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John Law's Theory of Money and its roots in Scottish culture

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ABSTRACT

This paper seeks to place the well-known lineaments of Law's System in France within the context not only of his earlier writings on the Scottish economy but also in the dimension of his lived experience as a 17th-century Scot, the son of a goldsmith-banker, and a man acutely conscious both of the history of his country's unstable monetary policy, and also of the final crisis into which it was lurching in his own day.

John Law (1671–1729) has long been viewed as a cross between a speculator and a scoundrel. In recent years his reputation has been substantially restored by a number of studies, culminating in Antoin Murphy's *John Law* (1997), which in its opening pages draws attention to perhaps the chief reason for the rising stock of its subject, namely the suspension of the Bretton Woods agreements and the abolition of the $35/oz fixed gold price in 1971. The subsequent flotation of exchange rates, final detachment of the gold price from its residual role as a currency guarantor, rapid expansion in capital flows and massive growth in the use of financial instruments to control institutional exposure to these deregulated markets, are lineaments of a brave new financial world which Law would recognize, and which in its turn has begun to recognize him. As Murphy states:

> Law believed in an economy functioning with banknotes and credit where specie had no role to play. . .While born in Edinburgh in 1671, his spiritual age of birth was really three hundred years later in the year 1971 (Murphy 1997, vii, 1)

Law's views on exchange rates and the importance of interest rates as an economic tool would today be fiscal orthodoxy; his views on the securitization of annuities would be familiar, if not always pleasantly so, to the many millions who have come to realize just how heavily their pension provision is secured on the health of the stock market. As Robert Minton (1975, 274) put it, 'Wall Street is but the rue Quincampoix institutionalized and better regulated'.

It is understandable that Law's ideas were controversial in his own time, but less comprehensible that he was so long viewed as a charlatan. In part this is because of the financial crash associated with the collapse of his System; in part because, alone of all the major economists, he used his ideas to enrich himself, to the tune at the height of his success of $1 billion in modern money. Most of all, however, the hostility he has experienced may be due to the imaginative history of gold as a symbol of desire and stability, with its concomitant role in an illusory quest for a tangible and final store of value. Many even now fervently support gold's traditional role. As Philip

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Coggan reflects in the Financial Times of 13/14 September 2003 , the conditions which give place to a rising bullion price can be those of belief, not objectivity:

> I have always been rather cynical about the case for gold, which sometimes has a quasi-religious tone. Much of this fervour derives from gold's traditional role as the basis for monetary systems, a role that was abandoned altogether in the 1970s. . .On the surface, it might sound preferable for monetary policy to be anchored by a real asset such as gold, rather than dependent on the fallible judgement of politicians and central bankers. Nevertheless, it is not clear why the growth rate of the global economy should rely on the ability of gold miners to find new deposits.[1]

The last part of this comment is, as we shall see below, core to understanding the cultural context of Law as a Scottish economist: the repeated historic crisis in both access to bullion and the ability to retain it which characterized the Scottish state into which three great economists were born in Law's lifetime, played, as this paper will argue, a crucial role in developing the values espoused by its subject. The arguments here will be different from those espoused by Richard Gray in his recent article on 'Economic Romanticism', but they will likewise argue for an understanding of economic theory and outlook on national grounds (Gray 2003).

The chief purpose of the present essay is thus not to remark on Law's contemporaneity, but rather to place his ideas in the cultural context of the society into which he was born, and in doing so to follow Donald Withrington's precept on the Scottish Enlightenment that, 'It is the close relationship of intellectual and social development which, in Scotland, largely accounts for its distinctiveness' (Withrington 1987, 16), a view which in its turn rests on the earlier suggestions of William Ferguson in his 1968 *History of Scotland, 1689 to the Present*. Law's theories have frequently been compared to those of other 17th- and 18th-century economists; what has not been done is to identify the Scottish dimension of Law's ideas and experience in depth. The Scotland of Law's youth was an independent state with a separate currency system more than 500 years old, and a distinct monetary policy of more than half that age: Italian bankers were used by and in Scotland by the late 13th century (Checkland 1975, 725, 727). The Scotland of his manhood saw the foundation of a bank to rival the Bank of England and of a great entrepreneurial trading company, the Company of Scotland, whose collapse demonstrated Scotland's inability to compete independently in imperial markets: the Union of 1707 was the consequence of the country's failure to weather these financial crises, which were moreover combined with an agricultural collapse in the 1690s. The Scotland of a generation after Law's death was to transform itself from a limited economy (whose lack of capital dismayed Law), to a significant centre of economic activity, which already possessed a hugely innovative banking system, which by the end of the 19th century would have pioneered everything from overdrafts to bancassurance style associations with loan companies to savings vehicles for the private investor:

> In the formative period of modern banking, before 1850, the Scottish system was a good deal more important than its absolute size would suggest, for it was more advanced relative to its economy than the English, or indeed any other. . .Scotland for several generations between the 1740's and the 1850's held a unique place in world banking development. The Scots pioneered in many areas, including banking on the limited liability principle, the early adoption of and extension of the note issue to the point at which gold and silver virtually disappeared, the elaboration of an agency/branch system, the invention of the cash credit (later to become the overdraft), the vigorous development of deposit-gathering reinforced by the

> payment of interest, the early adoption of joint-stock banking, experiments in exchange stabilisation (made between Edinburgh and London). . .It was a Scottish bank that led the way into the acquisition of hire-purchase companies and so to other subsidiaries. . .Scotland also began the Savings Bank movement and the investment trust; it formed the first Institute of Bankers; it exported trained young bankers all over the world, many of them rising to top positions and extending Scottish usages (Checkland 1975, xvii).

How did all this happen in a country which also produced three of the most significant figures of early economics, Law, Sir James Steuart (1713–80) and of course Adam Smith himself (1723–90)? Two of the above ideas (note issuance and exchange stabilization) were in accordance with Law's views: as we shall see, exchange stabilization had a much longer history in the Scottish polity before 1707. As with the Scottish Enlightenment, the tendency in economic history (itself in any case tending to be more wedded to Whiggish teleology because of the objectively measurable nature of economic development), has long been to seek explanations for Scottish over-achievement in the 18th century in terms of the effects of the Union in promoting a greater civility and modernity in Scottish society. As Donald Withrington ironically observes, 'why did dismal Scotland, of all countries in Europe, produce an Enlightenment' – or a financial revolutionary like Law, come to that.[2] In the pages that follow, I intend to set out the case for a different position, one which takes greater cognizance of the history of Scottish society before 1707 in providing lines of intellectual enquiry for Law and a field for the operation of the ideas resulting from them. To do this, we must begin with the monetary position of medieval Scotland.

Scotland's coinage was international as early as the Viking period: European and Middle Eastern coins both appear in surviving hoards of this time (Metcalfe 1977; Bateson 1997, 27). In the early centuries of the Scottish kingdom, there was no independent coinage, and this did not change until the 12th century: Anglo-Saxon England, by contrast, had its own silver coin from an early date, when Offa of Mercia (r 757–96) and other kings produced pennies like those of the deniers of Pepin and Charlemagne, and (in Offa's case) a copy of the gold dinar of Caliph Al Mansur (Spink's 2003, 98–101).

In 1136, David I (r 1124–53) captured the Norman mint at Carlisle together with local silver mines, and minting began of a Scottish coinage in his name and in that of his son, Prince Henry, Earl of Northumberland and Huntingdon (Seaby 1984, 1–3). David was careful to adopt policies which conserved the coinage, largely limiting the access of foreign merchants to the 'seven principal nodes of the commercial network' (Carlisle, Edinburgh, Berwick, Roxburgh, Perth, Hamer [East Lothian] and Corbridge) where silver was minted (it was also minted at Newcastle, St Andrews and Aberdeen), and where they could receive it in exchange for goods and services thus provided, 'through a carefully regulated regional trade network'. At the ports, 'local burgesses had first option of buying wares from the ships which could land only at these places approved by the crown'. Moreover, 'such produce as escaped these pre-emptive practices and was carried up-country by the aliens was further disadvantaged in being subject to the king's internal tolls, from which denizens of the royal burghs engaged in inter-regional trade were exempt' (Blanchard et al 2002, 129, 131).

These protectionist measures acted as a control on the circulation of Scotland's limited supply of bullion, which in any case dwindled when Henry II (r 1154–89) regained Carlisle from David's successor, Mael Coluim IV (r 1153–65). What is clear in successive reigns is that the Scottish silver coinage only forms a small proportion of the coin circulating in Scotland: only some three per cent of the Aberdeen hoards found in the 1980s consist of

the coin of the contemporary Scottish monarch, Alexander III, and 'as much as 95%' of surviving hoards before the end of the 14th century is English coin. The circulation of English coin was doubtless promoted by the fact that it and the Scottish coinage traded at par. Scottish coin indeed forms almost as large a proportion of early English hoards as it does in its country of origin (Metcalf 1977, 4; Bateson 1997, 52). At this stage there was 'homogeneity' in the currency in circulation in Great Britain, almost a 'Sterling Area', with Anglo-Irish coin also beginning to appear (Mayhew 1977, 90–1; Metcalf 1977, 13).

When this began to change in 1356, it was almost as the last act in the War of Independence: Edward III (r 1327–77), recently forced to accept the defeat of his protégé Edward Baliol, began to ban David II's (r 1329–71) coin in England. Although the ban was lifted in 1358, the relationship between the two currencies began to diverge: as it did so, Scotland's relative wealth, estimated at 31/40 of England's under Alexander III (Metcalf 1977, 6; Mayhew 1977, 95), began to decline: David II's tax receipts were only half those of his predecessor (Nicholson 1977, 103). In 1367, David (who also issued Scotland's first gold coin (Seaby 2003, 15)), reduced the value of the groat (4d) to 3d sterling, and also reserved '2% of the face value of the whole issue' of the coinage 'to the King as seignorage'. Reducing the silver content of the coinage and the amount of silver in circulation was a classic means of raising royal revenue and (particularly useful in Scotland's case), withdrawing bullion from circulation. It was resorted to repeatedly in the reigns that followed (Bateson 1997, 58). A second devaluation in 1373 meant that from the next year, there was a formal exchange rate of £1.2 scots to the £ sterling (Metcalf 1977, 6; Nicholson 1977, 103), and in 1393, a further devaluation under Robert III (r 1390–1406):

> brought about abandonment by the government of the fiction that Scottish coins were equivalent to sterling, and the term 'usual money of Scotland' replaced sterling in royal documents (Bateson 1997, 71).

By the 1380s, English coin begins to disappear from surviving hoards, though it returns to around the 50 per cent mark during the next century. Exchange rate divergence between England and Scotland was now a fact of economic life, but such divergence was also an established economic fact in the case of the many other currencies circulating in Scotland, as an Act of Parliament of 1385 establishing rates for English, French and Flemish gold in the realm makes clear (Metcalf 1977, 15; Bateson 1997, 75). In addition, foreign coin could be used in the settlement of debts in Scots currency, as at Edinburgh in 1508.[3] Foreign silver may have been recoined to boost supply, but its very presence in such force clearly separated Scotland from its southern neighbour, for the circulation of foreign coinage is quite anomalous in medieval England, and indeed was widely discouraged by strong governments everywhere throughout medieval Europe. Normally any that entered the country by trade were required to be exchanged (Metcalf 1977, 4, 9). In contrast, some early coin hoards in Scotland are totally dominated by foreign coin: for example those of Kirkcudbright, Galston, Cleuchhead and Fyvie from c 1300. The demonetization of foreign coin in England may have led to its migration north. A 14th-century Perth hoard is dominated by Flanders coin; a Dunblane hoard from the 1520s or 30s is almost half Burgundian (Metcalf 1977, 27–8, 50, 54, 89). Foreign gold was also brought in by French nobles and Stewart brides, thus further affecting the supply and variety of money. Scotland's economic transactions were often in the control of foreign agents (Checkland 1975, 738); Scotland's economic strength was inadequate to rid itself of such money and impose its own currency, even if it had wanted to: in fact, an attempt of 1467 to 'attract foreign specie' by favourable exchange rates indicates economic weakness,

an impression intensified by the fact that the deteriorating Scottish currency (down by one-third against sterling in the generation after 1450) led to inflationary pressures which defeated the project (Mayhew 1977, 89; Nicholson 1977, 109, 110). By 1483, the English pound was worth £5 scots, by 1594 £10: although its value fluctuated, the general trend over time was down (Gilbert 1977, 139). A low output of silver and gold in the 15th century helped to compound the problem. In England, bullion was acquired by 'raising the mint price of gold and silver, forcing coin back to the mint by banning its circulation, and contracting with special suppliers'. Scotland's economy was more vulnerable to bullion export, and had much less coin to recall. Base silver alloy began to appear in Scottish coins from the reign of James II (1437–60); by 1533, James V's (r 1513–42) billon placks were only one sixth silver, yet even so, the extensive hoarding of billon which took place is indicative of the desperate need for silver felt in Scotland (Metcalf 1977, 16).

The focus of Scottish government monetary policy in the later Middle Ages and early modern period was trained on the preservation and acquisition of bullion: export of bullion or specie was first put under restraint in 1357, and five further attempts to do this followed in the 15th and ten in the 16th century (Checkland 1975, 727); the 17th century saw further attempts, despite the stabilization of exchange rates at the Union of the Crowns. How did such restraints operate? First, bullion export could be discouraged by tariffs: James I put a tax of 40d in the £ on gold and silver export in 1424, but even this was insufficient, and a succeeding Act of 1436 forbade export and put merchants under an obligation to bring 85g of silver bullion into Scotland 'for each exported sack of wool'. This and subsequent attempts to prevent export failed however. Scotland's over-provision of religious houses was possibly another source of problems for its currency, leading to an outflow of bullion to the Papacy. The Reformation, however, solved little in this as in other respects: further export regulations were attempted. In the 1560s, merchants were only permitted to export 26,000 stone of lead in return for 'the equivalent of 1300oz of fine silver'. Recall and recoinage were practised under James VI (r 1567–1625), but the government only achieved a profit from this (£46,000 scots by 1579) by significant debasement, which had a major impact on exchange rates. The Scots pound fell from £6 to the £ sterling in 1564 to £10 in 1594. In 1597, 'all foreign coin was demonetized' for recoinage, and this may have contributed to a further slippage in the exchange rate, to 12:1 (Challers 1977, 178, 191–2; Nicholson 1977, 109, 110). Measures to restrict or forbid the export of bullion were common throughout Europe, as Adam Smith observes (Campbell et al 1976, vol I, 431): but in comparison with her nearest neighbour, Scotland's efforts in this direction wore the air of crisis management.

A single British monarchy and a fixed ratio of 12:1 in the scots/sterling exchange rate were introduced in 1603 and the years that followed: but although this might have been expected to lead to the introduction of a single British monetary system, in fact the evidence of coin hoards from the reign of Charles I suggests a 'truly European' currency, with many Spanish, Dutch, German and Austrian issues. A Scottish coinage continued alongside: some 8000 stone of Charles II copper turners (23,000,000 twopenny pieces) were minted by 1668, and a second coinage of 3000 stone in 1677 went into circulation, but there was also 'much French copper' among the coin of Scotland (Bateson 1997, 124, 142–4, 148). At the time of the Union of 1707, when the silver money of the country was 'brought into the Bank of Scotland to be recoined', there was £239,000 worth of Scottish coins (three-fifths of it old hammered rather than milled silver), £40,000 in English (possibly am underestimate of the coin in actual circulation, as Adam Smith claimed (Campbell et al 1976, vol I, 298) and £132,000 in foreign coin. Thus even as Scotland ceased to exist as a political entity, 30 per cent of her

circulating currency was non-British. For hundreds of years, there had been no single currency standard in Scotland: an experience which set the country apart, and which, it can be argued, underpinned the willingness of its 18th-century economical theorists and practitioners to develop a concept of currency in the abstract, whether through paper currency, securitization of assets or overdraft provision. Currency to the Scots was a negotiable asset, not a single series of coins based on bullion. Seventeenth-century developments were to make this distinction even clearer (Metcalf 1977, iv), and there is, as we shall see, a clear knowledge of Scotland's historic economic condition in Law's early work.

The nature of specie in Scotland was thus fundamentally unstable. The core currency changed its value in exchange many times, and in doing so tended steadily to devalue against sterling. Devaluation was the European norm, particularly in the medieval period (Gibson & Smout 1995, 5); but although England's currency was unusual in that its devaluations were more gradual or more temporary than this norm, it was also a currency which was disproportionately important in Scottish affairs due to the size and proximity of the English economy, which strengthened markedly in relative terms against Scotland's in the late Middle Ages and early modern period. Moreover, Scottish specie was often outnumbered in circulation by non-Scottish coin, 'the currency was to a considerable degree made up of the coins of the states with which it traded' (Checkland 1975, 11). A devaluing currency circulating in its own country in competition with a variety of other currencies against which its rates of exchange vary over time can hardly appear to be a steady storehouse of economic stability. Early economic thinkers such as John Hales and Thomas Gresham were already drawing a connection between a debased currency, rising prices and bullion flight; and it was also being pointed out that the circulation of foreign currency internally tended to 'deprive the prince of coinage revenue' by reducing the scope for seignorage (Monroe 1966, 55, 66, 99), thus feeding the need to debase the domestic currency to restore the loss. Scotland's monetary policy was trapped in a self-reinforcing cycle of decline.

Unsurprisingly, balance of payments problems were endemic: a limited range of home products, often with declining markets by the late medieval and early modern period, led to an expansion in trade sucking in imports, with consequent loss of bullion to pay for them. By the 1660s, the growing use of bills of exchange outwith Scotland rendered as payable at Edinburgh were discounted against the exchange rate, since Scotland's lack of coin in effect rendered the payment of 'uncertain value', not least since some of it might have to be paid in non-Scottish coin, presenting additional exchange rate risk. In 1681, there was a further balance of payments crisis, and London bills fetched a premium of up to 15 per cent at Edinburgh. It was all too clear that Scotland was 'under the restraint of an inadequate monetary and credit system', and emergency attempts by the Privy Council to ban the import of luxuries and fix the value of the coinage failed. Faced with such uncompetitive exchange rate costs, merchants 'or their agents went about gathering coin, plate and bullion' to an extent where the country was 'almost stripped of its monetary basis'. Credit shrank as its costs rose, and the merchants' understandable determination to export bullion to meet their liabilities and in the process save prohibitive transaction costs, contributed to a vicious spiral of decline (Checkland 1975, 11–12).

Credit arrangements were strongly emplaced in burgh trading, and any crisis in them was extremely damaging. A British economy was impacting on Scotland, especially when English wars with the Netherlands and France disrupted historic trading patterns. Domestically, the situation was considerably better: within Scotland even in the late 1690s, the premium for Glasgow, Dundee or Aberdeen bills at Edinburgh did not exceed 0.33 per

cent, thus demonstrating much lower premia for internal credit (Checkland 1975, 32; Des-Brisay et al 2002, 51).

Moreover, the value of Scottish specie itself deteriorated further. In 1682, a Mint Commission set up to investigate possible abuses reported excessive issuance of copper coin and the issuance of coin of 'low weight' and 'poor fineness' together with internal corruption, in total amounting to the embezzlement of almost £700,000 scots (c £6m at 2003 prices). The mint was closed, in what was obviously a severe blow to remaining confidence in the currency. In 1686, James VII's new coinage exchanged at 13:1 with the English pound, the first devaluation since 1603 (Bateson 1997, 148–50), and although the situation improved, by 1699 there was a premium even for specie at London of 8–9 per cent, thus driving the exchange rate back down to 13:1 again (Checkland 1975, 35–7). The Union of 1707 restored the 1603 standard.

That Union itself was to a significant extent a response to Scotland's worsening economic position (Gibson & Smout 1995, 162, 275). The last Scottish gold coinage, the Pistole (£12 scots) and Half-Pistole (£6 scots) of 1701, 'were struck from gold dust imported by the Darien company' from Africa (Seaby 2003, 87). They thus rather piquantly summed up a longstanding problem of Scottish monetary policy (the lack of domestic bullion) and the last attempt to make Scotland an international economic power, the Darien Scheme.

The 1690s had seen the development of joint stock companies in Scotland, the Bank of Scotland (1695) and the Darien Company of the same year. All these measures were attempts variously to raise capital and to protect bullion reserves in order to avoid a run on the instruments and notes which expanded capital. The Bank of Scotland, 'got its notes into circulation by making payments on them to its borrowers. In this way it could levy an interest-free loan on the economy of Scotland and lend the proceeds to selected people at 4 to 6 per cent'. This procedure would be effective only if the Bank had adequate bullion reserves. By 1704, the Bank was providing notes for use even in 'smaller transactions'; Darien, which in its early stages threatened the Bank's stability, attempted to raise capital in London: its failure to do so due to political obstruction brought about a crisis in the availability of capital in Scotland. Despite the poignant pistoles of 1701, the time seemed ripe for what was to be Law's key idea, that 'of freeing monetary policy from the need to conform to the imperative of the gold standard' (Checkland 1975, 16, 17, 31, 38, 607).

Law's family were well aware of the importance of bullion and the effects of its scarcity, for they were goldsmiths. Following Charles I's seizure of mercantile bullion reserves in London in 1640, merchants began increasingly to place their bullion on deposit with goldsmiths, who 'issued deposit receipts' which began to circulate as notes. Although this process was slower to develop in Scotland, it was still the case that 'a large part of Scotland's supply of the precious metals passed through the hands of the goldsmiths', who sometimes failed to maintain its fineness. Law was thus aware from youth of the scarcity of bullion and its effects in both public policy and private practice. This practice itself was undergoing a process of change. By 1660, the goldsmiths of Edinburgh were making loans and dealing in foreign exchange from their booths round St Giles, and were commonly issuing bills of exchange. Borrowers and lenders 'entered into private contracts, drawn in the form of bonds', which were often secured on land ('heritable bonds'); parish assets were also lent out at 4–6 per cent. This was later the Bank of Scotland lending rate; and the Bank also lent on land security (Checkland 1975, 6–8, 13, 30). This securitization of immobile or geographically delineated assets was later to emerge as one of Law's key ideas. Goldsmiths also participated in arbitrage and futures business within Scotland, whereby drovers paid a low price for cattle in the Highlands using their notes (where they circulated 'as a type of medium of

exchange'), and sold for a higher price at the Border, both covering their debts and any interest due to the goldsmith (Murphy 1997, 15), who could thus presumably issue his notes for a higher value at Edinburgh than that at which they could be subsequently exchanged at Crieff.

Law's family was thus at the heart of the capital's financial markets. Two members of the family ran goldsmith shops in Parliament Close, and were prominent in Edinburgh society; three of Law's brothers later became goldsmiths. His father, William, was 'called in to assist a Royal Commission. . .to inquire about a mint' in 1674, was Deacon of Goldsmiths in 1675–6, was re-elected for a further year, and in June 1677 became Assessor to the General Convention of Burghs; in 1681, he was elected Deacon again, but immediately resigned office; in 1683, he died, his estate being valued at £55,000 scots (Minton 1975, 37). Law's uncle, John, was Council Assessor in 1680 (when the business included imposts on imported wine) and a burgh auditor in 1683; on 29 October 1688 he was elected Deacon but also declined office. Whatever his father and uncle's reasons for declining office were at these times, Law's own shadowy politics clearly inclined towards Jacobitism, as will be demonstrated below.[4]

As the government and economy of Scotland lurched into further crisis, the young John Law produced his 1704 MS *Essay on a Land Bank* (finally edited by Antoin Murphy in 1994) and perhaps the first occurrence of supply and demand analysis in economic literature, although land bank plans had been circulating in England for about a decade (Murphy 1975, 18, 43–4). The *Essay* tackled the issue of expanding the money supply in Scotland by securing the currency on land, and thus increasing economic activity, for the Bank of Scotland's shortage of reserves restricted its lending capability: this was even more marked after the failure of Darien 'drained specie out of Scotland and reduced the potential reserve base of the Bank': Law was to argue that this 'severely limited' the potential for 'expansion of the money supply'. Money based on land was capable of greater 'elasticity of supply' (Murphy 1975, 66, 72, 82) and pledged land had a more certain value than the multitude of coin of uncertain fineness which formed the basis for the daily currency of Scotland: Law also argued that the English monetary standard for gold and silver should be adopted, probably in response to the instability of Scottish currency. As he diplomatically noted, 'the power the Prince has to alter the money in its denomination or fineness makes silver money uncertain in its quality', though his examples of devaluation 'in countries where the money is often changed in the denomination or fineness' are, patriotically, English ones (Murphy 1994, 58–9). In the *Essay*, Law went as far as to suggest the replacement of silver by a land-backed currency, whereas in *Money and Trade Consider'd* (1705), Law rather stressed the role of land banking 'as a method of increasing the money supply' (Murphy 1975, 51–60, 77). *Money and Trade* was written against the background of Law's concern with unemployment and underutilization of resources in Scotland. In the Scottish environment Law envisaged an increase in the money supply as having output and employment effects rather than a price effect (Murphy 1975, 63). Law saw a potentially large expansion in the money supply occurring, as a result of land bank reform, which could benefit the English as well as the Scottish economy: although Scotland was bereft of bullion reserves, Law criticized the Bank of England for only having 20–25 per cent of banknote issuance backed by silver reserves, meaning that it could be broken by a determined run. The land bank, in contrast, would always carry land equal to the value of issuance, plus a £1m sterling reserve. The English financial system was also heavily indebted to its bondholders, and one of the interesting economic features of the period was the manner in which Jacobite scares depressed the markets and had the ability to create a run on the Bank, for fear the

restored Stuarts might repudiate the National Debt and thus destroy the bond market, on which in turn both government credit and the credit of stocks depended. Famously in 1745, the Bank of England issued instructions only to pay its creditors in sixpences in order to reduce the capital value of silver loss, and to deter the prospect of a destructive run where large numbers of notes were presented for redemption. Law's critique was almost justified by events (Murphy 1975, 66).

Law recognized Scotland's divergence as an economy, in that the supply of silver, increased in Europe by the booty arising from Spanish military triumphs in the Americas, continued to be poor in his home country. He was also a confirmed proponent of low interest rates in order to encourage growth. Lending money at interest had been illegal in England until 1571 and Scotland until 1587: subsequently, the 17th century had seen a fall in the maximum interest rate from 10 to 6 per cent. England and Scotland, however, marched roughly in step on this, whereas Law saw lower rates as a means of feeding differential growth: the Bank of Scotland had already adopted an interest rate which undercut the Bank of England's. Law's proposal in *Money and Trade* was discussed by the Scottish Parliament, but rejected in 1705. Its author's career in Scotland (he had already fled from England to avoid being hanged for killing his adversary in a duel) was at an end (Murphy 1975, 20–34). Despite this, the country he left was still seeking an economic nostrum: and state-backed paper and 'the establishment of some kind of official body to sponsor economic development' were both high on the agenda and chimed with Law's ideas. In his support for these measures he was more radical than William Paterson at the Bank of England, because Law favoured forcing paper money into circulation to break the hold of specie and inflate the economy: somewhat as the 'Barber Boom' succeeded the flotation of sterling in 1971. Indeed, the modern power of monetary authorities has been well identified as 'nearer to the thinking of John Law. . .than to that of. . .Adam Smith' (Checkland 1975, 42–4, 621).

Moreover, *Money and Trade's* text clearly indicates Law's understanding of not only international economic possibilities, but also the domestic background of his own country. He claims that his proposals are preferable 'tho' Silver were the Product of Scotland' (indicating of course his ironic realization that it is not, and that is part of the problem), and discusses the dilution of silver fineness in Scotland and its depreciating currency since the 15th century, before proposing that a land bank, since the 'Quantity and Quality of the Lands' of Scotland bear a ratio of 1:6 to English wealth, would expand Scotland's national product ratio, then below a tenth of England's. Law also notes that the Scottish people are 'starving or forc'd abroad' from lack of money, and that national poverty may leave Scotland 'expos'd to its Enemies' (unspecified): and this two years before a Union driven largely by economic problems. Law also claims chauvinistically that 'it were to be wish'd England were as capable of it [this reform] as we are'. Law's proposal is explicitly patriotic (Law 1720, 50–1, 53–6, 69ff, 85, 95–6). Given his politics this was no wonder.

Law's Scotland neither adopted his System nor stayed independent. The evidence is that he would have wished it to do both, given his support for the exiled Stuart dynasty, and their opposition to the Union. As early as 1695 Law had visited the exiled James VII at Saint-Germain, and he visited his successor, James VIII, there in 1708, the year in which the young king launched what was to prove an abortive Rising intended to restore him as King of Scots and end the Union (Gibson 1988; Minton 1975, 20).[5] In France in 1718, Law was instrumental in advancing James VII's widow, Mary of Modena, 100,000 livres, corresponded with James, and the next year 'took time to arrange the transfer of the payment of Maria Clementina Sobieska's dowry. . . to James [VIII]', while all the while showing

generosity to Jacobite exiles in Paris. His financial success was recognized by Jacobite poetry, and plotted with Ormond and Strafford to enlist the Regent to the Stuart cause, while reserving £20,000 in Mississippi stock for the latter.[6] It was Viscount Stair's opinion that Law's 'daily discourse' was to 'raise France to a greater height than ever she was, upon the ruin of England and Holland', and whether this was true or not, Law had publicly to deny Jacobite links in December 1720 (Murphy 1975, 201, 310), the year in which Lord Forbes of Pitsligo (1678–1762) met him in Paris for the purposes of Jacobite intrigue.[7] Law's policies and role in France were consistent with his support for Jacobite politics, which he shared with that other afficionado of state pump-priming rather than Smithian free markets, Sir James Steuart. Law's brother William, who joined him in France, had a son who became a French general and governor of Pondicherry; his grandson was one of Napoleon's marshals and Marquis de Lauriston (Minton 1975, 271). It was the path of the Auld Alliance and French naturalization that the Law family followed, not the new way of British identity and empire. That way helped to silence his influence, as it helped to silence Sir James Steuart's, for both figures were ambivalent in a British context: one a Jacobite plotter, the other a Jacobite officer in the field: both Scottish patriots. In *The Wealth of Nations*, Adam Smith adopted Law's ideas (and examples) of value in use and value in exchange from *Money and Trade Considered*: but as with his debt to Steuart, he is silent on the value of Law, dismissing him as 'splendid, but visionary' and blaming him 'perhaps, in part' for the ills of banking in Scotland and elsewhere (Robertson 1997, 9, 19; Campbell et al 1976, vol I, 44–5, 317–18).

After the failure of his Scottish scheme, Law offered the idea of a land bank to France as early as 1706, and after 1708 spent a considerable time travelling across Europe, where he made a fortune on the gaming tables, proposing a bank at Turin to Victor Amadeus II along the way. In 1715, he once again proposed a French banking project, and after further rejection and delay on 2 May 1716 letters patent were granted for a *Banque Generale*. The *Compagnie d'Occident* followed in 1717. At the end of 1718, Law's bank became a Crown enterprise, and in the course of the following year, Law's *Compagnie* took over other trading companies, tax farms and their revenue stream and the national debt, in the Mississipi System. Jacobites received large American land grants, and following his conversion to Catholicism, Law became Controller General of the national finances of France on 5 January 1720. Seven weeks later, the *Compagnie* took control of the now Royal Bank; three months after this, the System began to collapse (Murphy 1994, 1–2; Dickson, P G M 1967, 91).[8]

Law's System has been written about in great detail elsewhere, most recently by Antoin Murphy. Essentially, it involved the securitization of the national debt of France by repeated share issues, which in their turn also provided capital to meet the debts of the trading companies which the *Compagnie d'Occident* took over. Initially issued at a deep discount which reflected the parlous state of Government credit, repeated issues both diluted the real value of equity and at the same time increased the supply of money to the System, as prices rose. The bubble situation which developed was no doubt inflated further by the fact that owners of 5 per cent state annuities were forced to trade them for 3 per cent System annuities with the prospect of growth: but by this time, the growth was more than in the price. As the market for the various share issues began to stall, the demonetization of gold and devaluation of silver was attempted to prevent a run: such drastic measures were bound to fail. As Murphy observes, 'the real economy proved to be incapable of generating a sufficient growth in commodities to match the monetary expansion' (Murphy 1994, 7–14). Law had expanded the money supply far beyond the potential of the growth

it could enhance, and moreover had done so in an economy much more developed than Scotland's. Perhaps he was forced to move too rapidly to try and outflank political opposition, an opposition which helped to ensure the final collapse. But in any case, the System failed. During the rest of the 18th century, France remained economically weaker than its potential, and, more importantly, than Great Britain.

Law's ideas thus included using state power to reflate the economy through the banking system (cf the nationalization of the Bank of England in 1946); the detachment of such reflation from specie and the requirement to denominate value in terms of bullion; exchange rate manipulation and low interest rates. The Scotland in which he grew up had for 500 years sought to use state power to control the money supply, and had failed; it had been an independent European state at the mercy of the circulation of foreign currency within its borders; it had three centuries of struggling to maintain a variety of exchange rates, not least that with sterling; and in the 1690s it had attempted to use low interest rates to encourage economic activity, an attempt which was undermined by the massive exchange rate risk Scottish bills carried, not in inter-burghal trade, but in trade with England. Law's central ideas were thus addressed to the experience and policy failures of his own country. He came from a tradition of state-driven monetary policy, and he adopted it, just as Sir James Steuart, also a proponent of state banks, was to do; he attempted to address its historic failings by detaching it from bullion policy, and addressed the history of Scotland's uncertain exchange rate and mongrel currency by using exchange rate policy as a financial instrument. In the 20th century, the Exchange Equalisation Account provided funds for the Bank of England to manipulate currency in the interests of sterling stabilization, a quarter of a millennium after the same idea had surfaced in the Scottish banking system. By 1750, the Scottish banks were in the lead in European note supply; in 1769, the Ayr Bank at last 'in a sense' introduced the land bank principle to Scotland. Likewise, Law's assignat issue in France foreshadowed that of the French Revolution, whose own assignats in turn almost replicated, 'the land bank model advocated by Law in his *Essay on a Land Bank* (1704) and in *Money and Trade*'. Adam Smith criticized Law for creating a system which might allow governments to finance themselves at less than the market rate: for Law, this was the point (Murphy 1975, 5; Checkland 1975, 125, 258, 265, 266, 607).

Law's System was thus originally geared to Scottish needs. He suggested that a limited money supply was the cause of unemployment in the country and, by implication, exile, and the presence of so many Scots abroad as mercenaries and in other roles. He thought that Scotland, as a small open economy, was at the mercy of international market conditions as regards domestic inflation: thus its size implied a freedom to set monetary policy without fear of inflation, since prices in its open market were beyond its control. In France, a much more powerful economy, he appeared to have forgotten this principle. Perhaps Law's desire to adopt sterling in Scotland was in order to ease exchange rate pressure on prices, for this would have been in his view the only way in which Scottish domestic monetary policy could impact on inflation. Most particularly though, and in the light of his own country's experience, Law held that a bullion-backed currency was one which restricted monetary policy and the banking system as gold and silver were subject to 'imperfect flows. . .the size of which were dependent on the vagaries of discoveries of such minerals': an especially appropriate judgement in the case of Scotland, which had trouble finding any of them (Murphy 1975, 89, 97, 108).

The weakness of Law's System of 1720 in France was in part because of the economic scale of the challenge in a huge country, then much more heavily populated than England, and in part because the main aim of the policy

had always been to meet the government's crushing debts by creating a market to monetize its assets, and placing the incomes (annuities etc) of its dependents in securities held over these same over-monetized assets: in other words, to inflate away debt. Law's System was in this way an equity version of War Loan: a refinancing of government debt to the advantage of the debtor. Exchange rate manipulation was used 'to increase the attractiveness of. . .[Law's] banknotes vis-à-vis specie'. Law's belief in securing low interest rates by debt management walked a tightrope in heavily-indebted France as it might not have done in under-monetized Scotland (Murphy 1975, 223ff, 332, 334). As Smith implicitly observed in his critique of Law, debtor governments have the power to renegotiate the terms in which their liabilities are denominated, unlike individuals: they can thus rig the market in their own interest. Even in this, Law was an avatar.

This paper then, has sought to place the well-known lineaments of Law's System in France within the context not only of his earlier writings on the Scottish economy but also in the dimension of his lived experience as a 17th-century Scot, the son of a goldsmith-banker, and a man acutely conscious both of the history of his country's unstable monetary policy (as he shows in *Money and Trade*), and also of the final crisis into which it was lurching in his own day. Those who seek to understand Law as a prophet of Nixon's final abandonment of the gold standard, should meditate not only on the history of an independent Scotland, but also on the economic symbolism and reality that lay behind those last gold pistoles of 1701, the Darien Company's currency, and the first gold minted in Scotland for circulation since before 1642.

NOTES

1 Philip Coggan, 'Do we really need a new golden age?', *Financial Times: FT Money*, 13/14 September 2003, M30.

2 See Withrington (1987, 12) for a rebuttal of the traditional view of the Enlightenment as a post-Union product. More recent studies, particularly those of Alexander Broadie (eg *The Scottish Enlightenment* (Edinburgh, 2001) & and (ed) *The Cambridge Companion to the Scottish Enlightenment* (Cambridge 2003) have reinforced this revisionist position, which is in any case implicitly present in earlier texts which view the Scottish Enlightenment and its achievements as a rival to English dominance, not its product (cf Youngson, A J *The Making of Classical Edinburgh* (Edinburgh 1966)).

3 *Extracts from the Burgh Records of Edinburgh 1403–1528* (Edinburgh: Scottish Burgh Records Society, 1869), 116.

4 *Extracts from the Records of the Burgh of Edinburgh 1665–1680*, Wood, M (ed) (Edinburgh, 1950), 210, 234, 277, 308, 377, 395; *Extracts. . .1681–1689*, Wood. M & Armet, H (eds) (Edinburgh 1954), 25, 75–6, 246; Murphy 1975, 14, 16.

5 I am indebted to Eveline Cruickshanks' great generosity in showing me her work on Law from her forthcoming book (co-authored with Howard Erskine-Hill) on the Atterbury Plot, which helps to establish the dates and likely details of Law's visits to Saint-Germain.

6 The quotation is from Eveline Cruickshanks, to whom again I am indebted for this information.

7 See Forbes' entry in the New *Dictionary of National Biography*, forthcoming.

8 I am again indebted to Eveline Cruickshanks for details on Law's land grants to Jacobites in North America.

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