THE BANK OF ENGLAND, 1694-1797

THE EVOLUTION OF CENTRAL BANKING FUNCTIONS

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INTRODUCTION

The history of the Bank of England is regarded as an illustration of the evolution of the central banking principles and functions.\(^1\) The Bank of England was the first of the institutions now commonly known as central banks. The present position of the Bank was not authorised by any corporate act or resolution of Parliament\(^2\). Like the English Constitution, it has grown out of its past, and we cannot hope to understand its present, and still less to peer into its future, unless we know something of its past.

Started as a joint stock bank in 1694, the Bank of England acquired a special position in its relation to the Government from the outset of its career. In fact, it was brought into being for the express purpose of advancing money to the Government, in return for certain rights and privileges conferred by legislation. Besides acting as a banker to the Government, the Bank secured the privileges of note issue and the monopoly of joint stock banking three years after its foundation.

These privileges gave the Bank great prestige in the eyes of the public as well as the private bankers of England. With the accumulation of the legal privileges by a single bank, all other banks grouped themselves round it and realised the advantages of keeping their accounts with the Bank of England. The Bank, thus, assumed the position of central bank and has till recently retained its place as the premier central bank of the world.

The First Hundred Years: Significance

The present study confines itself mainly to the history of the Bank of England during the eighteenth century, or roughly its first hundred years. This was its formative period, marked by new ventures in an atmosphere of bad political outlook, deplorable financial condition and speculative fever. The Bank had to face long continued misfortunes and ‘romantic incidents and adventures’.

Also, this period demonstrates the soundness and usefulness of joint stock banking enterprises, the growth of the national debt, and

\(^1\) De Kock, M.H., Central Banking, pp. 2-5.

\(^2\) Bagehot, W., Lombard Street, p. 153.
the foundation of industrial capitalism. Towards the end of the century, the Bank had almost assumed the present position of national responsibilities as the ‘Old Lady of Threadneedle Street’. In 1791, as Lord North expressed before the Parliament defending the claims for the extension of the Bank Charter, ‘The Bank from a long habit and usage of many years was a part of the constitution’.

Goldsmiths and the Crown

A distinctive feature of the goldsmiths’ banking is their transactions with the Government. They advanced loans to Government in anticipation of supplies. With their aid the national finances were managed with little difficulty till the outbreak of the Dutch War. The War caused a ‘run’ on the bankers, and the King was compelled to order suspension of payments from the Exchequer.

The goldsmiths when they failed to receive payments from the Exchequer were compelled to stop their payments to the City’s merchants. The public confidence in their stability and safety of deposits were weakened. The goldsmiths were also accused of debasing coinage, charging exorbitant rates of interest, yet offering inadequate security to the public. The dislike of the London goldsmiths’ banking and the financial needs of the government, as we shall see presently, led to the foundation of the Bank of England.

The Need for a National Bank

During the second half of the seventeenth century several attempts were made to establish a national bank on the model of continental banks. The merchants who were in touch with the banks of Amsterdam, Venice and Genoa, had realised the advantages of such banks to meet the growing needs of England’s industry and trade. A national bank, among other things, would help them to: 1. grant loans at cheap rate of interest to finance trade and industry, 2. to receive deposits, 3. to issue bank notes, and 4. to help the expansion of trade by discounting bills.

Besides these factors, there was a political factor. During the long period of struggle between the Stuart Kings and their Parliament, the Kings tried many devices to raise money: sale of monopolies, private borrowings, debasement of coinage etc., and when these measures were exhausted, Charles even seized the treasure deposited by the City merchants. ‘Like a drowning man clutching at straws’, Andrèadès describes, ‘Charles committed folly after folly, each one more fruitless than the last. But dishonour was all that he obtained’.

3 Dunbar, C.F., The Theory and History of Banking, pp. 138-140
During the reign of Charles II, many projects for national bank were proposed. One of them was even considered by a Committee of Parliament in 1658. But the general fear that such a bank would make the king despotic seems to have been the main reason for its failure.

After the Restoration, these difficulties of raising money by the king became more desperate than before. A Government created by a Revolution found it impossible to borrow money to wage a war with Louis XIV. William III was finally compelled to accept Paterson's plan for the establishment of the Bank of England.

**Paterson and His Scheme**

William Paterson was a London merchant of Scottish ancestry. He took active share in public affairs with the Whigs. By his close association with the London merchants, he started a proposal for the foundation of the Bank of England in 1691. His scheme failed; yet, as a great adventurer, he went on working for his scheme. Indefatigable Montague, having tried all methods to meet the financial needs of the expensive French Wars, then turned to Paterson's proposal.

According to the scheme, it was to raise £1,200,000 to be lent to the Government in return for a yearly interest of £90,000 and £4,000 towards the expenses of management. The subscribers to the loan were to form a corporation with the right to issue notes up to the value of its total capital. The corporation to be called "The Governor and Company of the Bank of England".

When the Government accepted Paterson's scheme, the plan of the new Bank was included in the Tonnage Act. The Tonnage Act granted the privilege of a bank for 12 years. It was allowed to deal in bullion and coin; to lend on security; and to discount bills of exchange, besides the privilege of note issue and exclusive possession of the government balances. But it was forbidden to trade in any merchandise.

The scheme was well received by the public, as judged by the enthusiastic subscription. On the opening day alone over £300,000 was subscribed, and within three days enough capital was raised to make it a corporation. The whole subscription was raised in ten days, and the Charter of Incorporation was granted on July 27, 1694.

The Bank of England differed from the Continental Banks in many respects. The banks of Amsterdam, Venice and of Genoa were not banks in the complete sense of the term. They were not authorised to make loans. The Bank of England, on the other hand, was more than a mere credit institution. It was a real repository of credit and issued notes on its credit. The Continental banks were merely banks of deposits.

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1 See Acres, op. cit., pp. 5-6.
2 Andrèdès, A., op. cit., pp. 74-82.
3 Gilbert, J.W., The History and Principles of Banking, p. 28.
4 Andrèdès, op. cit., pp. 75-83.
Central Banking Functions

The theory and technique of central banking is essentially a feature of the present century. The conception of central banking, in its relation to government and other banks, developed slowly through several centuries. The Bank of England, as we observed earlier, was the first to assume the position of a central bank. Besides acting as a banker to the government, the Bank acquired the present position and power over the London money market gradually as a result of a long train of causes.

A more systematic development of its functions as the custodian of cash reserves of the banks and the lender of last resort is a feature of the nineteenth century. Joint stock banking was legalised after 1826, and the system of note issue was placed on a definite principle by the Bank Charter Act of 1844. However, the early history of the Bank reveals the leading features of these functions. The minutes and accounts of the Bank are inadequate to trace the detailed account of these functions indicating the principal characteristics. Yet, it is possible to show that the Bank of England from its inception played the role of a responsible public institution.

The Bank and the Government

From the beginning, there was a close contact between the Bank and the Government. The privileges of the Bank are to be sought in political causes. The history of the Bank of England is therefore closely connected with the general financial activities of the State, such as the growth of the national debt, Exchequer bills and other financial operations of the Treasury.

Beginning with a loan of £200,000 in 1694, by the middle of the eighteenth century, the total national debt handled by the Bank of England stood at over £77,265,945 out of the total debt of £110,613,836. ‘By this time’, Clapham remarks, ‘the Bank had become, by habit, not by law, banker to the state and most of its departments’.

Exchequer bills were first introduced in 1696. In the beginning, the Bank’s official policy towards Exchequer bills was hesitant, and the Bank even demanded terms for assistance. Originally the Exchequer bill was designed as a sort of rival to its own bill. However, by the turn of the century the time was getting nearer ‘when the Bank would circulate the Exchequer bills for the Treasury, cash them on demand, accept them as deposits, make generous advances on their security and even pay a dividend in them’.

During the war years, the Treasury borrowed from the Bank to meet short-term requirements, while long-term requirements were met in the early years of the war, mainly by the sale of annuities. In 1707, a bill was passed, according to which the Bank was to circulate the

Exchequer bills and exchange them for ready money on demand. Until they were paid off, no others were created and so long as they remained unredeemed the Bank was to continue as a Corporation.

The Bank thus acquired an indefinite prolongation of its Charter. It became the principal agent for that business of the Exchequer bills which became the permanent part of the financial system of the country both in war and peace. This strengthened the Bank’s national position. After 1707, increasing needs of finance to the Government compelled the Bank to make additional loans to Government. The Act of 1709, authorised the Bank to enlarge the capital stock and to raise further supply. The conditions for the termination of the Charter thus became less and less likely of fulfilment.

Besides the Exchequer bills, the Bank had other obligations. It agreed to receive subscriptions for the lottery loans. The new loans after the Hanoverian succession were largely managed by the Bank. The subscriptions were paid to the Bank and the Bank was required to keep appropriate accounts in return for an annual grant. Thus the relationship between the Bank and the Government had been completely regularised. The Bank’s records revealed the accounts maintained by the Army, the Navy, Excise and Customs Departments, etc. When Lord North renewed the Charter in 1781, he found that the Bank ‘from a long habit and usage of many years, was a part of the Constitution. It did the Exchequer business much better than the Exchequer used to do it’.

Discounting and Lending to Institutions

From the beginning, lending by the Bank took the form of discounting of papers. It was a day to day activity to discount tallies for specified branches of public revenue, promissory notes, inland and foreign bills of exchange. The supervision was entrusted to a committee of Directors, known as the Committee in Waiting. In May, 1711, a set of rules for handling bills was approved by the Court. The rate of discounting was fixed at 6 per cent for those who kept their cash at the Bank. No client to have more than £30,000 of inland bills or notes running at one time. Furthermore, every bill or note delivered was to pass the Committee in Waiting; and various other matters of detail were left to the discretion of the Committee.

The records of the Bank, as Clapham found them, are not adequate to examine, in details, the extent of its business in the early years. The general ledgers do not give the details of bills, but give mainly the value of bills handled. The discounting business of the Bank, however, fluctuated considerably with the fluctuations of politics and commerce; less in war years and more in peace time. Before 1700, it is

1 Ibid., p. 59.  
2 Clapham, op. cit., p. 98.  
3 Ibid., p. 103.  
4 Clapham, op. cit., p. 128.
observed, there were not more than ten transactions a day. The
tallies and other government papers were of relatively great importance.

After 1700, the discount policy takes definite shape. Trade bills
and notes gradually took the lead relative to government tallies and
orders. The limit of specified credit to each customer was raised from
£10,000 in 1695 to £40,000 by 1711. During this period, the Bank
found discounting a profitable business and also a principal way by
which the Bank could put its notes into circulation¹. Yet, there was
no substantial increase till 1763. The rules of 1711 for dealing in bills
were modified in detail in 1763, and foreign and inland bills kept close
together.

Besides discounting, the Bank's records reveal its transactions with
many corporations. It maintained accounts and allowed regular loans
and overdrafts to big trading companies such as the East India Co.,
South Sea Co., Hudson Bay Co., London Assurance Co., Royal Africa
Co., Russia Co., and also the Royal Bank of Scotland².

Regarding its relation with private bankers in early years are inade-
quate, and the Bank seems to have had limited loans and discount
transactions. The banking enterprise was in the form of private partner-
ships, and their number was also limited. According to Clapham's
estimate there were not more than 150 banks in 1776.

Note Issue

The Bank of England had secured the privilege of issuing notes.
When the Bank was established in 1694, it had no monopoly of note issue.
The original Charter merely allowed it to circulate notes up to the value
of its capital, which was lent to the Government. They were not legal
tender; on the other hand, they bore interest in order to help the Bank
to circulate easily. They were, therefore, analogous to Treasury bills
rather than to the present bank notes. The holder of these notes had no
guarantee of conversion, such as the existence of a metallic reserve
representing a fixed proportion of the issue. Consequently, their value
fluctuated considerably.

As Dunbar observes, the Bank Act of 1697, laid the foundation for
a true bank notes' circulation³. This Act gave the Bank the monopoly
of note issue and the issue of notes payable to bearer. But the Bank
was not permitted to issue notes of less than £20, consequently, limited its
general circulation. The Bank secured the privilege of issuing notes of
less than £20 in 1750, and notes of £5 in 1795. During the Napoleonic
Wars, Pitt had even allowed the Bank to issue notes of £1 for a limited
time.

The records of the Bank of England do not show the details regard-
ing the extent of circulation of notes in the early years. The circulation
was limited to London city; yet the volume of notes circulated seems to

be fairly large. From the records of notes lost, Clapham infers, the bank notes may have had relatively more extensive circulation than in the early decades of the eighteenth century. Unincorporated private bankers continued to issue notes till their privilege was taken away by the Peel’s Act of 1844. Yet, many private banks practically discontinued issues finding the cheque system more convenient in practice. Bagehot observes that the discontinuance was also due to the popularity of the notes issued by the Bank of England.

The privilege of note issue had caused bank ‘runs’ and the Bank suffered a good deal, especially during the crises of 1696 and 1797. The first, owing to confusion in the metallic currency and the second, paper currency. The Bank was forced to suspend its cash payments. At other times, there were ‘runs’ caused by political troubles or commercial crises resulting from insane speculation. The Bank was also partly to be blamed for not properly utilising its discretionary power in the matter of note issue. The Bank Charter Act of 1844, however, put an end to the discretionary power of the Bank and placed note issue on a legal basis.

Relation with the Mint

To trade in precious metals was a statutory right secured in 1694. But there was no law determining the relation between the Bank and the Mint. The history of how these authorised dealings in gold and silver and the Bank’s relation with the Mint developed is obscure like the evolution of other functions.

From the beginning the Bank of England was engaged in buying and selling gold and silver. The country was virtually on the gold standard. Further, the Bank’s clients, the East India Co., for example, were engaged in exchanging gold and silver in the course of their trade. In 1700 the Bank offered to store any gold and silver for which the bills of lading were deposited with it. Gradually, it began to make advances against deposits of gold and silver, what was known as ‘specie loans’. It had a Committee of Directors, and also agents, to deal in these matters. As the Bank acquired precious metals, it began to transfer metal to Mint in exchange for coins. By 1720 the Bank had become the chief furnisher of the Mint with gold and the public with guineas.

During the second half of the century, London was transformed into a chief metal market of Europe displacing Amsterdam. Considerable accumulation of precious metals by the Bank formed a sound ratio of treasure to liabilities. In 1752, according to Clapham, the gold reserve amounted to nearly 50 per cent of the value of notes in circulation and the amount payable on demand. ‘Without professing any doctrine of a ratio’, remarks Clapham, ‘it is evident that the Bank Court of the eighteenth century did not neglect the practice’. Even in war years, it did not fall below 25 per cent of the total liabilities.

2 Dunbar, op. cit., p. 145.  
3 Lombard Street, p. 96.  
The Bank and the Crises

In the early years, the Bank of England had to face many discomforts caused by rivalry, depression, panic or friction between England and Scotland. The Bank's activities were speculative; it over-lent or over-issued, and as a result of her indiscretion and recoinage, the Bank was led to, what Clapham calls, 'reckless infantile staggerings'. Added to it, a scare of French invasion or a Jacobite landing gave occasion to the Bank's domestic enemies to create organised 'runs'.

Perhaps the most unwise act on the part of the Bank of England was its bidding with the South Sea Co., fighting for position. When the South Sea Co. offered its romantic project in 1720 to take over the entire national debt of over thirty million pounds at 5 per cent, the Bank in turn started a desperate struggle. In a wave of veritable madness, the Bank offered an insane and impracticable proposal. Luckily for the Bank, the proposal was not accepted by the Parliament.

After the crisis, the South Sea Co., was compelled to apply for loans to the Bank. Induced by Walpole, the Directors are said to have undertaken to circulate £3,500,000 of the Company's bonds. But subsequently they appear to have refused to execute it; the Bank thus had to break its word just to save its ruin. According to Andrèadès, it was unworthy of a great establishment.

The Bank of England of the mid- and later eighteenth century was an institution devoted to a great cause. The increased inflow of gold after 1750 resulted in improved cash position and helped her to increase her notes. The Bank thus stood as a rock of refuge around which the waves of speculation might break.

Conclusion

It is clear from our study that the Bank of England was started with the main object of raising money for the use of the Government. The Bank supplied the financial needs however great and embarrassing for the Bank, and as many historians have rightly emphasised, the Bank saved the nation from its ruin.

Besides acting as a banker to the Government, the Bank undertook during this period other responsibilities as a public institution, such as note issue, depository of reserves, discounting and 'lender of last resort'. In short, the Bank emerged by the end of the century with the leadership as the central institution of the British financial structure. In 1783, for example, the promoters of the Bank of Ireland requested the Bank of England for advice about the laws and conduct of business.

This period is thus the most fruitful period in the history of the Bank of England, and during this period the Bank was transformed to its present role of leadership. This transformation, however, was not a simple process; on the other hand, it was a long continued story of misfortunes, marked by 'romantic incidents and dramatic adventures' of her youth before she became the 'Old Lady of Threadneedle Street'. This story with varied activities, provides facts of great value for our understanding of the growing future of the National Banks.