Money at the crossroads: the birth of the "discount system" in France, 1776-1808

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Merchants and industrialists depend on money to launch their production or commercial cycle of activity. But, conversely, they depend on the revenues of their cycle of activity to get the money they need to start it. To break this vicious circle, they have two typical solutions: either they use permanent capital, or obtain short-term credit. Permanent capital may be borrowed or previously possessed, but it has a cost and sets a very strict limit to the productive capacity of a producer or a merchant. On the contrary, short-term credit is perfectly proportionate to the level of activity, and because it is part of the productive cycle, is also proportionate to its duration and seasonality. These ideas were very well expressed by Adam Smith, in 1776, and, in a slightly different way, by Walter Bagehot in 1873[2]:

> *« In every district small traders have arisen, who 'discount their bills' largely, and with the capital so borrowed, harass and press upon, if they do not eradicate, the old capitalist. The new trader has obviously an immense advantage in the struggle of trade. If a merchant have 50,000 l. all his own, to gain 10 per cent on it he must make 5,000 l. a year, and must charge for his goods accordingly; but if another has only 10,000 l., and borrows 40,000 l. by discounts (no extreme instance in our modem trade), he has the same capital of 50,000 l. to use, and can sell much cheaper. If the rate at which he borrows be 5 per cent, he will have to pay 2,000 l. a year; and if, like the old trader, he makes 5,000 l. a year, he will still, after paying his interest, obtain 3,000 l. a year, or 30 per cent, on his own 10,000 l. As most merchants are content with much less than 30 per cent, he will be able, if he wishes, to forego some of that profit, lower the price of the commodity, and drive the old-fashioned trader the man who trades on his own capital out of the market. »*

Therefore, during the 18th and 19th centuries, many economic writings related to short-term credit[3], defined as a credit financing either the cycle of production or commercial activity, i.e. working capital requirements. According to the different authors of the time, merchants and producers were directly interested in the establishment of a specific system that would lend them some money on behalf of their revenues to come, and that would allow them to reimburse that money once the revenues were cashed in[4]. Different credit systems could be built upon this necessity.

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[2] Walter Bagehot, *Lombard Street, A description of the money market*, 1873, Chapter 1 – Introductory, Text provided by: Rod Hay, rhay@odyssey.on.ca, McMaster University Archive of Economic Thought, downloaded on the Website of the Centre d'Histoire de la Pensée Economique (Université Paris I).

[3] P. Baubeau, « crédit commercial », in A. Stanziani, Dictionnaire historique de l'économie-droir, Paris, LGDJ, 2007, pp. NOMBRE PAGES ;

[4] B.L. Anderson, « Money and the structure of credit in the eighteenth century », *Business History*, 12:2, 1970, pp. 85-101.

For example, Rowena Olegario has shown how the creditworthiness constraint of long-range credit relations in 19th century United States led to the emergence of credit reporting firms[5]. Another solution rested upon the concentration of commercial bills in banks portfolios, letting these banks screen and assess the value of each bill, the bills being collateral to the banks emission of liquid means of payments. Basically, this was the discount system[6].

In theory, there is not much room for state intervention in such a system. To 19th century French economists – from Say [1803] to Coquelin [1852], Courcelle-Seneuil [1852] or Boudon [1862] – state should not intervene in discount banking but promote free banking – i.e. freedom to circulate banknotes in exchange of discounted bills. Nevertheless, we know that the state was not completely absent altogether, and we can then imagine two opposed ways to have this discount system worked: through "pure" market mechanisms, or through specific organizations.

Building on the so-called "market" constraints and on the theories and doctrines of the time, we will try to show how and why some market mechanisms could not work or were set aside in France (Part I), and how and why mixed institutional arrangement were designed in between 1776 and 1808. Indeed, French markets prior to the 19th century were not mainly driven by prices – which means that contrary to dominant contemporary economic literature, prices were not the only or the main market signals. In the case of the discount system (Part II), albeit a "modern" – that is to say a price-driven – market existed, this market was not a powerful enough instrument to manage periodic money shortages nor a national system of payments. Then, merchants and state promoted in 1776 a common solution: the *Caisse d'escompte*. This institution proved to be organized on the same principles as quantity-driven market: its role was to address the market limits when quantity rationing – coined money shortage – menaced bankers' solvency. The French Revolution (Part III) had two major consequences on the discount system: first it destroyed the *Caisse d'escompte* (1793), and then it apparently suppressed the very possibility of that kind of institutional arrangement between state and merchants typical of a corporatist and privileged society, by clearly separating private interests (merchants') and general interest (state's). But the problems once addressed by the *Caisse d'escompte* remained, and it is then remarkable to see how the *Banque de France* was founded and evolved as a price-setting and quantity-rationing institution whose roles and functions set it apart from a purely profit-driven company as well as from a public utility service.

Part I – Limits to the markets: prices and quantities

1.1. Quantity-driven markets for staples and money

[5] R. Olegario, *A Culture of Credit: Embedding Trust and Transparency in American Business*, Cambridge (MA), Harvard University Press, 2006, XIV-274 p.

[6] P. Baubeau, *Les « cathédrales de papier » ou la foi dans le crédit. Naissance et subversion du système de l'escompte en France, fin XVIIIe-premier XXe siècle*, PhD dissertation, Université Paris X Nanterre, 2004, NOMBRE PAGES et Jean-Louis Billoret, *Système bancaire et dynamique économique dans un pays à monnaie stable, France 1816-1914*, Thèse de l'Université de Nancy, 1969, XI-612 p.

In *Ancien Régime* France, given the weak integration of markets at kingdom level, sales and purchases were socially, geographically[7] and functionally specialized[8]. This specialization encompassed staples, raw materials, consumer or industrial goods, and also means of payment. This last specialization aggravated economic hazards. Indeed, in case of a shortage, say a wheat shortage, it was nonetheless necessary to find ways to import wheat, but also to export means of payment, which meant specie collection, transfer and remittance[9]. Since areas were relatively isolated one from the other, such trade, even in the same country, was more or less equivalent to foreign exchange[10]: local wheat importers had to collect specie or to find a guarantee, a collateral, to their credit payment, or had to be supported by royal authority. That was of course a heavy cost, and as such an important limit to nationwide business. It must then be no surprise that regional transactions – over the local community boundaries, the local community being defined as the area where payments can be made through non-commercial credit forms[11] – were highly dependent upon the availability of quantities – quantities of goods, but also of money or credit – which, in reverse, means that prices could only very partly fulfill their orthodox function of market signal. The usual price theory of the time – that of "*juste prix*", or fair price – just emphasized the fact that prices were not the main indicator in transactions: in an economy always on the verge of shortage, the sheer availability, in terms of quantity at hand, of consumption goods, including monetary species, was the most important issue, the main constraint on market mechanisms.

For example, was market freedom the solution to periodic grain shortages? If grains are rare, market mechanisms may alleviate some difficulties, but they cannot do more than evenly distribute the precious staple. Moreover, market mechanisms will lead to a rise in the price of grains and of dependent staples – meat and substitutes – crowding out those who cannot afford it from the market, which may seem economically sound, until one remembers that grain was the basic food and that people life depended on it[12]. Or course, it may be argued that, in the long term, market incentives will promote grain production and make severe shortages less frequent. But, here again, and not judging the efficiency of market incentives, starvation is a short-

[7] An extensive literature deals with market integration through price convergence, most notably that of grain and wheat: Guillaume Daudin, "Coûts de transaction et croissance: un modèle à partir de la situation de la France du XVIII[e] siècle", *Revue Française d'Economie*, XVII, 2002, pp. 3-36, Akinobu Kuroda, "Emancipate the Chinese Monetary History from the Aristotle Postulates; From Multiple and Complementary Viewpoints", Working Paper presented at the Workshop *Visit Monetary History of A Quarter of Human Beings and Revisit What Monies Actually Are*, Tokyo, Tokyo University, 21[st]-22[nd] May 2007).

[8] That does not mean a merchant was specialized in one precise field. On the contrary, the most important "*négociants"* were characterized by a wide array of business interests, from raw material trade to credit, from change speculation to domestic system production and marketing. But they were specialized along networks of relationships. Most of them, apart from the most important, did not mix commercial banking with public finance. But the more modest a merchant was, the more specialized or local his activity.

[9] F. Braudel, *L'identité de la France, volume 2, Les hommes et les choses*, Paris, Fayard, 1986, pp. 358-359.

[10] Until 1848 in France existed an "internal" change rate between commercial "places" (financial centres), linked to the cost of metallic specie transportation (upper limit) and the relative abundance of metallic specie on each "place" (bottom limit). During the *Ancien Régime*, and far in the 1830s, local monetary peculiarities remained, insulating local communities (villages or "pays", i.e. small counties) monetary circulation from larger flows, see G. Thuillier, J. Blanc and R. Bigo.

[11] This, indeed, amounts to a circular reasoning…

[12] The – debated – Davenant and King'Law states the final result is even worse: the reduced consumption of more expensive food by higher social classes increases their grain consumption, which, in turns, aggravates the shortage and the price increase of basic staples.

term issue. So, one could say that *Ancien Régime* "markets" were more quantity-driven than price-driven. Moreover, the elaborate doctrinal conceptions of the fair price show that prices were not supposed to move wildly: they were constrained by a social norm.

That general way of thinking applies to money and credit. For example, P. Hoffman, G. Postel-Vinay and J.-L. Rosenthal[13] have well shown that the "market" for long term private capital funds in 17th to 19th century France never worked in an orthodox way, that is to say, by balancing supply and demand through price mechanism, but rather through quantity rationing. Or, to be more complete, that market price mechanisms did play a role as long as the economic situation was buoyant. But in times of crisis, people resorted to quantity rationing – as today, in case of crisis, economic models stop to function[14]. Another aspect of these limitations set to price mechanisms derives from the fact that in most European countries, the interest rate was not free to fluctuate. In France, for example, 5% was considered a maximum during the 18th century, which does not mean this norm was always followed: many examples show rates well above 8% per annum[15]. But as demonstrated by Hoffman, Postel-Vinay and Rosenthal, a convergence towards this norm of 5% took place for private rents during the 18th century, and again, after the Revolution disruption, during the first half of the 19th century.

The state rents "*denier*" is an example of such a norm for long term credits, while for short-term credits, the official banking discount rates – 5 to 4% – played the same role, because they were agreed on by state authorities. But, of course, because markets were segmented, the influence of the bank's rate was as limited as its influence on these markets. Anyway, all French emission banks have tried to stabilize the interest rate at a low level: it was their main goal. For example, the discount rate of the *Caisse d'escompte* – 4 % – was specified in its statutes. The *Banque de France*, from its foundation to 1847 – and even then it did not change its doctrine – preferred to reduce discounted amounts or to select shorter maturities, than to rise its discount rate. As Napoleon wrote,

> *"What you must say to the governor of the Banque de France and to regents [members of the board], is that they must write in gold letters, where they gather, these words: "What is the goal of the Banque de France? – To discount all the merchant houses credits in France at four per cent."*[16]

In short, the general choice in organizing transactions, in 18th century France, was to rely on relatively inelastic, relatively "fair" prices, and to resort to quantity

[13] Philip T. Hoffman, Gilles Postel-Vinay et Jean-Laurent Rosenthal, *Des marchés sans prix. Une économie politique du crédit à Paris, 1660-1870*, Paris, Editions de l'EHESS, 2001. 446 p.

[14] The "subprime crisis" is an archetypal example of this phenomenon, where elaborated mathematical models fail to deliver a "price" for complex financial assets, which leads to more uncertainty.

[15] For example, yields on government securities were constantly above 5.5 % from 1785 to 1789, and the 1784 loan yielded well over 7 % on average for the same period. E. White, "The French Revolution and the Politics of Government Finances, 1770-1815", *The Journal of Economic History*, vol. 55, n°2 (June 1995), [JSTOR digital ed.] p. 234.

[16] « Je reçois votre lettre du 8. Ce que vous devez dire au gouverneur de la Banque de France et aux régents, c'est qu'ils doivent écrire en lettres d'or, dans le lieu de leur assemblée, ces mots : "Quel est le but de la Banque de France ? – D'escompter les crédits de toutes les maisons de commerce de France à quatre pour cent." », Lettre de Napoléon Ier à Mollien du 15 mai 1810, Anonyme (Comte Mollien), *Mémoires d'un ministre du Trésor Public, 1780-1815, tome 3*, Paris, Imprimerie Fournier, 1845, note 1 p. 145.

management to balance the market. Money and credit transactions were no exception. On the one hand, it is clear that such markets cannot be said to be spontaneous: nonetheless were those markets institutions, which has become quite recognized through institutional economics, but they depended on rules, habits, and public intervention, by the state or by public bodies, i.e. privileged in *Ancien Régime*[17]. On the other hand, during the 18th and 19th century[18], the state has been promoting price mechanisms, as a way to manage or to reduce the frequent shortage crises and to encourage the transportation of staples and monies whenever and wherever needed, building a more unified, and a more controlled, territory. But it does not mean that governments relied only on price mechanisms, and abandoned quantity management. On the contrary, well into the 19th century, moving grain from one place to the other could result in violent demonstrations[19] and necessitated the use of public strength. But one has also to take into account that, more than price mechanisms, quantity managements called for a more powerful, more interventionist state, and granted more power to its servants. Indeed, public bodies had to organize the control, the warehousing and the transportation of goods and specie, rather than just relying on a "market police"[20].

These shortcomings of spontaneous adjustments explain why the state had a prime interest in facilitating transactions. Wheat and bread supplies being of foremost importance, French governments worked to facilitate transports at regional or kingdom level: the "wheat war"[21] is a famous example of the difficulties to promote market unification, i.e. sales and purchases of grains from one area to the other, and is associated with the name of Turgot, both a *laissez-faire* economist and *Contrôleur général des finances* (Finance ministry).

Similarly, the very idea that quantity management played a prominent role in times of crisis should not be limited to staples. From a fiscal and financial point of view, the state also tended to draw its resources from all over its territory, but to spend it on a more localized basis: capital city, military borders[22]. Its interest was then to limit costly specie transports and to avoid payment disruptions by taking away too much coins from one place or flooding another with too much gold or silver. Since most expenses were paid in Versailles and Paris, one solution was to print state notes, backed on taxes to be collected, and to pay state suppliers with these notes (suppliers of raw materials, but also of specie or credit). Of course, if these notes were staying in circulation, rather than coming back immediately for payment in specie, this increased state resources. If such a line of argument holds some truth, then one should not interpret state issuances only as a

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[17] The question to know if prices-driven markets are spontaneous will not be addressed her. The heating debate over accounting norms in financial markets makes me dubious…

[18] Of course, this promotion of state sovereignty through economic unification started well before the 18th century.

[19] Cynthia Bouton, "Les mouvements de subsistance et le problème de l'économie morale sous l'ancien régime et la Révolution française", Annales historiques de la Révolution française, n° 319, 2000, electronic version (http://ahrf.revues.org/document104.html#ftn1). The author quotes, for the 18th and 19th centuries, the following upheavals: 1709-10, 1725, 1738-42, 1747-48, 1757, 1760, 1770-72, 1773, 1775, 1788-89, 1792, 1795, 1802, 1811-12, 1816-17, 1829-30, 1846-47, 1852-54 (footnote number 2).

[20] Which, in itself, is already more complicated than one could thought, see Dominique Margairaz, *Foires et marchés dans la France préindustrielle*, Paris: Editions de l'EHESS, 1988, pp. 223-225.

[21] The "*guerre des farines*" took place in 1775, after Turgot promulgated a decree to free grain trade. People attributed the movements of grain to monopolists speculating on prices, and state officials were said to participate in that speculation.

[22] Marquis de Mirabeau, 1789; R. Bigo, 1948 (1933). See also Count Mollien, *Mémoires*.

way to overcome budgetary constraints – but also as a way to manage liquidity constraints and currency flows.

Anyway, in both cases – supply shortages and state payments – the increased pressure on specie circulation and the moving anticipations upon prices or quantities led to the frequent specie "shortages" of the 18th century: notes and bills bearers asked for specie payments, and specie bearers hoarded it because notes and bills lost quickly their par value[23]. These frequent crises, every 5 to 8 years during the 18th Century, led to the common idea of a ore or less general "coin shortage"[24]. Monetary quantitativism answered that such a notion was pure illusion: gold or silver coins could not be too rare, because their increased scarcity increased their relative value in proportion, so that all the product of the country was still matched by all the specie in circulation. To that naïve idea, Boisguilbert and its followers answered that the problem was not the scarcity of specie, but the flight from notes to specie (in today's words, "flight to quality"):

> *"The more or less quantity of gold and silver, especially in a country abounding with staples necessary and comfortable to life, is of absolutely no importance to have the inhabitants profit of these staples."*[25]

To Law, the solution rested in the creation of a bank:

> *"The Bank is, in relation to [state] finance, the heart of the Kingdom, where all the money shall come back to start again the circulation."*[26]

As stated by J.-L. Billoret, from 1720 on, any financial reform program in France would comprise, in complement to fiscal policy, a central bank: that was Law's *Banque Royale* goal, it was Turgot's *Caisse d'Escompte* purpose and revolutionary "Banque nationale" schemes, it was later Consulate's *Banque de France* intent[27]. For example, in terms of chronological coincidence, it is interesting to remark that the Turgot's 1774 grain reform was quickly followed by the 1776 foundation of the *Caisse d'Escompte*, a bank[28].

1.2. State and hierarchies

The importance of public intervention on markets was central to their organization: bankers and economists frequently referred to the necessity to maintain

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[23] Luckett, Thomas, « Crises financières dans la France du XVIIIe siècle », *RHMC*, tome 43, vol. 2, avril-juin 1996, pp. 266-292.

[24] It should be stressed that this question of the availability of means of payments induced local communities to rely on local coinage (for example monasteries *méreaux*) and also pushed, in times of grain shortage – which coincided with credit crises – hoarded monies back in circulation (see Braudel, op. cit., p. 352; J. Blanc for a more general approach and Thomas Luckett, *op. cit.*).

[25] Translation of Boisguilbert, quoted in French in Luckett, op. cit., p. 285 : « La quantité plus ou moins d'or et d'argent, surtout dans un pays rempli de denrées nécessaires et commodes à la vie, est absolument indifférente pour en faire jouir abondamment les habitants. »

[26] Quoted in French in Jean-Louis Billoret, *op. cit*., p. 72 : « La Banque est, par rapport aux finances, le cœur du royaume, où tout l'argent doit revenir pour recommencer la circulation. »

[27] J.-L. Billoret, *op. cit*., p. 74.

[28] The term « bank » was avoided, because it may have reminded mitigated souvenirs from Law's *Banque Royale*.

"*foi publique*" (or "*confiance publique*", credit of the public) in markets and transaction rules. *Foi publique* even epitomized the duties of merchants when it came to credit and timely payment (the "honor" of the merchant, as compared to the honor of the aristocrat), and it is no mistake this expression became the slogan of the *Caisse des dépôts et consignations*, founded 1816, whose role was to reestablish the credibility of the state debt. This necessity justified public intervention, but before French Revolution, this public intervention was not necessarily a state intervention. In a society organized through privileges, communities of merchants had often a regulating power over key elements of market and transactions procedures. We could quote of course *tribunaux de commerce*, first degree commercial courts, which were privileged bodies elected by commercial guilds but also parts of the royal judicial hierarchy[29].

But what is important is to see how this organization of public privileged bodies was coherent with "priceless markets": they intervened mainly in three directions. First, the role of these bodies was to set the rules of "quality" which applied to the goods to be produced, sold or purchased: the lead mark is the classical example of this role. Second, they registered all the habits related to transactions: measurement units, delivery and payment customs, technical and commercial vocabulary and practices. Third, drawing on quality and custom criteria, they decided who could or could not be part of the guild, and then acted as a limiting factor in output, but a factor that ought not be exaggerated[30]. A privileged body was not a perfect monopoly because of overlapping competences with other privileged bodies, geographical specialization and competition among the private producers who constituted it. But in the end, guilds did limit "market disputability" – a quantity factor more relevant than prices and put forward by some contemporary liberal theorists of concurrence[31].

A schematic hierarchy appears, with the king up the ladder, the guilds or other public bodies in the intermediate position, and the members of these bodies, "electing" their leaders at the base[32]. A never-ending movement of mutual reconnaissance linked the two ends of the ladder: downward, the king granted privileges and recognized the legitimacy of the regulating action of the guild, in his name; upward, the guild asked for privilege renewal and requested the king to right them when overlapping competences clashed. And the meaning of that relationship was, as we have said, "*foi publique*".

We have seen in the first part that banking took place in a market economy where quantities, more than prices, were the important variables. This quantity-driven economy was more prone to public intervention, because adjustment supposed stocking, transportation and centralized planning. Of course, attempts to reinforce price mechanisms were undertaken, but the results were limited, notably in the credit area. To organize such an economy, institutional coordination of public and privates interests was necessary: such was the goal of guilds and other intermediate public bodies.

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[29] J.-P. Hirsch, *Les deux rêves du commerce*. PRECISER NBP

[30] See for example Steven L. Kaplan, "Idéologie, conflits et pratiques politiques dans les corporations parisiennes au XVIIIe siècle", *RHMC*, 49-1, janvier-mars 2002, pp. 5-6.

[31] See, for example, Pascal Salin, *La Concurrence*, Paris, PUF, 1995. It is interesting to note that these "liberal economists" rely more than neoclassical economists on institutions and put more emphasis on money, being inspired by the "Austrian School of Economics" (Hayek, Von Mises).

[32] The internal hierarchy question is addressed by S.L. Kaplan, *op. cit*.

Part II – The heritage of 18th century banking: the *Caisse d'escompte*

Nevertheless, during the 18th century, some price-driven credit markets existed too[33]. At least two financial markets were developed in Paris: a market quoting rents – and actual yields on rents – and a market trading endorsed or accepted bills of exchange[34], from and to all of Europe[35]. This monetary market, in turn, allowed the emergence of private bankers – mainly merchant-bankers – the main shareholders in the *Caisse d'escompte* after 1778[36].

2.1. The nature of the Caisse

That same hierarchy between private interests, public bodies and king can be observed in money and credit questions. No bank of emission could be founded in France except under a privileged regime, during the 18th as well as the 19th century. Money being a regal attribute, any collective action upon money required an official approval, which came as a privilege. As long as no other company was privileged, this privilege amounted to a monopoly. Of course, some private bankers and many businesses emitted credit paper, but no large emission of banknotes has ever been done out of a privileged status, either national or regional, except during some war episodes, temporary by nature. Moreover, the emission of private paper itself took place under that privileged hierarchical organization before French Revolution. Indeed, under Colbert's (and Savary's) 1673 *Ordonnance du commerce* (commercial Law), bills of exchange and promissory notes were assigned a special field of the royal law, neither state nor civil law, and the disputes relative to credit and exchange had to be settled by the first degree commercial courts. In fact, from a legal point of view, commercial bill drawing was governed by a privileged set of rules, with specific courts, specific evidences (based for example on compulsory bookkeeping) and specific means of action, as imprisonment for debt[37] and the pronouncement of bankruptcy.

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[33] But a market like that of bills and notes depended highly upon reputation and information, which means disputability was constrained by networking and informative costs. It was not safe to bid on such a market only on the information delivered through prices. It could be added it is still not the case today.

[34] A recent review of the European development of the bill of exchange can be found in M. A. Denzel, « The European bill of exchange », IHEC Helsinki 2006, Session 2, 33 p. [downloaded from the IHEC website].

[35] Marc Flandreau, Christophe Galimard, Clemens Jobst, & Pilar Nogues Marco, "The Bell Jar: Commercial Interest Rates between Two Revolutions, 1688-1789", Final draft, August 27, 2007, Forthcoming in Jeremy Atack, (ed.), *The Origins and Development of Financial Markets and Institutions*, Cambridge University Press, 2008, 47 p. I warmly thank Marc Flandreau for the communication of this article.

[36] R. Bigo, *Les bases historiques…, op. cit.*, p. 37.

[37] T. Luckett, "The debate over imprisonment for debt in eighteenth-century France", in L. Fontaine et alii, *Des personnes aux institutions*, Louvain-La-Neuve, Bruylant, 1997, pp. 163-172. Before the Revolution, imprisonment for debt (*contrainte par corps*) was not specifically commercial. After it was abolished, in 1793 and reestablished, in 1797, the *contrainte par corps* underwent a legal specialization process, that led to a specific body of rules for merchants. See J. Leveillé, *De l'abolition de la contrainte par corps. Extrait de la Revue pratique de droit français (n° des 1er et 15 octobre 1866)*, Paris, A. Marescq Aîné, 1866, 32 p.

Being at the intersection of state interest and public organization, *Ancien Régime* emission banks cannot be reduced to private interest companies: they were public, nonetheless because their stock was publicly traded, but also because they were authorized by the state, and even created and promoted in the state and in the public interest. This is difficult to elaborate in French, where "public" has come to mean "state-owned". In the case of the *Caisse d'Escompte*, it was never state-owned, nor even directly state controlled, but it was a part of the public organization of credit and money, which itself was not purely state controlled. Laffon-Ladebat, when introducing the creation of the *Caisse d'Escompte* quoted first Turgot, finance minister[38], and only afterwards Panchaud, who designed the project[39]. Of course, private interests were crucial in promoting and creating the bank; but the mixed public and private nature of it and its role in fixing prices – which means prices could not freely move – can be seen easily. The main official, i.e. publicized, motive of the creation of the bank is the lowering of the interest rate: the discount rate of the *Caisse d'escompte* was soon set at 4 %, a low figure which implied a certain range of operations. But the most revealing piece upon the nature of the *Caisse* is a letter from Calonne, then *Contrôleur general des finances* (finance minister), dated from January the 26th 1785.

A crisis had then occurred between state authority and shareholders: speculative future operations on the *Caisse*'s stocks were based upon dividend anticipations[40]. To avoid this speculation, the State Council decided January the 16th 1785 that the dividend could be paid only from the past semester profits. But some stockholders replied it was a violation of the self-governing statute of the *Caisse* and of their property rights. Calonne answered in an official letter:

> *« Sa Majesté m'a chargé de faire connaître qu'elle avait vu avec mécontentement dans votre mémoire, des principes qui annonceraient l'opinion d'une prétendue indépendance relativement à la gestion des affaires de la Caisse d'escompte.*
>
> *Si de telles erreurs ne peuvent être imputées qu'à quelques actionnaires, aucun ne doit perdre de vue que le roi en a autorisé l'établissement, moins pour favoriser ceux qui l'ont proposé, que pour l'avantage du commerce de ses sujets, et que lorsqu'en même tems Sa Majesté lui a permis de mettre en circulation un papier représentatif de numéraire que le public y déposerait, elle s'est nécessairement réservée et a même contracté, pour ainsi dire, envers ses peuples, l'engagement de surveiller continuellement et de régler, toutes les fois qu'il en serait besoin, les opérations de cet Etablissement, qu'un accessoire aussi important a lié trop intimement à l'Etat pour qu'il puisse n'être considéré que comme une société particulière, dirigée entièrement et uniquement par les membres qui la composent.*
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> *Sa Majesté n'a jamais entendu empêcher que les actionnaires ne disposent à leur gré de tout ce qui concerne leurs intérêts particuliers, lorsqu'ils n'ont rien de contraire à l'intérêt général auquel ils sont subordonnés : mais s'ils s'en écartent […], s'ils contreviennent aux règles*

[38] Laffon-Ladebat, *Compte-rendu des opérations de la Caisse d'Escompte, depuis son origine (24 mars 1776) jusqu'à sa suppression (24 août 1793) ; et de sa liquidation depuis l'époque de sa suppression*, Paris, Bailleul, 1807, 92 p. [Electronic version, downloaded on Gallica.fr], p. 2.
[39] *Idem*, p. 4.
[40] At the same time, the *Conseil d'Etat* decided to forbid future operations, reinforcing old prescriptions that followed Law's bankruptcy.

qui servent de base à la confiance publique, il est alors indispensable que l'autorité intervienne pour les y ramener ; et c'est cette même attention vigilante du Gouvernement sur toutes les opérations de la Caisse, qui est le principal garant de son crédit. »[41]

As we can see, Calonne summoned, in just one text, several of the different characteristics we put forward: first, as a privileged body, the *Caisse* could not pretend to be completely free to act independently. Second, it is the more so since its very action put into question the "*confiance publique*" (synonym to *foi publique*), a question that links together private and general interests. Third, this general interest is the reason why the *Caisse* had to be privileged: given its purpose, its position on the hierarchical ladder was above that of private interests, and the privilege was simultaneously a way to recognize this fact and to put the *Caisse* under the king's arm. Which means that, when it came to general interest, and as a consequence of the benefit of the privilege, the king had the last word, even against the stockholders. There was nothing here as a state property nor as a clear-cut distinction between public affairs and private business, but a constant negotiation up and down this hierarchical ladder.

2.2. A heterodox legacy: from Boisguilbert to Smith

Why, then, since a private market of first-rate bills of exchange existed, was it necessary to create a privileged discount bank? It derives partly from the monetary structure of the French 18th century, and the answers lie in the monetary works of a few economists of the time, but it can already be said that the main motives have already been evocated: quantity, hierarchy.

Basically, two different sets of theories address the monetary question before Smith. To some authors, money was a mere instrument, and its effectiveness was only negative, i.e., it could cause disruption, but not growth. Hume is perhaps the most famous among those who considered money to be a veil and that formulated an elaborate quantitative theory of money. To others, and mainly to mercantilists, money was a wealth by itself, and the state's duty consisted in accumulating this money. Of course, by money, one has to understand coined money.

[41] Approximate translation: "His Majesty has asked me to let you know he has seen with some discontent in your memoir some principles leaning towards an alleged independence in the management of the Caisse d'escompte business.
If such errors are imputable only to a few stockholders, nobody can forget that the king authorized its establishment, not so in favor of those who promoted it, than in the advantage of the transactions of its subjects, and that when, at the same time, his majesty has authorized it to circulate a paper representative of the specie deposited by the public, he has necessarily retained and even contracted, so to say, with his people, to continuously supervise and rule, any time it is needed, this Establishment actions, which such an important purpose has too intimately linked to the State to consider it a private company, entirely and solely directed by its members.
His Majesty has never intended to prevent stockholders to dispose at will of what concerns their private interests, when these are not adverse to the general interest they are subordinated to: but if they move away from it, if they menace the Caisse's very safety, if they break the rules that are the foundations of the public credit, it is then necessary for the authority to intervene to bring them back; and it is this same vigilant attention from the Government upon all the actions of the Caisse that is the main safeguard of its credit." Document reproduced in Laffon-Ladebat, *op. cit.*, pp. 73-74.

But some economists are not so easy to classify: Adam Smith, of course, Richard Cantillon[42], John Law and Pierre de Boisguilbert[43] tended to adopt an ambivalent view of money. There are several reasons why they did not abide completely to the quantitative theory, while clearly rejecting the mercantilist view. One reason derives from the fact they admitted the variety of monetary forms, when Hume, for example, had famously discarded the use of banknotes excepting only gold or silver certificates.

That is precisely why those economists are so interesting: they bothered with details and tried to make their theory apt to explain and describe what they saw, offering both evidence and analysis. First, Boisguilbert, Law, Cantillon and Smith considered the working economy as a whole, this whole being irrigated by money: it is the all-too common metaphor of money being the blood of the kingdom. This very common argument is nevertheless important, because it founded their theory of an "economic circuit", which meant that every inhabitant was indirectly, through sales and purchases, in contact with all the others, this contact being transmitted by debts, credits and money.

Their second common point, from where they diverged mainly from mercantilists, was the role and function of money. Money, indeed, had an important role to play in the circuit: according to the blood metaphor, only money could perform the coordinating task. Money was an essential element in Boisguilbert "laissez-faire" intuition, because it allowed inhabitants to act for their own part: only money and private initiative could alleviate local shortages and excesses, by allowing trade at a wider geographical scale. It meant that a global equilibrium could not be reached by planning production or managing quantities – which is precisely the kind of state action promoted by mercantilists – but only through commercial exchange. With Boisguilbert, a quantity-oriented market gave way to a price *vs* quantity arbitrage market. But it also meant that, whatever the importance of money, it could never act as a cause: the heart of the system laid in the exchanges of goods and services, not in the circulation of money, which was only the reflection of these exchanges. This is a truly important difference with other "economists" of the 17th Century, inheriting the conceptions of Davanzati[44].

The third point, which distinguished them from "quantitativists", is their definition of money. Boisguilbert paid a lot of attention to the velocity of money. But what was really meaningful to him, was that the circulation took place into different but connected circuits, the disruption of only one circuit possibly leading to a standstill in the whole circulation. This idea of different but connected monetary circuits segmented along social or professional patterns, can be traced down in Cantillon's and Smith's works and to the conception of different kinds of means of payment.

The question is then the relationship between money and means of payment: substitute, equivalent or hierarchical? Whatever the answer, the important point to Boisguilbert and Law, of course, but also, albeit with a strange reserve, to Cantillon, was to consider money from a different point of view from that of monetary quantitativists. Of course, some quantitativists, and Hume first, did not think gold and silver have an ingrained and eternal value. But they did think that only the material value of money, deriving from need, lust or common conceptions, could guarantee its effectiveness as a mean of payment and a store of value. Boisguilbert, Law and Smith

[42] One of the few writers quoted in the *Wealth of Nations*, contrary to Steuart.

[43] Many other writers could be added, among them Steuart. See Michel Piteau, « Monnaie de compte et système de paiement chez James Steuart. Quel rôle pour la stabilité bancaire ? », *Revue économique*, 2002.

[44] Jean-Louis Billoret, « Le circuit économique et l'équilibre de Boisguilbert dans le courant de l'analyse économique », *in Boisguilbert parmi nous. Actes du colloque international de Rouen (22-23 mai 1975) présentés par J. Hecht*, Paris, INED, 1989, pp. 64-66.

were not so decisive: the “wheel of commerce”, to take a metaphor common to these authors, was not only gold and silver. Indeed, since what really matters is the general and decentralized exchange of goods, which, itself, is made possible through a network of debts and credits, and since gold and silver are, simply put, general credits upon the production, money can be equalized to a credit in the hands of the buyer, and a debt upon production. Moreover, the store of value function, which is key to quantitativism, appeared to Boisguilbert[45] as a dysfunction. It is only when money is hoarded, that is, when consumption slows, that the store of value function becomes important: in time of crisis and price variations[46]. Then, the commercial bill appears to be a logical consequence of the nature money and commerce: socially and technically specialized, strictly linked to exchanges, not suited for long-term hoarding. By the means of the commercial bill, the quantity and the speed of money are highly adaptable to the economic circuit variations, and can obviate to coined money scarcity and even reduce the cost of immobilizing a great store of value in the form of coined money, which capital can be put back into the productive system, as Smith demonstrated, or as in Bagehot’s quotation (*supra*).

The spectacular rise and fall of John Law’s *Banque Royale*, the former *Banque Générale*, led to the commonly assumed notion that French people derived from this “traumatism” a deep aversion towards banknotes and paper money, later reinforced by the revolutionary *assignats*. This idea can be found in numerous works from historians and economists. That may be true, but on the other hand, every source indicates that bills on paper never ceased to be exchanged in growing numbers. More important, such judgments rely on a very simplified perception of the French monetary circulation, as stressed by Braudel: “we have put too much emphasis on the rumors and demonstrations from rue Quincampoix”[47]. Several different estimations have been made of the paper circulation in France at the end of *Ancien Régime*: compared to a metallic circulation of two to three billions *livres*, the paper circulation represented four to five times this amount[48]. In 1789, the near bankruptcy of the *Caisse d’Escompte* – the largest bank in France at the time – led to new paper emissions, the *assignats*, and only one year after the demise of the French State debt, in 1797, two banks of emission had already been founded in Paris alone. Last, as soon as 1800, the state did take a large responsibility in the foundation of the *Banque de France*, and its notes never suffered

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[45] Jacques Wolff, « L’élaboration du circuit monétaire aux XVIIe et XVIIIe siècles : Petty, Boisguilbert, Cantillon », in Paul Coulbois (éd.), *Essais en l’honneur de Jean Marchal, Tome 2, La monnaie*, Paris, Cujas, 1975, p. 41

[46] Which led to the Keynes’ analogy, because it’s equivalent to the idea that the desire to hold money in cash depends upon prices anticipations.

[47] “[…] nous avons été trop attentifs aux rumeurs et aux grands spectacles de la rue Quincampoix”, and F. Braudel adds, “et nous apercevons aujourd’hui que le Système de Law n’a pas été, dans les profondeurs de la vie française, la tempête qu’on a dit.”, *op. cit.*, p. 359.

[48] For example, although he offers a very stimulating analysis of the social determinants of money circulation in France during the *Ancien Régime*, Jérôme Blanc repeats that old *lieu commun*. First he states that after Law, « Paper money is discredited for a long time. » [p. 8] and then writes « Overall, it is estimated that all paper moneys together, private or public, represent a 8 billion livres circulation in 1789, including 3 billion of state debt, to be compared with a 2,2 billion metallic specie circulation. » [p. 11]. Jérôme Blanc, « La complexité monétaire en France sous l’Ancien Régime : étendue et modes de gestion », working paper, s.d. [2006], Université Lumière Lyon 2, L.E.F.I. The most commonly used source on paper circulation before 1789 is Sabatier: see Crouzet, François, *La Grande inflation. La monnaie en France de Louis XVI à Napoléon*, Paris, Fayard, 1993, p. 48.

any strong diffidence, even if their circulation remained modest for over two decades[49]. In fact, the "traumatisms" from "Law's *expérience*" and the "*Révolution*" have been, during most of the 19th century, a line of argument in favor of free banking[50], against state intervention, or against any paper money altogether and in favor of a pure metallic monetary system[51]. If there was a degree of backwardness in France's banking system, it was clearly not a psychological consequence of past failures, however spectacular, but rather the result of a social and political state of affairs – which may also explain these failures in the first place.

If we try to sum up what has been known as Smith's legacy, but was in fact inherited from extended banking practices and numerous writers, we find several traits. First, money is considered by the supra-mentioned economists as an instrument of great importance but with no moving action in proper: from that point of view, only production and exchange matters. On this, they agreed with Hume's idea that money is the "oil" in the engine. It is the point where they stick the most to the quantitative theory: an increase of circulation not matched by production or exchange has no real effect, but a price increase. Nevertheless, even there, Smith, Cantillon or Boisguilbert's positions differed slightly, especially Cantillon and Boisguilbert's: they considered that the price increase may take different forms and be effective after different delays, depending on where in the circuit the increase in circulation had occurred[52]. There is no mechanical and immediate relationship between money and prices variations.

Second, money needs not to have an intrinsic value to play its role of medium of exchange. We have seen that, to Boisguilbert, the storing value is even dysfunctional to money: its main purpose is to circulate ceaselessly. But the question remains to know if bills of exchange are really money or not. In fact, it seems we touch here one of the limits in pre-classical (and classical) analysis: there is not really a conception of a hierarchical or complementary monetary system, where the banking system primary function is to organize the transfer of value from one mean of payment to the other, as

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[49] Raoul Boudon tells an interesting anecdote: the 12th March 1848, during the February Revolution crisis, a rumour circulated in Paris, that *Banque de France*'s banknotes were to be declared unredeemable, starting a "true panic". The author went to the Bank offices, to redeem his banknotes, but after one hour waiting, resumed his attempt. Then, the 13th, he met a trader who had just cashed in a payment in silver from the United States and who proposed to exchange the banknotes on par. Boudon, *op. cit.*, p. 23. One could add that 1) it was true only in one circuit – most Frenchmen of the time had never seen a Banque de France banknote – and 2) that the return to convertibility was done in practice before being done by law, because the public confidence into the *Banque* remained very high.

[50] A good example of such an argument can be found in Coquelin's article (in fact a little essay) on banks in the *Dictionnaire de l'économie politique, tome 1,* he directed and published at Guillaumin, Paris, in 1852 [he died soon afterwards] : at least three times (p. 135, p. 136, p. 137) he summons the *lieu commun* to criticize it, but one can wonder if there is really an idea that French banking is hampered by bad memories and social habits, or if it is a rhetoric line of argument to promote free banking.

[51] A memoir develops, with very old-fashioned arguments, the very contemporary idea that any tradable debt is a form of paper money and, then, of inflation: Paul Cère, *Des abus du crédit, par un ancien chef de bureau des Caisses d'amortissement et des dépôts et consignations*, Paris, Revue analytique et critique des arts et de l'industrie, 1839, 31 p. The date of publication is meaningful: 1839 is a year of dire financial crisis in the world and in France, with numerous bank failures, notably that of Laffitte: see B. Gille, *La banque et le crédit en France de 1815 à 1848*, Paris, PUF, 1959, p. 63, p. 149, pp. 337 sq.

[52] The "cantillon's effect" is still used in contemporary economics, to describe the gradual effect on prices of a localized increase in monetary resources. This concept is more commonly used by the heirs of the Austrian school, see Steven Daley and Richard Wagner, "Money and the Real Economy: A Computational Search for Cantillon Effects", Global Prosperity Initiative, Working paper 49, Mercatus Center – George Mason University, octobre 2004, downloadable on www.mercatus.org/repository/docLib/MC_GPI_WP49_041018.PDF

smoothly as possible, and between the different means of payment and the standard currency (gold or silver in a metallic standard area).

Third, because intrinsic value is of secondary importance, it is feasible to use conventional means of payment – bills of exchange, banknotes, etc. – on a large scale. Since any metallic money, that is money of a high intrinsic value[53], is an immobilization of capital, a country which develops paper circulation makes a relative saving; if paper circulation replaces partly coined circulation, then it even makes a net capital gain, through the export of gold and silver, and it can use this capital in machinery or consumption. This is at the heart of Smith's explanation on *fiat* money[54]. Apart from the monetary quality of bills of exchange and banknotes, lies here the very practical question of emission and reimbursement, and their meanwhile circulation, a question to answer by rules and networks.

Fourth and last point: what is the price of money? Price being a central feature of markets, a money market necessarily implies a price setting mechanism. Here again, Smith does not appear as a pure market orthodox: he justifies a state intervention limiting interest rate levels, to avoid anti-selection problems, which means also that he resorts to some extent to quantity mechanisms[55], i.e. rationing. Of course, it can be argued that such a position is hardly theoretical: in most European countries, or areas, the interest rate was not free to fluctuate above certain limits, most commonly around 5 or 6 % *per annum*. The problem is even more complex if one admits that several monies circulate together: then, the interest rate can be analytically split up in two parts: the pure interest on time at maturity; an exchange interest rate which corresponds to the anticipated value of one money against the others at the considered term[56]. This complexity of rates took a new importance during the 18th and 19th centuries for two main reasons: the development of discount; the increase of inland bills, for which there was no international exchange from one currency into another. But because of these limits put to price mechanisms, we find again the possibility of quantity-driven markets.

2.3. The Caisse d'Escompte, the state and the market

To what extent may the commercial bill be considered as money? And how to organize, at a lower cost, the transfer of value from bills to coined money and *vice versa*? These questions are at the heart of the designs, functions and controls of the French banking systems, tried and operated before, during and after the Revolution. As we have seen, the theory derives mainly from the works of Boisguilbert, Cantillon and Smith, but theory follow facts here, and the key experiments to French governments and bankers were those of Law and Panchaud before the Revolution, but also foreign examples and, of course, an extended record of discount techniques and practices in all important French trading centers – like Lyons, Marseilles or Paris.

As we have seen, the idea of a fixed interest rate and of a circulation medium met the general interest as promoted by the state. At the same time, it is clear that the state – or the king – would also meet its private interests if specie transfers were facilitated and

[53] We do not include her billon coins and monetary tokens.
[54] Smith [1776], book 2, chapter 2. It is nevertheless true that Smith insists on the fact that a paper circulation is more risky, for the stability of the country at whole, than metallic circulation.
[55] Most notably through quality screening, open to moral conceptions.
[56] Marc Flandreau, op. cit., used brillantly this property to compute prime commercial interest rates in Amsterdam, London and Paris during the 18th Century.

government short-term bills easily sold, so budget expenses did not depend on the Treasury highly seasonal revenues. The merchant-bankers promoted, as Calonne wrote in 1785, a private interest: easy access to coined money. Indeed, the trading of bills of exchange took place on an actual "market place", the stock exchange. But these exchanges were only paper exchanges: most of them were settled through crossed remittances or on book accounts. This was a serious limit to monetary operations that were supposed to be at par with cash, coined money. And here we understand why the interest rate of the *Caisse d'escompte* seems so low (4%): in fact, the *Caisse* discounted only first-rate bills, endorsed by selected banks (*Haute Banque*): there was almost no solvency hazard, the only goal being to lift the liquidity constraint. The *Caisse d'escompte* was a "bank of bankers" (a common reproach at the time).

But was liquidity constraint a sufficient cause for a regular turnover of the *Caisse d'escompte*? When bills were regularly paid at maturity, when confidence was high, cash payments easily balanced the bankers cash needs – they even tended to reduce their cash reserve as much as possible, because cash brought no revenue. On the contrary, in case of cash shortage, there was a flight to liquidity, and cash suddenly seemed scarce. This alternation is linked to the hierarchical nature of the monetary system. The merchant's system was regulated in times of plenty through market price mechanisms. But when the liquidity constraint rose – reflected by the interest rate on the bill market – the quantity mechanism became dominant, because it was the main constraint: a rise in prices did not offer any easy access to cash, which was what was really sought for and not higher rates; the higher rates only reflected the loss of market value compared to bills face value. The *Caisse* then faced a paradox: in times of plenty, it had to find lucrative investments to avoid the losses of too heavy a cash reserve; but bankers preferred to exchange on a fluid market where rates were below or equivalent to *Caisse*'s rate of discount, on a price-driven market[57]. So, the *Caisse* had to find alternative ways to circulate its banknotes, which were the primary source of its revenue, because discounting commercial bills was not sufficient. In times of crises, the question was, on the contrary, to hold enough cash to pay at view its own banknotes, which were cashed in by bearers who wanted to liquidate their positions.

The solution to the paradox has been quickly found: in fact, the solution was the reason why the *Caisse* was privileged. When cash was abundant, and when the *Caisse* had difficulties to circulate its banknotes, it discounted state debts, for example to facilitate public specie transfer, or to average seasonal differences in tax incomes and revenues. And when cash flowed out of the *Caisse*, the *Caisse* turned to the Treasury to get its loans reimbursed in coined money and keep its liquidity and solvency. This way, the *Caisse* found a safe revenue and bought an insurance against insolvency. The problem, of course, was whether the Treasury could and would repay in cash its debts to the *Caisse*. In fact, all the crises of the *Caisse* followed more or less the following pattern: forced loan to the state, diffidence to its banknotes, run on the Caisse, and impossibility for the state to pay back in cash without delays, or even *cours forcé*. Its final bankruptcy derived from the hazardous consolidation attempt by the *assignats* emission, in 1789-1790.

The *Caisse* could not, by itself, guarantee anytime the transferability at par value of the merchant money (bills of exchange) into coined money. Indeed, if it acted so as to be always able to pay its banknotes in cash, the *Caisse* would reduce its emission to its metallic store. If it discounted on a larger base, and circulated more banknotes as compared to its cash reserve, it would need state intervention, and in case of a dire

[57] See Flandreau et alii, *op. cit.*

crisis, a decree allowing suspension of cash payments[58]. The solution to market crises could not come from price mechanisms, for example a sky-rocketing interest rate, but from quantity management, with the intervention of state authorities that would "suspend" the meaning of prices. But during the Revolution, the National Assembly opposing camps used the state finances as a major political stake, avoiding immediate solution[59], which led to the liquidation of the *Caisse d'escompte* (1793) and the ban on banks.

In a schematic way, we could say that the bank feasibility was at the crossing of two different monetary circuits. The fiscal-financial circuit[60], hierarchical, vertical, linked fiscal payments and budgetary expenses, and was based on coined money, minted under state authority. The fiscal system, in that respect, served as a medium and an impulse for the monetarization of French society through fiscal constraint. The main actors of this circuit were the "traitants", the "financiers". The commercial circuit, almost horizontal, moderately hierarchical, linked sales and payments, but also credit relationships, and was by design a paper circuit managed by merchants, merchant-bankers, bankers and brokers. Focusing only on the technical feasibility of discount banking, French 19th centuries liberal economists failed to recognize the simultaneous necessity for the bank to find revenues in times of plenty, and cash in times of crises. This same failure explains why, despite the works of Carrière and Luckett, the traditional idea of a general shortage of money still holds today among historians.

Part III – The Revolution and the building of a new institutional compromise

3.1. The revolutionary gap between public and private interests

After the Revolution, such complexities and paradoxes had to be addressed if one desired to create a new sound monetary and banking system. The desire to do so was especially great because the abundance of bills of exchange and of discount operations was associated, after 1795, with the commercial prosperity of the *Ancien Régime*. But the idea of an intermediate and collaborative level between the head of the state, mainly protecting general interests, and the merchants, pursuing their own private interests, was destroyed with the laws forbidding the "*corps intermediaires*"[61]. To limit the consequences of this breakup, one had to push the unification of market rules over the whole territory, because no specialized body would issue and enforce local rules of quantity and quality.

This amounted to give price mechanisms a greater importance as compared to quantity mechanisms: unifying norms would facilitate transactions by reducing

[58] For example in september 1783, banknotes were declared legal tender and payable not in cash but in commercial bills of exchange.
[59] See F. Crouzet, *La Grande inflation: La monnaie en France de Louis XVI à Napoléon*, Paris, Fayard, 1993, 608 p.
[60] To pay tribute to D. Dessert's seminal works on the "système fisco-financier".
[61] The Décret (decree, but it was actually an act) d'Allarde, 2 and 17th of March 1791, and the loi (act) le Chapelier, 17th of June 1791, dissolved guilds and corporations and other intermediary bodies.

information costs, supervision costs and arbitrage costs. This question applied of course to money and means of payment. For example, in 1798, the *Corps Législatif* debated of a uniform legislation concerning commercial bills[62]:

> *« Le vœu des négocians exprimé par notre collègue Rabasse, les lumières répandues dans le discours qu'il a prononcé à cette tribune, l'expérience de chacun de nous : tout démontre que si le commerce est fondé sur la liberté, il a néanmoins besoin de la direction des lois, pour en régler les conventions & même en assurer la bonne foi, sans laquelle l'honorable réputation du négociant qui enrichit sa patrie par ses utiles spéculations, se trouve confondue avec celle du vil agioteur qui dissipe ou engloutit ses richesses. »*

In this short excerpt, we find this typical trait highlighted by J.-P. Hirsch: the will to combine freedom and law. Moreover, we find again the idea of "*foi*" (confidence): but it is not "*foi publique*" anymore, only the confidence the well-famed merchant should inspire, that is to say, its credit. The link between private actions and "*foi publique*" is broken. From now on, the "*foi publique*" is associated with the state, and it is only with precautions that the expression is used to describe the general character of the bills of exchange[63] or of banknotes. Last but not least, law is supposed to discriminate between speculators and real merchants.

Such distinctions between state and private affairs, between public law (*droit public*) and civil law (*droit privé*), commercial law being a subordinate part of civil law, were implemented following the Revolution. They were symbolized by legislative and executive powers separation (and not checks and balances), itself reflected in the double system of jurisdiction – public law dominated by the *Conseil d'Etat* and civil law by the *Cour de Cassation* – and of course in the codification of law, which took place between 1804 (Civil code) and 1807 (Commercial code) for our matter.

But could that separation be implemented in monetary matters? Indeed, money still belonged to the state "regal" functions. The revolutionary unification movement had even reinforced the state control over measurement units, of which money was an element, and decided a common currency to the whole territory: for the first time since Charlemagne, the unit currency and the minted coins were equivalent. Commercial credit, necessary to national prosperity, still belonged to private initiative: only merchants, not government, could decide to draw, endorse, exchange and discount bills, a "private money" expressed in legal tender. And this bill circulation still mattered much for government fiscal policy, through tax levies and specie transports, but also because it reflected the country's general prosperity.

[62] Corps Législatif, Conseil des Cinq Cents, *Rapport fait par Challan sur la nécessité d'établir une législation uniforme relativement à l'échéance des lettres de change & billets de commerce, Séance du 27 messidor an 6* [15 juillet 1798], Paris, Imprimerie Nationale, 8 p.
[Electronic document downloaded from Gallica.fr]

[63] For example, A. Troullier, who shows the continuities in the history of the bill of exchange, uses the expression in a very cautious way, referring to the Ancien Régime to establish it, *Documents pour servir à l'histoire de l'évolution des effets de commerce et notamment de la lettre de change,* Thèse pour le doctorat, Paris, Sirey (Larose & Tenin), 1912, p. 88 and 251.

3.2. The "founding father": Mollien

Then, it is no surprise that the main architect of the compromise was, at the same time, a public financier, a political man, and a good economist, grounded both in pre-Revolution finance and in post-Revolution governments, specialized in monetary and banking matters: Nicolas-François count of Mollien[64].

An early reader of Smith, whose metaphors and principles are abundantly present in his writings, Mollien has been in a position to play a key role in the banking system implementation at three different occurrences. As the first director of the *Caisse d'amortissement*, in 1800, he tried unsuccessfully to resist the First consul will to have him lend 5 million francs – a huge sum then – to the newly founded *Banque de France*. In 1802, he became "the professor of political economy" [65] of Bonaparte, and progressively gained influence over Crétet and Barbé-Marbois, through almost weekly discussions in the gardens of the Malmaison, sometimes followed by detailed notes upon the various subjects discussed: future markets, banks, money, discount, state budget, etc. In 1805-1806, he designed the general sketch along which the *Banque de France* was to be reformed. As Ramon stated: "Mollien has undoubtedly been of more help to the banking institutions by his critics than a hundred flatterers by their praises."[66]

But why call Mollien the "founding father", if he was not part of the project and only resisted the new bank? It is an *a posteriori* opinion by the *Banque de France* management, which has, more and more, modeled itself on the high-ranking civil servants. Let us give two examples of this late recognition. The book of G. Ramon, the first founded upon archives and original sources (as proclaimed in its title) includes only one portrait: that of Mollien. And several internal memos or quotations after the Second World War state its role in the shaping of the *Banque*'s doctrine:

> *« Mais s'il n'est pas du tout détourné de son sens essentiel, nous maintenons que le papier commercial reste le meilleur instrument du crédit bancaire. Ce n'est pas certainement le seul à encourager, mais celui qui contient en soi la meilleure justification économique et juridique du crédit.*
>
> *C'est une très vieille notion à la banque, puisqu'elle nous vient de Mollien, qui est l'un de nos fondateurs, mais nous l'avons constamment repassée au crible de l'analyse et nous l'avons constamment, je dois dire, trouvée juste […]. »*[67]

The fact such a tribute was paid almost 150 years after the foundation of the *Banque de France* shows how important is Mollien's role in its doctrine. But to reach

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[64] On Mollien and banks, see G. Jacoud, « Mollien's contribution to the analysis of the bank of issue », *Financial History Review*, vol. 8, part. 2, Oct. 2001, pp. 123-141. A general biography of Mollien, albeit published long ago, in A. Liesse, *Portraits de financiers : Ouvrard, Mollien, Gaudin, Baron Louis, Corvetto, Laffitte, De Villèle*, Paris, Félix Alcan, 1908, pp. 69 sq. But the best introduction to Mollien's life and works remains his *Memoirs*, first published in 1837. No biography of reference has been written on Mollien.

[65] Pierre Bougerol [*La Banque de France et la crise de 1805*, PhD dissertation in economics, Paris, 1969], quoted par G. Jacoud, *Le billet de banque en France (1796-1803). De la diversité au monopole*, Paris, L'Harmattan, 1996, p. 200.

[66] G. Ramon, *Histoire de la Banque de France d'après les sources originales*, Paris, Grasset, 1929, p. 36.

[67] Archives of the *Banque de France* – Archives of the *Conseil national du Crédit*, plenary meetings, file n° 8, stenography of the meeting 1948/6/30, feuillets J4 et J5

that point, the *Banque* had to try and fail several times, until a new compromise was reached.

3.3. A secretive and difficult implementation

We will not write here, again, the first years of the *Banque de France* but to show how this compromise was reached.

The *Banque* was founded both by private bankers and the state, as the *Caisse d'escompte*. In fact, in many, ways, it placed itself in the continuity of the *Caisse d'escompte*[68]. This double origin has provoked a voluminous literature about the independence of the *Banque*, or the degree of this independence. But, as we tried to show, perhaps is it not the right question: by nature, the *Banque* could not be a strictly private and independent body. And the main reason is not that the state had a hand in its foundation and in its subsequent reforms: the main reason is its connecting role between two monetary circuits, the commercial and the fiscal ones.

The *Banque* had been founded as a *sui generis* juridical object, because that connecting role was in contradiction with the new rationalization of law, opposing individual and nation, public (i.e. the state) and private (i.e. anything apart the state, and specially property). As shown by Jean Hilaire[69], to cut commercial law from public law was to cut it from some of its main sources and reasons: state-managed general interest and police questions. As a result, the very juridical status of the *Banque* has been a question in itself: for example, from 1800 to 1803, it has functioned as a joint stock company, a type of company that didn't exist in French law at the time. And when the status of joint-stock companies was introduced in French civil law in 1804, still the *Banque de France*'s statutes remained distinct from the general rule.

The resulting institution functioned on two separated plans: on the discourse level and on the business practices level. For example the *Banque* was proclaimed private and completely independent from state intervention. But when it came to business, the results were completely different. A good example of the discourse level can be found in the speech of the first president of the *Banque de France*, Lecoulteux-Canteleu, at the first stockholders meeting, in October 1800:

> *"Il est sur-tout à remarquer que la Banque de France, par le fait seul du caractère de généralité sur laquelle elle s'est établie, n'est nullement gouvernementale : libre par sa création qui n'appartient qu'à des individus, indépendante par ses statuts, affranchie des conditions qu'auroit pu lui imposer un contrat privé avec le gouvernement, ou un acte législatif, elle existe sous la protection des lois générales, et par la seule volonté collective de ses actionnaires. Lorsqu'elle traite avec le gouvernement, ses transactions prennent le caractère qu'elles doivent avoir avec un gouvernement libre : elle ne négocie avec lui que lorsqu'elle rencontre ses*

[68] The first president of the *Banque de France* (see below) was a former member of the board of the *Caisse d'escompte*.
[69] J. Hilaire, *Introduction historique au droit commercial*, Paris, PUF, 1986, p. 33 and 86.

convenances et le complément de ses sûretés ; enfin elle est absolument hors de lui." [70]

Then it seems clear that the *Banque* should be absolutely independent and that its main activities were "its relations with commerce". But, the reasons why the *Caisse d'escompte* had to take part into public finance had not disappeared. In fact, they were even reinforced by the consequences of the Revolution. One of the main sources of commercial bill drawings at the times of the *Caisse d'escompte*, were the sugar trade and the related traffics with the West Indies French Islands, including re-export to Europe, and also wine exports. But in 1800, these traffics were completely disrupted. Many witnesses evoked the depressed activity of French ports (Bordeaux and Nantes). No large establishments were needed: the two main banks already founded in Paris, the *Caisse des comptes courants* (1796) and the *Caisse d'escompte du commerce* (1797) were as modest as necessary in such business conditions.

But, of course, some did not accept that reduced activity and were quick to conclude that, since commercial prosperity was associated, during the *Ancien Régime*, with a large bill circulation, encouraging bill circulation would bring prosperity back. This voluntarism, present in the general meetings of the *Banque de France*, shifted the precarious balance of the former *Caisse d'escompte*. At that time, the plan came from bankers and financiers, who needed state approval to incorporate, even if the *Caisse* developed its operation only after Necker convinced Paris most prominent bankers to take it under control. In 1800, the plan was promoted both by bankers and the state, one of the reasons being that two banks already operated. To create the *Banque de France*, its promoters must obtain a monopoly, one way or the other. In 1776, the monopoly followed from the privilege; in 1800, the privilege was necessary to establish the monopoly. Moreover, because commercial bills emission was so low, the new *Banque* relied even more on the services to the state.

First example of its dependency, the *Banque* successfully lobbied to obtain public resources: the 5 millions francs reluctantly transferred by Mollien from the *Caisse d'amortissement*. Then, it serviced the state: national lottery service, pension payments or management of the current account of the Treasury. But the real point is the high proportion of state bills discounted by the Banque, either as "extraordinary operations", i.e. not authorized by its statutes, or through sheer complacency. In the first case, as soon as May 27th 1800, only three months after its foundation, the *Banque* discounted almost 1 million francs of public bills at a reduced rate. In the second case, and Mollien explained the mechanism in details[71], the *Banque* discounted bills which resembled commercial bills in every formal aspect. But the drawees were fictitious: they were only puppets behind which stood a civil or military state officer, in charge of supplies. Indeed, according to the law, the French state could not be seized and executed to pay a bill which meant that the *Banque* could not discount a bill when the drawer and the drawee were state servants, because in case of protest, there was no fast commercial way to settle the case. To discount such a bill was then a sure sign of complacency, but also, and mainly, of the scarcity of commercial bills to be discounted.

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[70] Archives of the *Banque de France* – Assemblées générales de la Banque de France, Assemblée du 25 vendémiaire an IX (October 17th 1800), speech of the president [at that time, the *Banque* is still headed by a president], p. 63.

[71] Mollien, *Mémoires, tome 1*, pp. 329-330. He uses several times the expression "foi publique" in his *Mémoires*.

The frequent crises that followed, in 1803, 1806, 1811 to 1815, proved the limits of the *Caisse d'escompte* model in this new context and the necessity to build a new compromise between state and commercial interests.

3.4. The compromise: an institutional arrangement

From 1802 to 1810, with a growing capacity to convince, Mollien became the man behind the successive negotiated compromises. His action took two main directions: general interest and the rules of discount.

First, and faithful to a public interest morale, he forced the *Banque* to separate, at least officially, its operations from those of its stockholders. As in the letter by Calonne of 1785, the link to general interest was given by the "*foi publique*" implied by the circulation of banknotes in the public[72]. In his justification of this reform, we find a very convincing description of what is a conflict of interest and of its hazards. A more famous line of argument of Mollien was the idea that, contrary to other privileged banks in France and abroad, the *Banque de France* was the first to be paid by the state (the 5 millions francs sum received from the *Caisse d'amortissement*) for its privilege.

Second, Mollien exposed in rather detailed notes the sound principles of banking. Here, he faithfully followed Smith, but what is interesting is that he did not promote a free-market attitude to banks and emission. To him, banks were essentially local: their emission must be limited to one commercial centre, an area small enough for any banknote bearer to cash it in easily. Second, he did not promote freedom to establish banks and did not support the idea of a variable rate of interest. Concerning internal change, i.e. the difference in the sum paid on a bill as compared to its value where it was drawn, Mollien linked it to the cost of specie transport. But he did not think that cost could be reduced by scriptural transfers: banks must stay local; at best, scriptural transfers would reduce the need for change, not reduce its price.

In short, when it came to money, Mollien sticked to the quantity-driven market and to the metallic, merchandise, definition of money, much more than to modern price-driven markets and conventional money, because he put forward the "*foi publique*" and quality criterions. The quality question, i.e. the confidence of the bearer in the banknote, was crucial. It corresponded also to the idea that several kinds of monetary circulation coexisted, but that only silver and gold were real monies. That is why Mollien, and the *Banque de France,* following Smith, were hostile to small denomination banknotes: at the beginning of the 19th century, the smallest denomination was 500 francs, at least 6 months of a worker's pay. And it did not change until 1847, even if, out of Paris, and given the reduced scale of commercial affairs, 250 francs banknotes were authorized.

Conclusion

We can see now the different aspects that have to be taken into account. Of major importance is the question of hierarchy: different monies mean a hierarchy and/or some coordination between them, and some institutional procedures and bodies to transfer one

[72] Mollien, *Mémoires, tome 3,* p. 151.

money into the other: banks. Then come the laws and the rules, which settle the way monies are valued and measured, and force the intervention of state, either for economical reasons (anti-selection) or for moral ones (the usual condemnation of usury and fluctuating interest rates). For example, from 1800 to 1807, as long as the *Banque de France*'s rate of discount was over 5%, a legal rate of interest could not be decided, because a commercial margin of at least one percent was necessary between the first purchase of a bill by a banker and its discount by the *Banque de France*. But as soon as the government convinced the Banque to lower its rate of interest at 4%, as was done the 5th of August 1807, a legal rate regime could be reestablished: the law of September the 3rd 1807 fixed the maximum of the civil rate at 5%, and the maximum of the commercial rate at 6%. But, because that rate differed from one mean of payment to the other, as demonstrated by internal change, it was necessary to decide which rate mattered, and also to figure out an institutional arrangement that would reduce, as much as possible, the opportunity cost of transferring one money into another – a civil debt into a commercial one.

The choice of rate stability – no movement of the *Banque de France*'s interest rate occurred from 1815 to 1847 – and of bank localism[73], the separation between bill market[74] and bill discount by the *Banque de France*, the mix of commercial and state bills discount behind the veils of the so-called *Banque de France*'s independence, mixed in the convenient "commercial portfolio" published, all this shows that neither the government nor the bankers were ready to resort to pure market mechanisms in 1800 nor in 1830 and still in 1848. The quantity constraints and costs of arbitrage (information and transport) meant that prices could not be used as an efficient signal without endorsing, in times of crises, excessive levels, and called for a permanent managing position of the state, which only had the authority to face shortages and runs (the new form of shortages) through *cours forcé* and legal tender.

[73] Coquelin reported that, before 1848, Banque de France's banknotes were seldom accepted outside of the town's limits. Coquelin, *op. cit.*, p. 138.

[74] Which had its own problem, beginning with the fact that stockbrokers, who had a monopoly on commercial broking, did not want to get involved into operations dominated by bankers and not enough paying. That precise question deserves much new research.