibility at all times cannot be effectually secured, and the maintenance of the value of the currency, as measured by its ancient metallic standard, must become precarious and uncertain.⁶⁷

What Overstone classified as ‘capricious’ Palmer saw as a discretionary response to ‘special circumstances’.⁶⁸ A standard allows decision-makers licence to adapt policy to unforeseen emergencies and contingencies. Though rule-like, Palmer’s guidelines were self-imposed and, crucially, had built into them exceptions ‘under special circumstances’.⁶⁹ Yet it was precisely Palmer’s willingness to acknowledge the ‘special circumstances of the case’⁷⁰ and to extend assistance to commerce that led to Overstone’s concern about the ‘precarious and uncertain’ status of convertibility. Special circumstances might multiply and the BoE might find ‘that it is extremely difficult, as well as unpopular, to refuse the demands which are made upon her; and, therefore, easily convinces herself that it is impossible’.⁷¹ The Act of 1844 attempted to tip the balance between the BoE’s conflicting duties back in the direction of what the currency school called its ‘essential duty’ to maintain convertibility, and it attempted to do so through a rule that limited the freedom of the BoE to create paper money. It is to the Act of 1844 that we now turn.

⁶⁷ S. Jones Loyd, *Remarks on the Management of the Circulation* (London: Pelham Richardson, 1840) 91-92.

⁶⁸ Testimony of J. H. Palmer, *Report from the Select Committee on Bank of Issue* (HC, 1840, 602-IV) Q. 1419.

⁶⁹ Testimony of J. H. Palmer, *Report from the Committee of Secrecy on the expediency of renewing the Charter of the Bank of England* (HC, 1832, 722-VI) Q. 1142-1148.

⁷⁰ Testimony of Palmer, n 68 above, Q.1261.

⁷¹ Jones Loyd, n 67 above, 51.

THE ACT OF 1844 AND THE BENEFITS OF A ‘STRICT AND JUDICIOUS RULE’

By stressing the BoE’s ‘essential duty’ to convertibility over its ‘superfluous duty’ to the commercial community, the currency school followed the famous Bullion Report of 1810. That Report had argued that the loss of convertibility meant the absence of ‘That natural check or control ... which maintains the value of money, and, by the permanency of the common standard of value, secures the substantial justice and faith of monied contracts and obligations between man and man’.⁷² It is these two aims—supporting the value of money and securing relations between creditors and debtors—that also come to the fore in the writings by currency school figures such as Robert Torrens and Lord Overstone. According to Overstone,

In adopting a paper circulation we must unavoidably depend for a maintenance of its due value upon the adoption of a strict and judicious rule for the regulation of its amount. Upon such maintenance of its value depends the price of all commodities; the relative situation of the debtor and creditor classes of the community.⁷³

The ‘strict and judicious rule’ Overstone had in mind arrived courtesy of the Act of 1844. That Act introduced a regime in accordance with which the quantity of BoE notes was intended to vary in response to flows of gold into and out of the country. Towards achieving that objective, the Act

⁷² *Report from the Select Committee on the High Price of Gold Bullion* (HC, 1810, 349-III), 74.

⁷³ S. Jones Loyd, *Further Reflections on the State of the Currency* (London: Pelham Richardson, 1837) 35-36.

introduced a novel institutional arrangement which saw the creation of two departments within BoE, the issue department and the banking department.⁷⁴ All of the BoE notes created by the issue department had to be backed by their equivalent in gold coin or gold bullion, with the exception of a £14 million issue backed by securities such as government debt.⁷⁵ With the issue department responsible for the note-issue, the banking department accepted deposits, advanced loans, and discounted bills of exchange. Through these arrangements, the Act's promoters hoped to guide the behaviour of the BoE by curtailing its discretion over money creation and they hoped to guide the behaviour of other bankers too, by 'strengthening the hands of the Bank'⁷⁶ in its bid to curb the extent to which it supported the commercial community during times of crisis. As one commentator explains, 'It was a principal aim of the Act [...] that the note issue could be increased only if the Issue Department's [gold] reserve rose'.⁷⁷ In keeping with that aim, a flow of gold overseas deprived the issue department of the gold it needed to back the creation of BoE notes and,

⁷⁴ On the history of the plan of separating the BoE into two departments, see Arnon, n 60 above, chapter 8. See also J. K. Horsefield, 'The Origins of the Bank Charter Act, 1844' (Nov., 1944) *Economica* 180.

⁷⁵ Bank Charter Act 1844, s. II. Moreover, the Act, at Sections X-XIII, only permitted provincial banks issuing notes on 6 May 1844 to continue to do so, and only on the condition that (i) the bank did not exceed its average issue as of the twelve weeks ending 26 April 1844; and (ii) the bank's issue remained continuous (i.e. the bank could not resume a lapsed issue). See Clapham, n 62 above, 183. Even prior to these restrictions, the note issue of provincial banks had been in decline. See R. Cameron, 'England, 1750-1844' in R. Cameron, O. Crisp, H. T. Patrick, and R. Tilly (eds) *Banking in the Early Stages of Industrialization* (London: Oxford University Press, 1967) 15, 42. Separate legislation, enacted in 1845 and similar in spirit to the Act of 1844, applied to Scotland and Ireland.

⁷⁶ Jones Loyd, n 67 above, 53

⁷⁷ M. Collins, *Money and Banking in the UK: A History* (1988) 175.

with the note issue limited, the banking department had a reason to refuse some or all requests for assistance from the commercial community.

In contrast to the issue department, the banking department lacked the power to create BoE notes in any circumstances. Its reserve of notes consisted of those notes created by the issue department minus those in circulation. As would become clear in the decades after 1844, the banking department had considerable discretion over how it might use that reserve of notes.⁷⁸ But the banking department could not augment its note reserve by creating additional notes at will as the BoE had done in the 1830s. Such a constraint deliberately disciplined the banking department because, from the notes it held in reserve, it had to cover those liabilities owed to the BoE's depositors as well as all requests for discounts or advances or both from the commercial community. It is here that the 'Bank screw' comes to the fore. To protect its limited reserve of notes when gold was flowing overseas, the banking department had to ration access to it. It did so by turning its 'screw', through raising the rate at which it sold its notes in return for bills of exchange. Such an operation was, in theory, a 'mechanical',⁷⁹ 'automatic'⁸⁰ rule-like process: if gold flowed overseas, then the banking department applied its 'screw' so that, with 'hydraulic

⁷⁸ The banking department also had considerable discretion over deposit creation because it could create deposits at will subject only to convertibility. The contrast between the Act of 1844's tight control of the note issue and the absence of any direct control of deposit creation was a source of controversy in the debate between the currency school and the banking school. See Arnon n 60 above, 187-247.

⁷⁹ Testimony of Lord Overstone, *Report from the Select Committee on Bank Acts* (HC, 1857, 220-X) Q. 3895.

⁸⁰ M. Daunton, *Wealth and Welfare. An Economic and Social History of Britain 1851-1951* (Oxford: OUP, 2007) 275.

smoothness’,⁸¹ the discount rate increased as gold reserves decreased. If such a manoeuvre failed to curb demand for the banking department’s notes so that its note reserve started to decline towards zero, it might decide to cease discounting altogether. As one of the BoE’s directors, J.G. Hubbard, explained

the change which has been affected by the Act of 1844 has been this, that the Bank of England now has no such unfailing supply of notes; the Bank of England, as a bank, has limits to its means ... and it cannot undertake, and does not undertake, and it is quite right that other banking bodies in London and the country should understand that it does not pretend to be able at any moment to turn into cash for them the Exchequer bills and Consols, or other Government securities, [or bills of exchange] when they ought, with due prudence and proper management, to have kept the cash themselves.⁸²

Such a regime meant bankers and merchants and manufacturers knew—or ought to know—that at some point the BoE would have to withhold access to its notes from them.⁸³ Now unable to call upon the BoE for assistance, the mercantile world would need to adjust its behaviour accordingly. Torrens saw the system working in the following way: when the banking department turned its ‘screw’ tighter, ‘the several banks of deposit would have the amounts of their available cash diminished, and would immediately perceive the necessity of limiting the amount of their

⁸¹ D. O’Brien, ‘The Lender-of-Last-Resort Concept in Britain’ (2003) 35(1) *History of Political Economy* 1, 13.

⁸² Testimony of Hubbard, n 5 above, Q. 2629.

⁸³ See E. Wood, *English Theories of Central Bank Control, 1819-1858* (Cambridge, Mass: Harvard University Press, 1939) 113.

discounts and credits in like proportion'.⁸⁴ Put another way, if bankers did not 'immediately perceive the necessity' of disciplining their lending by 'timely precaution and restraint';⁸⁵ if they failed to respect this 'rule of prudence';⁸⁶ if they ignored the reality that 'their sole reliance now must be only on their own till',⁸⁷ then, according to Overstone, 'Monetary pressure really render good service to the community – by exterminating noxious weeds and destroying the seeds of spreading mischief'.⁸⁸ As Overstone explains, 'When the transactions of trade and commerce are in a sound state – a temporary pressure on the monetary system produces no evil effect'⁸⁹ because banks and others would respond to the signals sent by the level of the banking department's reserve by standing ready to meet their obligations with their own reserves. The 'unsoundness' underlying those enterprises that could not do so was then exposed to their creditors. In a context influenced by the early Victorian doctrine of atonement, the penalty for the non-compliance of these 'noxious weeds' was their 'extermination' via bankruptcy.⁹⁰

⁸⁴ R. Torrens, *An Inquiry into the ... Renewal of the Charter of the Bank of England* (London: Smith, Elder & Co, 1844) 29.

⁸⁵ Anon. [S. Jones Loyd and R. Torrens], *The Petition of the Merchants, Bankers, and Traders of London, against the Bank Charter Act; with comments on each clause* (London: Pelham Richardson, 1847) 18.

⁸⁶ J. E. Cairnes, *An Examination into the Principles of Currency* (London: Ridgeway, 1854) 16, quoting from *The Times*, October 1847.

⁸⁷ S. Neave, *Report from the Select Committee on the Bank Acts* (HC 1857, 220-X), Appendix, 5.

⁸⁸ Lord Overstone to G. C. Lewis, 6 Nov. 1856 in D. P. O'Brien, *Correspondence of Overstone*, volume ii (Cambridge: CUP, 1971) 682.

⁸⁹ Lord Overstone to G. W. Norman, 4 Nov. 1856 in O'Brien, *ibid*, 679.

⁹⁰ B. Hilton, *The Age of Atonement* (Oxford: OUP, 1988).

ENFORCING THE ACT: ‘GRIEVOUS AND UNNECESSARY EVILS OF A COLLATERAL KIND’

Harvest failures in England and Ireland in 1846 saw the price of wheat rise and imports increase. Gold flowed overseas to pay for these imports and in the spring of 1847 the BoE raised its discount rate. Doing so increased the cost of borrowing money at the tail end of the railway boom; it hit hardest those struggling to meet calls from railway companies on partly paid shares.⁹¹ Yet gold continued to flow overseas. The BoE responded by increasing its rate further and by reaffirming its decision to buy only the most desirable securities.⁹² Such measures added to the burden of those with obligations to honour. In August 1847 London’s merchants petitioned Parliament to complain ‘That this pressure has manifested itself in the fact of the suspension of the ordinary facilities of business – such as the discounting legitimate commercial bills of unquestionable credit and solvency, and the withholding other ordinary monetary accommodation’. The petitioners claimed that the BoE had a responsibility to give ‘temporary aid, if called for by the mercantile body at such periods of emergency’,⁹³ and yet the Act of 1844 prevented the BoE from doing so.

⁹¹ Campbell, n 18 above. See also R. Dornbusch and J. A. Frenkel, ‘The Gold Standard and the Bank of England in the Crisis of 1847’ in M. D. Bordo and A. J. Schwartz (eds) *A Retrospective on the Classical Gold Standard, 1821-1931* (Chicago: Chicago University Press, 1984) 234-237.

⁹² See R. G. Hawtrey, *A Century of Bank Rate* (New York: Augustus M. Kelley, 1962) 22 and Fetter, n 62 above, 201-211. On the situation in Ireland, see Charles Reid, ‘Laissez-faire, the Irish famine, and British financial crisis’, (2016) 69(2) *Economic History Review* 411.

⁹³ Petitioners quoted in Anon. (Jones Loyd and Torrens), n 85 above, 4.

Although the Government was unmoved by the petition and held firm in its support of the Act, by October another deputation of London bankers and merchants met with the Chancellor of the Exchequer and ‘implored him to take steps to remove the legal restriction on the Bank’s issues’.⁹⁴ On 25 October 1847 that pressure produced the outcome desired by the petitioners. In a letter from the Treasury to the BoE, the Government recommended that the BoE ‘enlarge the amount of their discounts and advances, upon approved security’, adding that, ‘[i]f this course should lead to any infringement of the existing law’ the Government would protect the BoE by submitting a bill of indemnity to parliament.⁹⁵ The Government confirmed the ‘extraordinary and temporary’ nature of the measure by asking the BoE’s directors to ‘reduce as soon as possible the amount of their notes, if any extraordinary issues should take place, within the limits prescribed by law’.⁹⁶ Upon receipt of the letter, the BoE ‘immediately began to lend more liberally’ and, with ‘the BoE no longer bound by the Act, the panic subsided’.⁹⁷

⁹⁴ W.T.C. King, *History of the London Discount Market* (London: Routledge, 1936) 146-7. On the various deputations that tried to persuade the government to suspend the Act in 1847, see *Morning Post*, 20 October 1847; *Bankers’ Magazine*, November 1847; A. E. Feaveryear, *The Pound Sterling. A History of English Money* (Oxford: Clarendon, 1931) 284; and S. E. Thomas, *The Rise and Growth of Joint Stock Banking* (London: Pitman, 1934) 437, 439 and 446.

⁹⁵ See Editorial, ‘The Triumph of the Banking Principle’, *Bankers’ Magazine*, November 1847, 534. The government set a minimum rate of interest on the BoE’s discounts and advances of 8 per cent. The same remedy was adopted in 1857 and 1866. Only in 1857 did the BoE actually issue the additional notes.

⁹⁶ *ibid.*

⁹⁷ King, n 94 above, 147.

Shortly thereafter, the Chancellor of the Exchequer, Charles Wood, explained to Parliament his decision to suspend the Act of 1844. The Act was, he said, ‘the result of human wisdom’, and so, though it upheld the value of the currency, it was ‘not indispensable to carry into strict execution under all circumstances ...’.⁹⁸ As an alternative to the ‘strict execution’ of the Act, Wood was open to the ‘exceptional course’ of suspending it even though so doing represented a *volte-face* in government policy. After all, Wood had spent most of 1847 declaring that increasing the note issue was ‘contrary to the law’ and that the monetary pressure would be even worse ‘if matters were not allowed to take their course’.⁹⁹ During 1847 his seemingly unshakable resolve to uphold the Act of 1844 had even led to cuts in famine relief spending in Ireland.¹⁰⁰ What then accounts for his willingness to suspend the Act in the autumn of 1847? In search of an answer this part of the Article explores the assets held by those who petitioned the Chancellor of the Exchequer, the value of which was threatened by the turning of the ‘Bank screw’.

Characterising the late eighteenth century and much of the nineteenth was the proliferation of ‘property in ... the unsecured but contracted-for performance of executory commercial promises ...’.¹⁰¹ This form of property drew its value not from a right to a specific material object—such as land, factories, machinery, or, indeed, gold coin—but from a claim to future revenues. However, these abstract, intangible property claims were, and still are, intensely vulnerable. They depend on

⁹⁸ Chancellor of the Exchequer (Charles Wood), HC Deb vol 95 col 377 30 Nov. 1847.

⁹⁹ Quoted in the *Morning Post*, 20 October 1847.

¹⁰⁰ Reid, n 92 above, 420-421.

¹⁰¹ R. Gordon, ‘Paradoxical Property’ in J. Brewer and S. Staves (eds) *Early Modern Conceptions of Property* (London: Routledge, 1996) 95, 99.

contractual promises to pay, and these contractual promises to pay in turn depend on the realisation of expectations. Where the expectation—the bet on future productivity—is misplaced, contractual promises unravel.¹⁰²

The monetary architecture created by the Act of 1844 deliberately increased the likelihood of these promises unravelling. It did so by encouraging the BoE to limit the quantity of bills of exchange that it discounted.¹⁰³ Under the Act, a flow of gold overseas prevented the issue department from creating BoE notes. Under these conditions, the banking department rationed those notes it held by raising its discount rate: on 1 January 1847 the BoE's minimum discount rate stood at 3 per cent. By the middle of January it had increased to 3.5 per cent; by April to 4 per cent; by August to 5 per cent; and by October to 8 per cent.¹⁰⁴ By turning the 'Bank screw' and increasing the expense for bankers seeking to discount bills of exchange, the BoE withheld access to its notes from those unable or unwilling to meet its increased rate. Moreover, in the background hung the threat that the BoE might cease to discount altogether. The Act of 1844 placed a limit on the BoE's capacity to create paper money. If the banking department's reserve of notes fell to zero—it decreased throughout 1847, from over £8 million in January 1847 to £1.5 million on the eve of the

¹⁰² See, for example, Gordon, *ibid*; P. Ireland, I. Grigg-Spall and D. Kelly, 'The Conceptual Foundations of Modern Company Law' (1987) 14(1) *Journal of Law and Society* 149; and P. Atiyah, *The Rise and Fall of Freedom of Contract* (Oxford: Clarendon, 1979) 102-112.

¹⁰³ Hawtrey, n 92 above, 7-8 and 21.

¹⁰⁴ The Government imposed the rate of 8 per cent as part of the conditions it set in return for suspending the Act. See Tooke, n 11 above, 330; and testimony of A. Hodgson, *First Report from the Secret Committee on Commercial Distress* (HC, 1847-48, 395-VIII) Q. 7, 70, 99.

Act's suspension¹⁰⁵—it would have had no choice but to stop lending.¹⁰⁶ No wonder then that those who depended on discounts to help them bridge the gap between their assets and their liabilities described the Act of 1844 as an 'iron-cage'¹⁰⁷ and 'cast-iron system'¹⁰⁸ built on a 'denial of discounts'¹⁰⁹ where '[t]he rule is, no gold, no paper; no paper, no money; no money, no discounts, except on terms of extortion'.¹¹⁰

The petition to Parliament from London's merchants in August 1847 was provoked by the BoE's refusal to discount 'commercial bills of the first credit' except 'at rates of interest hitherto unknown in this country'.¹¹¹ Those who agreed to pay such rates saw their 'legitimate gains' 'plundered ... by extortionate discounts on account of the statutable scarcity of legal tender'.¹¹² Those who refused to accept the BoE's terms still had to find income from somewhere to cover their current liabilities, such as those owed by bankers to their depositors and by manufacturers to their workforce. A prudent banker might respond to the scarcity of legal tender by heeding the advice of the currency school and adjusting the ratio between their liabilities and reserves. They could do

¹⁰⁵ See *Second Report from the Secret Committee on Commercial Distress* (HC, 1847-48, 584-VIII) appendix, 20-21.

¹⁰⁶ See Hawtrey, n 92 above, 21.

¹⁰⁷ Testimony of J. Lister, *Report from the Secret Committee of the House of Lords, Appointed to Inquire into the Causes of Commercial Distress* (HL, 1848, 565-VIII) Q. 2565, 2566.

¹⁰⁸ Cairnes, n 86 above, 45.

¹⁰⁹ W. J. Norfolk, 'Remarks on What Should Regulate the Currency' in *Bankers' Magazine*, Nov. 1844, 71.

¹¹⁰ J. Duncan, *The Bank Charter Act* (London: Daniel F. Oakey, 2nd ed., 1858) 176.

¹¹¹ Petitioners quoted in Anon. (Jones Loyd and Torrens), n 85 above, 11.

¹¹² Duncan, n 110 above, 7-8

so by restricting ‘the accommodation previously granted to their commercial connections’¹¹³ such as merchants and manufacturers. ‘[D]enied their usual facilities’, these merchants and manufacturers were ‘*compelled* to diminish the number of their operatives and ... to sell goods at a ruinous sacrifice, for the purpose of discharging engagements contracted in times of less difficulty’.¹¹⁴ Yet if others without the income to cover short-term liabilities opted to sell property too, ‘the most general and frightful decline in the value of commodities’ would then follow.¹¹⁵ In the aftermath of the crisis of the autumn of 1847, one critic of the Act of 1844 speculated that the depreciation in the value of property ‘probably would not be overstated at from 10 to 20 per cent.’, ‘extending over all merchandise, stocks, railroad shares, &c’.¹¹⁶ These ‘forced sales of produce, and other property’ compelled merchants and manufactures to incur ‘immense losses’, which then resulted in further forced sales.¹¹⁷ At some point, these merchants and manufacturers would find it difficult ‘amounting, perhaps, to an impossibility, of obtaining the means of discharging stipulated payments’.¹¹⁸ With many ‘unable to fulfil their engagements’,¹¹⁹ ‘[s]ome firms ... stopped payment: their failure involved more or less deeply many other firms which had trusted

¹¹³ Anon, *A Metallic Currency. A barrier to the progress of civilization* (London: J. B. Nichols, 1844) 10.

¹¹⁴ *ibid.* Emphasis in original.

¹¹⁵ Anon, *The National Distress: its financial origin and remedy* (London: Longman, 1848), 40-41. The fall in prices during 1847 is well documented. See D. M. Evans, *The Commercial Crisis 1847-48* (London: Letts, Son and Steer, 1848) 132-159.

¹¹⁶ Ashburton, n 8 above, 18.

¹¹⁷ Tooke, n 11 above, 313.

¹¹⁸ Carines, n 86 above, 37-38.

¹¹⁹ William Blacker, *Statement of Evidence which would have been given to the committee of the House of Commons on commercial distress* (London: Pelham Richardson, 1848) 7-8.

them'.¹²⁰ The result was a system 'wantonly involving hundreds of good men in bankruptcy, and throwing out of employment millions of men',¹²¹ all because 'the Bank of England has not a given amount of bullion in its coffers'.¹²² These apprehensions reflect the facts: bankruptcies jumped from 1,533 in 1846 to over 2,000 in 1848;¹²³ and unemployment in Manchester during the first six months of 1848 is estimated to have reached 18 per cent.¹²⁴

Perhaps some of the firms denied access to credit were the 'noxious weeds' Overstone was content to see 'exterminated' during periods of monetary pressure.¹²⁵ Moreover, the fall in the value of property during 1847 was exactly what Hume's model called for: as the currency school's leading

¹²⁰ J. S. Mill, *Principles of Political Economy* (London: Longmans, 1871) bk. 3, chap. 12, sec. 3.

¹²¹ W. Pickering, *The Currency, its defects and cure* (Liverpool: Wareing Webb, 1848) 13-14.

¹²² E. Norton, *The Bank Charter Act of 1844 and how to remedy its evils* (London: W. Skeffinton, 1857) 23. In the same spirit, see also L. Levi, *On the Bank Charter Act and other laws regulating the currency* (Edinburgh: T. T. Clark, 1856) (Levi was a member of the Liverpool Chamber of Commerce); and J. F. Macfarlan, *Our Monetary Affairs Considered with Reference to the Currency Act of 1844* (Edinburgh: John Greig, 1856) (Macfarlan was the honorary chairman of the Edinburgh Chamber of Commerce and Manufactures).

¹²³ By 1850 the number had fallen below 1,000. See B. Weiss, *The Hell of the English: Bankruptcy and the Victorian Novel* (Toronto: Associated University Press, 1986) Appendix, 179. See also Evans, n 115 above, appendix.

¹²⁴ G. R. Boyer, 'The Evolution of Unemployment Relief in Great Britain' (2004) 34(3) *Journal of Interdisciplinary History* 393, 402. See also H. M. Boot, 'Unemployment and Poor Law Relief in Manchester, 1845-50' (1990) 15(2) *Social History* 217; and C. N. Ward-Perkins, 'The Commercial Crisis of 1847' (New Series, 1950) 2(1) *Oxford Economic Papers* 75, 84

¹²⁵ Much of the contemporary commentary on the crisis displays apprehension about 'speculation' and 'over-trading'. See Ward-Perkins, *ibid*, 89.

lights argued during the crisis, only a fall in the price of domestic commodities would attract gold back to the country. Yet even if ‘those houses that were notoriously weak had gone down’, supporters of the Act still recognised that ‘the pressure began to break what you may term solvent houses, and to occasion others to sacrifice their property to an enormous extent’.¹²⁶ Joseph Pease, a coal mine owner from the county of Durham, agreed and added, in response to the question ‘Do you think even solvent houses have suffered?’, ‘I have no doubt of it ... generally, from the circumstances under which they have carried on business, the high rate of discount, and the failures and losses, and the great depreciation of stock, they have very bad accounts’.¹²⁷ Pease also stressed that it was the working classes who were least well placed to escape from harm and who had suffered the most, before concluding,

I am really of opinion that there never was a greater amount of distress amongst all classes, and borne with more admirable fortitude, than that which existed in the [autumn of 1847]. That which has come under my own notice, going amongst thousands of my work-people, is harrowing to the extreme. The amount of Sunday clothes in pledge I never saw equalled in the same degree: food has swallowed up everything with the want of work.¹²⁸

¹²⁶ Testimony of C. Turner, *First Report from the Secret Committee on Commercial Distress* (HC, 1847-48, 395-VIII) Q. 657.

¹²⁷ Testimony of J. Pease, *First Report from the Secret Committee on Commercial Distress* (HC, 1847-48, 395-VIII) Q. 4670.

¹²⁸ *ibid*, Q. 4731.

The line between Overstone's 'noxious weeds' and those firms in a 'sound state' is difficult to draw *ex ante*. The dynamics of a crisis constantly shift the boundary, often causing 'grievous and unnecessary Evils of a collateral Kind'¹²⁹ as a growing number of firms are caught on the wrong side of the line. Forced sales lead to losses, which induce contractual defaults; those who would otherwise have been able to pay off debts default too, shifting another round of losses on to contractual counter-parties; lay-offs then follow and eventually, insolvency. This produces further job losses, and the scenes Pease described as 'harrowing to the extreme'. The dilemma facing the Chancellor of the Exchequer in the autumn of 1847 was whether to allow these harrowing scenes of 'grievous and unnecessary Evils' to multiply, or whether to enforce the Act and proclaim 'Perish commerce, live the Act of 1844!'¹³⁰

THE 'HORNS OF THE DILEMMA' AND THE CRISIS OF 2008

The rule-like structure of the Act of 1844 wobbled at the moment when a group of merchants and bankers petitioned the Chancellor of the Exchequer asking him to suspend the Act. It wobbled because rules do not determine their own application. The Chancellor had to decide whether to apply the Act regardless of circumstances and consequences, or whether to suspend the Act when turning the 'Bank screw' threatened consequences intolerable even to the Government. Enforcement left many facing insolvency; suspension extended credit. Enforcement promoted

¹²⁹ *Report from the Secret Committee of the House of Lords, Appointed to Inquire into the Causes of Commercial Distress* (HL, 1848, 565-VIII) xliv.

¹³⁰ Tooke, n 11 above, 320.

values such as self-reliance and self-discipline, but it left vulnerable the assets, the property in expectations, held by the country's banks. Suspension dispelled the 'Fear of Mills being stopped'¹³¹ but it threatened the convertibility of bank notes into gold.

In that moment of crisis in the autumn of 1847, the 'horns of the dilemma'¹³² facing the public authorities revealed the inescapable role of public authority in the construction of a monetary order.¹³³ During and after the events of 2008 the authorities in the US and in the EU had to grapple with that same dilemma in a context also shaped by a rule-based monetary order. As we saw in the introduction, the design of these rules—section 13(3) of the FRA and Articles 123 and 125 of the TFEU—in part responds to the importance these jurisdictions attach to sound money. When the viability of the credit created by the banking system was at stake, however, the authorities had to reassess the meaning and purpose of these rules. In the US, creative 'legal maneuvering'¹³⁴ by the Federal Reserve allowed it to adopt a flexible interpretation of its then powers under section 13(3) of the FRA, a provision which allowed the Fed to extend loans to non-bank financial institutions provided these loans were 'secured to the satisfaction of the Federal reserve bank'. The provision granted the Fed considerable discretion to weigh up whether a loan was 'secured to [its] satisfaction'. But the nature of the support offered to Bear Stearns and AIG in 2008 saw the Fed

¹³¹ Testimony of J. Morris (Governor of the BoE), *Report from the Secret Committee of the House of Lords, Appointed to Inquire into the Causes of Commercial Distress* (HL, 1848, 565-VIII) Q. 41.

¹³² Duncan, n 110 above, 8.

¹³³ Kreitner, n 25 above, 427.

¹³⁴ E. A. Posner, 'What Legal Authority Does the Fed Need During a Financial Crisis?' (2017) 101 *Minnesota Law Review* 1529, 1542.

accept collateral of no value at all. That interpretation freed the Fed to support institutions which would otherwise have collapsed but at the cost of leaving the transaction looking, in the words of one commentator, ‘legally dubious’.¹³⁵

Similar controversies mark Europe’s response to the 2008 crisis and its aftermath. Article 123 of the TFEU prohibits the ECB from providing ‘overdraft facilities or any other type of credit facility’ to EU member states; similarly, Article 125 declares that ‘the Union shall not be liable for or assume the commitments of’ its member states. Both Articles 123 and 125 have strong rule-like characteristics: they fix *ex ante* the limits of the ECB’s obligations. And yet in the context of the sovereign debt crisis the EU applied these rules in such a way that governments and, indirectly, the banks bailed-out by these sovereigns received the support that these rules appear to prohibit. Although Article 125, for example, prohibits the EU from assuming responsibility for the debt of member states, it is silent on whether the member states can use an international treaty to establish a new autonomous institution—such as the European Stability Mechanism (ESM)—that might then make loans to or purchase on primary and secondary markets the debt of member states. Even though the European Court of Justice sanctioned this legal manoeuvre as a legitimate means of crisis management, many scholars view it as ‘legally dubious’ for failing to accord with the spirit of the TFEU.¹³⁶

¹³⁵ *ibid*, 1550.

¹³⁶ Eg, B. De Witte, ‘Euro Crisis Responses and the EU Legal Order: Increased Institutional Variation or Constitutional Mutation?’ (2015) 11 *European Constitutional Law Review* 434, 453.

Legally dubious to some, a ‘creative moment’ to others,¹³⁷ intensely controversial to all, some scholars have observed the extent to which the authorities in both jurisdictions searched for a legal basis to support their actions.¹³⁸ As Bruno De Witte writes of the EU, ‘even when they felt pressed for urgent action, [EU institutions and Member States] always tried to respect existing constraints of EU law (or national constitutional law), even when they made creative use of the instruments available in the legal toolbox’.¹³⁹ Such legal creativity marks a point of contrast with the 1840s. Rather than try to stretch or side-step the Act of 1844, the Government cut to the chase and suspended the limitation on BoE’s note issuing powers. But despite this difference, notice a thread connecting the 1840s to the present. Whether the monetary authorities stretched, side-stepped, or suspended legal directives, such actions cast doubt on the viability of *ex ante*, preventative legal measures. Contemporaries described the suspension of the Act of 1844 as a ‘shameful’¹⁴⁰ breach of ‘constitutional laws’,¹⁴¹ which ‘has produced on the public mind a want of confidence in the existing law’¹⁴² and allowed the Act’s opponents ‘to pounce on what seems the carcass of a dead law’.¹⁴³ In a similar vein, scholars have described the Fed’s actions during the crisis in the US as

¹³⁷ M. Ioannidis, ‘Europe’s New Transformations: How the EU Economic Constitution Changed During the Eurozone Crisis’ (2016) 53 *Common Market Law Review* 1237, 1262. See also Wallach, n 16 above, 45, 54.

¹³⁸ De Witte, n 136 above and Wallach, *ibid*, 202.

¹³⁹ De Witte, *ibid*, 451-2.

¹⁴⁰ G. Hudson, HC Deb vol 148 col 438 9 Dec. 1857.

¹⁴¹ Testimony of S. Neave (Governor of the BoE) and B. Dobree (Deputy-Governor of the BoE), *Report from the Select Committee on Bank Acts*, (HC, 1858, 381-V) Q. 223.

¹⁴² J. Wilson, HC Deb vol 95 col 415 30 Nov. 1847.

¹⁴³ *The Times*, 13 November 1857.

‘an enormous violation of the rule of law’,¹⁴⁴ as ‘legal trickery’,¹⁴⁵ and as ‘beyond the scope of the Fed’s ... authority’.¹⁴⁶ In a like manner, commentators in Europe fear that, in the euro crisis, ‘illegality has followed illegality’,¹⁴⁷ threatening law’s ‘integrity’¹⁴⁸ and ‘legitimacy’,¹⁴⁹ forewarning the ‘demise of the rule of law’.¹⁵⁰

Interlaced with these fears for the viability of monetary rules is another thread, one which traces discomfort with the discretion at the disposal of the authorities. In accounts of the euro crisis, such discretion emerges when ‘[l]awyers-practitioners and academics’ support political actors ‘by

¹⁴⁴ T. A. Canova, ‘Financial Market Failure as a Crisis in the Rule of Law: From Market Fundamentalism to a New Keynesian Regulatory Model’ (2009) 3 *Harvard Law & Policy Review* 369, 392. See also Gary Lawson, ‘Burying the Constitution Under a TARP’ (2009) 33 *Harvard Journal of Law & Public Policy* 55.

¹⁴⁵ Chad Emerson, ‘The Illegal Actions of the Federal Reserve: An Analysis of How the Nation’s Central Bank Has Acted Outside the Law in Responding to the Current Financial Crisis’ (2010) 1(1) *William & Mary Business Law Review* 109, 128.

¹⁴⁶ A. Mehra, ‘Legal Authority in Unusual and Exigent Circumstances: The Federal Reserve and the Financial Crisis’ (2010) 13(1) *University of Pennsylvania Journal of Business Law* 221, 243.

¹⁴⁷ M. Everson, ‘The Fault of (European) Law in (Political and Social) Economic Crisis’ (2013) 24 *Law and Critique* 107, 124.

¹⁴⁸ J. Tomkin, ‘Contradiction, Circumvention and Conceptual Gymnastics: The Impact of the Adoption of the ESM Treaty on the State of European Democracy’ (2013) 14 *German Law Journal* 169, 174.

¹⁴⁹ C. Joerges, ‘Europe’s Economic Constitution in Crisis and the Emergence of a New constitutional Constellation’ (2014) 15 *German Law Journal* 985, 996. See also M. Dawson and F. de Witte, ‘Constitutional Balance in the EU after the Euro-Crisis’ (2013) 75(5) *The Modern Law Review* 817; and J. White, ‘Authority after Emergency Rule’ (2015) 78(4) *The Modern Law Review* 585.

¹⁵⁰ Everson, n 147 above, 124.

taking the letter of the law so lightly as to run afoul of it'.¹⁵¹ It follows that 'law can no longer be understood as a body of rules';¹⁵² instead when 'interpreted flexibly'¹⁵³ only 'a thin veneer of legality on the political'¹⁵⁴ remains, exposing 'standards which are sufficiently vague to empower policymakers to act according to their understanding of what needs to be done'.¹⁵⁵ A new style of 'discretionary governance'¹⁵⁶ emerges; rule by 'political expediency'¹⁵⁷ becomes the norm 'almost irrespective of, and perhaps entirely unconstrained by, what the Treaties say'.¹⁵⁸ With the loss of 'a set of rules that constrain the actions of politically responsive decision-makers',¹⁵⁹ other losses follow, including the benefits of a rule-bound monetary order. Absent the prohibition on financial support, how will sovereigns and their banks learn to act with financial prudence and assume

¹⁵¹ Joerges, n 149 above, 999-1000.

¹⁵² *ibid*, 1014.

¹⁵³ N. Scicluna, 'Integration through the disintegration of law? The ECB and EU constitutionalism in the crisis' (2018) 25(12) *Journal of European Public Policy* 1874, 1883.

¹⁵⁴ Joerges, n 149 above, 1014, quoting D. Dyzenhaus, *The Constitution of Law: Legality in a Time of Emergency* (Cambridge: CUP, 2006) 103.

¹⁵⁵ Joerges, *ibid*, 1014.

¹⁵⁶ C. Joerges and C. Kreuder-Sonnen, 'European Studies and the European Crisis: Legal and Political Science between Critique and Complacency' (2017) 23(1-2) *European Law Journal* 118, 120.

¹⁵⁷ De Witte, n 136 above, 451.

¹⁵⁸ G. Beck, 'The legal reasoning of the court of justice and the euro crisis – the flexibility of the court's cumulative approach and the Pringle case' (2013) 20(4) *Maastricht Journal of European and Comparative Law* 635, 638.

¹⁵⁹ R. Bellamy and A. Weale, 'Political legitimacy and European monetary union: contracts, constitutionalism and the normative logic of two-level games' (2015) 22(2) *Journal of European Public Policy* 257, 259

responsibility for their own solvency?¹⁶⁰ And how will the monetary authorities guard against superficially attractive but ultimately short-sighted support for special interests?

These concerns also surface in scholarship on the US response to the 2008 crisis, where the problem of short-sighted support for special interests follows from ‘The tendency for regulatory officials to leave government posts for lucrative positions in the private financial industry’.¹⁶¹ When that happens, writes Timothy Canova, ‘Policy naturally comes to reflect the bargain of the moment between the most powerful private interests’.¹⁶² The ‘bargain of the moment’ during and after 2008 secured ‘A bailout for Wall Street before Main Street’, one made possible by the Fed stumbling ‘from one subsidy to another’.¹⁶³ Such ‘ad hococracy’¹⁶⁴ provoked even those sympathetic to the Fed. Paul Volcker, for instance, warned that the Fed might be viewed ‘as the rescuer or supporter of a particular section of the market, [which] is not strictly a monetary function in the way it’s been interpreted in the past’.¹⁶⁵

¹⁶⁰ R. Palmstorfer, ‘To bail out or not to bail out? The current framework of financial assistance for euro area Member States measured against the requirements of EU primacy law’ (2012) 37 *European Law Review* 771 and D. Wilsher, ‘Ready to Do Whatever it Takes? The Legal Mandate of the European Central Bank and the Economic Crisis’ (2013) 15 *Cambridge Yearbook of European Legal Studies* 503.

¹⁶¹ Canova, n 144 above, 384.

¹⁶² *ibid.*

¹⁶³ *ibid.*, 389, 391.

¹⁶⁴ Wallach, n 16 above, 43, 66.

¹⁶⁵ Quoted in Canova, n 144 above, 392.

We have encountered opposition to ‘discretionary governance’ and ‘ad hococracy’ before: recall Overstone’s dispute with Palmer, his objection to ‘fitful and capricious’ responses ‘under special circumstances’, his search for a rule ‘strict and judicious’. These patterns reveal a further thread, the traces of which start with the fate of the Act of 1844: although its rigidity was smoothed over by intermittent suspensions, it was not repealed.¹⁶⁶ Its on-going presence meant that the BoE could continue to refer merchants and bankers to the note issue limit imposed by the Act and maintain that this formal barrier prevented the BoE from offering them assistance.¹⁶⁷ As we have seen, for many, the alternative to assistance was bankruptcy. The response today in the US and Europe has moved in a broadly similar direction. Perhaps because of the way it was stretched by the Fed in 2008, section 1101 of the Dodd-Frank Act modifies section 13(3) of the FRA to prohibit the Fed from offering support to specific firms.¹⁶⁸ A specific non-bank institution can still receive public funds but only via the Orderly Liquidation Authority, and so only to assist with its winding up where the institution is already insolvent.¹⁶⁹ In Europe the ESM remains in place but, perhaps because it represents an innovation some see as outside of the spirit of Europe’s monetary order,

¹⁶⁶ On the political manoeuvrings behind the retention of the Act, see C. Molyneux, ‘Reform as Process: the parliamentary fate of the Bank Charter Act of 1844’ in M. J. Turner (ed.) *Reform and Reformers in Nineteenth Century Britain* (University of Sunderland Press, 2004) 63-80; and A. Cohen, ‘Cobden’s stance on the currency and the political forces behind the approval of the Bank Charter Act of 1844’ (1998) 5(2) *The European Journal of the History of Economic Thought* 250.

¹⁶⁷ Kennedy, n 54 above. See also P. Barrett Whale, ‘A Retrospective View of the Bank Charter Act of 1844’ in T. S. Ashton and R. S. Sayers (eds) *Papers in English Monetary History* (Oxford: Clarendon, 1953) 126, 128.

¹⁶⁸ See Posner, n 134 above; and M. Ricks, ‘Regulating Money Creation After the Crisis’ (2011) 1 *Harvard Business Law Review* 75, 130-31.

¹⁶⁹ Dodd-Frank Wall Street Reform and Consumer Protection Act 2010, Title II, s. 214.

the Bank Recovery and Resolution Directive¹⁷⁰ puts in place a number of preconditions that must be met before public funds—including access to the ESM—may be used to recapitalise a bank in financial difficulties.¹⁷¹ From 1847 to the present, from Europe to the US, the general pattern repeats: *ex ante* restrictive measures limit the use of public funds to ‘afford assistance’ to troubled financial firms and instead channel these firms towards some version of a bankruptcy-style regime.

As a number of commentators have argued, the obstacle facing special restructuring and liquidation regimes is their limited capacity to deal with economy-wide defaults and price collapses. They struggle to deal with such problems because bankruptcy-style regimes concentrate by design on specific financially troubled firms—many of which no doubt resemble Lord Overstone’s ‘noxious weeds’. But dealing with noxious weeds is not the same as responding to problems of a systemic nature.¹⁷² Indeed, it is plausible that bankruptcy-style regimes may even add to these problems. Where the bankruptcy-style regime imposes losses on creditors of a specific firm, creditors of other similarly situated firms—perceived to be or actually hovering on the line between solvency and insolvency—may decide to cut their losses by selling assets. Yet doing so

¹⁷⁰ Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms.

¹⁷¹ *ibid*, Article 37 (10) and Article 56. See E. Avgouleas and C. Goodhart, ‘Critical Reflections on Bank Bail-ins’ (2015) 1(1) *Journal of Financial Regulation* 3, 12-14 and C. Hadjiemmanuil, ‘Bank Resolution Financing in the Banking Union’ (2015) *LSE Working Papers* 6/2015.

¹⁷² S. L. Schwarcz, ‘Beyond Bankruptcy: Resolution as a Macroprudential Regulatory Tool’ (2018-19) 94(2) *Notre Dame Law Review* 709, 713-714. See also A. J. Levitin, ‘Bankruptcy’s Lorelei: The Dangerous Allure of Financial Institution Bankruptcy’ (2019) 97 *North Carolina Law Review* 243.

only adds to the general collapse in asset prices.¹⁷³ If that happens, and if more people are harmed by these *ex ante* constraints than rule-makers expect, the party applying the rule will be faced with the same dilemma which confronted the Chancellor of the Exchequer in 1847, namely, just how much harm, how much ‘blood on the tracks’,¹⁷⁴ will they tolerate before constraints are set-aside?

CONCLUSION

Formal barriers in the shape of *ex ante* restrictive measures are laudable for attempting to prevent the socialisation of losses. As we have seen, such regimes try to deter conduct harmful to the financial system from occurring by changing the behaviour of those who might otherwise make financially imprudent decisions. The hope is that financial institutions will act with greater self-discipline and prudence if they know that they cannot seek the support of the monetary authority. And yet the obvious problem with such restrictive measures is that of credibility: what is to stop the authorities from suspending, or finding a plausible legal means of circumventing, these *ex ante* restrictions? If financial institutions know that suspension or circumvention is likely, why change their behaviour? Perhaps, then, the 1840s indicate that changing behaviour depends on an absolute and unconditional commitment to strict enforcement, no exceptions under any circumstances.

¹⁷³ See Avgouleas and Goodhart, n 171 above.

¹⁷⁴ J. Crawford, ‘The Moral Hazard Paradox of Financial Safety Nets’ (2015) 25 *Cornell Journal of Law & Public Policy* 95, 132.

Such a commitment is, however, a highly risky strategy.¹⁷⁵ It assumes that, should financial crises continue to occur, decision-makers will tolerate whatever consequences follow, no matter how unjust or absurd.¹⁷⁶ But allowing losses to lie where they fall is difficult because a crisis involves contractual defaults and the collapse of asset prices both of which, as we saw in the 1840s, affect a broad range of individuals and communities. Consider again the choice confronting the employees of Joseph Pease, the coal-mine owner from Durham, between pawning their Sunday clothes and having enough to eat. Should Charles Wood have turned a blind eye to these consequences?

The ‘drama of governance, the trivial or murderous drama of breaking eggs to make omelettes’,¹⁷⁷ saw Charles Wood tolerate willingly these harsh consequences—and much worse for the people of Ireland—for much of 1847. It is perfectly possible that no matter how absurd or unjust or fatal the consequences, some rule-appliers may decide to stand by the rule. Currency school proponents welcomed the turning of the ‘Bank screw’ because they saw it as protecting the value of the currency. Andrew Mellon, the US Secretary to the Treasury from 1921-1932, famously preferred to ‘liquidate labor, liquidate stocks, liquidate the farmers, liquidate real estate’; Alan Greenspan, chair of the Federal Reserve from 1987-2006, favoured the viewpoint of the second observer when he remarked that ‘one observer might use the term “market failure” to describe what another would

¹⁷⁵ *ibid*, 132; and A. J. Levitin, ‘In Defense of Bailouts’ (2011) 99 *The Georgetown Law Journal* 435, 439.

¹⁷⁶ See Levitin, *ibid*, 439; Crawford, n 174 above, 132; and I. Anabtawi and S. L. Schwarcz, ‘Regulating *Ex Post*: How Law Can Address the Inevitability of Financial Failure’ (2013) 92 *Texas Law Review* 75, 93.

¹⁷⁷ D. Kennedy, ‘Legal Formalism’ in N. J. Smelser and P. B. Baltes (eds) *Encyclopedia of the Social & Behavioral Sciences* (Amsterdam: Elsevier, 2001) 8634, 8637.

deem to have been a market outcome that was natural and healthy, even if harsh'.¹⁷⁸ Yet harsh consequences are not inevitable. Since rules do not determine their own application, rule-appliers must choose to stand by the rule. As they face up to that choice, rule-appliers confront again the dilemma at the centre of the monetary order, that simultaneous desire for both sound money and expansive credit.

¹⁷⁸ Quoted in S. L. Schwarcz, 'Systemic Risk' (2008) 97 *The Georgetown Law Journal* 193, 196.