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Sismondi on Paper-money, Convertibility and Public Debt (1810): or, a missed (?) Opportunity to join the Bullionist Controversy

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This contribution intends to discuss Sismondi's early monetary theory (1803-1815) and his attempt to connect it with his vision of the social contract. Besides some references to Sismondi's vast correspondence, this article is centred on the monetary chapters of his 1803 *Richesse commerciale* (Book I, chapters V and VI), his little-studied 1810 article on paper-money, chapter V, *Of Money*, of his entry "Political Economy" written in 1817 for the *Edinburg Encyclopaedia* and, of course, the monetary chapters of his *Nouveaux Principes d'économie politique* (1819 and 1827).

After some brief considerations on Sismondi's early publications around *Richesse commerciale* an attempt is made to contextualise his monetary thought in relation with Napoleonic war financing in Continental Europe. In connection with his Smithian source of inspiration, Sismondi's theoretical framework is then presented and discussed in connection with Austrian/Russian public debts and paper money (and his role as economic adviser to the Austrian emperor and his minister of finance). Connections with the upcoming flood of literature in England on the bullion controversy are offered and questions are asked i) why Sismondi did not take part in a debate he partly anticipated in his 1810 article; and ii) how he dealt theoretically with the Austrian 1797 suspension of convertibility; iii) how he urged an prompt return to such a convertibility based on a discussion of the comparative states of Continental and English banking systems (thanks to his banking system England can afford a Ricardian scheme which is out of reach for Austria). Remarks are then offered on the author's opinion on the progressive emergence of an 'art of public borrowing' according to which the people who provided the money also controlled the government (the so-called Anglo-Dutch model). Finally, some reflections are offered on the explicit connection Sismondi establishes between the (ab-)use of inconvertible paper money and the partial collapse of the social contract initiated by governments using it.

1. From *Richesse commerciale* (1803) to "Paper money" (1810)

Volumes II and III of Sismondi's *Oeuvres économiques complètes* contain Sismondi's little known (and much neglected) early contributions to economic theory. Volume II includes an annotated edition of his 1803 *Richesse commerciale* and its companion volume III *Écrits* *d'économie politique 1798-1815* offers eighteen articles (half of which published for the first time) spreading from 1798 to 1815. In fact this collection of articles illustrates the origins of *Richesse commerciale* and the use and development of its main argument during the difficult Napoleonic wars when Sismondi was barred from publishing anything of importance in the field of economics. One of the central results of the work undertaken by the editors of Sismondi's *Oeuvres économiques complètes* has been to put a strong emphasis on the continuity in Sismondi's theoretical and philosophical argument between his two main books. In other words, the traditional 'conversion argument' initiated by Marx according to which Sismondi moved from a straightforward Smithian arch-liberal position in *Richesse commerciale* to some sort of proto romantic socialism in *Nouveaux Principes* has been found severely wanting.

This paper brings back from oblivion one of Sismondi's very original article on paper money that anticipates in many ways Ricardo and the Bullionist controversy. In fact, it is a first attempt to show that the Continental tradition in monetary theory is much richer than the traditional arch-Ricardian school inaugurated by MacCulloch led economists to believe.

2. Sismondi as an economic adviser to the Austrian emperor (1808)

Tract for the time in 1808 on a burning issue in war-torn Europe, Sismondi's forgotten article on paper-money offers not only a very original and early contribution to inflation theory and public finance, but also a much wider discussion linked to the nature of political regimes using such war-financing techniques (Austria, Russia and Denmark). Initially written in two parts[1] during a stay in Vienna with Germaine de Staël from April to June 1808, the manuscript was immediately read by the emperor himself and discussed at length with the finance minister Zizendorf. Obviously without any success! However, and under the constant suspicion de Staël and Sismondi suffered from Napoléon, an agent of the French secret police working in Vienna sent a report to Paris to inform his superiors about Sismondi's activities. Similarly, manuscript versions of this text reached Denmark[2] and were immediately seized and a potential translation forbidden. Slightly altered to include Russian and Danish data, the final version dated 12th May 1809 was published in French at Weimar (i.e. outside the reach of Napoléon's police!) in an obscure German journal for 'military art' called *Pallas : Eine Zeitschrift für Staats- und Kriegskunst*[3].

1 In three letters written to his mother on April, 29 and 30 and on May 12, 1808, Sismondi describes in great details his Viennese stay and the circumstances which led him to write initially two separate memoirs which were finally merged into for the 1810 publication (J.C.L. Simonde de Sismondi, *Un viaggio d'altri tem*pi (éd. M. Chiostri), p. 69, 74, 76, 79 and 85).
2 A member state of the anti-Napoleon coalition.
3 1810, 2, Heft n° 1, pp. 1-28 et Heft n° 2, pp. 122-156. This essay is reproduced and annotated in volume III of Sismondi's *Oeuvres économiques complètes*, *Écrits d'économie politique 1798-1815*, pp. 273-307.

A few offprints of this text were circulated in a confidential manner in countries outside French control. This text met apparently with some success but bizarrely remained totally unknown in England (even after the start of the Bullionist controversy). No evidence has been found so far to indicate that any of the leading Bullionist debaters read Sismondi's piece. Despite all his efforts, Sismondi never managed to have it republished.

3. An analytical guide to Sismondi's argument

In *Richesse commerciale* as well as in his 1810 article, Sismondi's main argument revolves around a distinction he makes between (backed or unbacked) paper-money as a fiduciary mean of payment and convertible banknotes as an interest-bearing instrument of credit.

Following Smith's original argument, Sismondi acknowledges fully the resource-saving qualities of paper-money as long as it is fully convertible in gold. Paper money is a simple addition to the supply of *numéraire* understood as metallic currency. With a given number of exchanges in an economy, any additional paper money drives metallic currency (both coins and bullions) either out of the money market or out of the country (gold points) raising thus the price of gold in term of paper money. Hence, just like a commercial banker issuing more bank notes than his discounted IOUs, a government turning its Treasury bills into means of payment « ne fait que multiplier le signe pour s'approprier la réalité » (*Richesse commerciale*, p. 86).

The first half of Sismondi's 1810 article is a detailed and extremely thorough analysis of the various techniques used by the Austrian government from the beginning of the 18th century down to the suspension of convertibility in 1797 to finance a growing part of its rocketing deficits via paper money.

Sismondi's main argument is straightforward and very much akin to the upcoming Bullionist position in Britain. If banks (public of private) are not required to convert notes into gold, then they will be tempted to issue notes in excess of the gold in their vaults. This will lead to an excess supply of money and hence, in their view, a cheapening of the price of money, i.e. inflation. They argued that to avoid inflation, required convertibility of notes into gold should be restored. Among the spokesmen for the Bullionists were Henry Thornton (1802) and, a slightly later, John Wheatley and, of course, David Ricardo (1810, 1811).

Following Thornton (1802), Sismondi (without however quoting a book already available in French in Geneva in 1803) provides an admirable critique of Smith's real bills doctrine via the indirect interest rate mechanism (*Richesse commerciale*, p. 110)[4]. Namely, he asks, who

[4] The monthly *Bibliothèque britannique* turned Geneva into a quasi English intellectual city in the middle of a French dominated Continent. Ricardo, Malthus and Thornton made their first appearance in French (Paris

guarantee that the demands of commerce were limited? Suppose actual capital yields returns higher than the rate of interest (or discount) charged by the banks? Would not merchants demand an interminable amount of notes - however "real"? Bills offered for exchange into notes, he argued, might not readily be "limited" as the real bills advocates argued. Inflation and forced savings must thus ensue. Similarly, to turn an initial (and perfectly legitimate) issue of government paper money by the central bank to save on real resources and increase the efficiency of tax gathering into a systematic technique for raising taxes via inflation would lead to the same result. The distributional effects would simply be in favour of the government – and not in favour of the private beneficiaries of the commercial banks' over-issue.

In that respect, and in line with Thornton, Sismondi's analysis seems to form one of the many contemporary germs for the later "cumulative process" of Knut Wicksell (1898): the drop in market interest rates resulting from deficit financing via paper money would only be temporary; the rise in money prices resulting from a rise in the demand for a given quantity of goods would rapidly ("three weeks to a month" argues already Sismondi in his *Richesse commerciale*, p. 112) bring the interest rate back to its higher initial level. Anticipating in a somewhat crude fashion Cagan's modern hyperinflation model, Sismondi is in fact using the then recent *assignats* episode to warn the Austrian government about the cumulative and accelerating inflationary process leading to higher and higher inflation rates forcing the Treasury to print more and more paper-money to end up in hyperinflation (implying the value of money falling to zero). The value of the interest payments on and the capital of the initial funded debts are rapidly brought down to zero; interest-bearing Treasury bills are turned into paper money and the exploding budget deficit leads the government to bankruptcy.

4. Sismondi as a precursor to the English bullion controversy

The timing of the writing as well the date of the publication of Sismondi's essay is particularly intriguing. Both are rising many more questions than can be answered today. Without mentioning any of the already abundant theoretical literature resulting from the suspension of the convertibility of the Pound sterling on 26th February 1797[5], Sismondi's text written en April 1808 is finalised in May 1809, six months before the beginning of the flood of pamphlets linked to the *Bullion Controversy* which only erupts in England in the Autumn of 1809.

editions only appeared after the fall of Napoléon). In particular, the sophistication of Genevese bankers allowed them –and Sismondi- to understand fully the importance of Thornton's slim volume which appeared in French barely ten months after the original 1802 London edition.

[5] Followed the same year by the suspension of the convertibility of the Austrian currency…

As a matter of fact, and oscillating with the fortune of war, and for the third time since 1797, in the Autumn of 1809, the price of gold rose temporarily above its parity in term of paper money (or, in other words, the Bank of England banknotes were depreciating on their definition in gold). Hence the celebrated *Bullion Controversy* (implicating in particular Ricardo, Malthus, Trower, Horner and the *crème de la crème* of the English political and financial establishments) began well after Sismondi put the final touch to his pamphlet on 12th May 1809. Ricardo publishes his first (anonymous) article in August 1809, the House of Commons *Bullion Committee* is appointed on 19th February 1810, the *Bullion Report* is submitted to the *House of Commons* on 8th June 1810 and made public the following month. Ricardo's celebrated theoretical answer – the *High Price of Bullion* - is already published in January 1810. And during this very same month of January 1810, the first part of Sismondi's pamphlet eventually appears in Weimar. Ricardo's pamphlet will reach its third edition during the summer of 1810. During the same period, Malthus establishes his first contacts with Ricardo precisely in connection with the *Bullion Report*. A series of pamphlets and articles under his pen followed from 1811 onwards.

One can only be baffled by the total absence of connection between the two simultaneous discussions on the very same theoretical problem. Clearly, no direct cross references can be found during this 1809-1811 period in either Sismondi's or Ricardo's or Malthus's works. Even much later neither in Ricardo's 1816 *Proposals*, nor in his 1817 *Principles*, nor in Sismondi's 1819 *Nouveaux Principes* nor in Malthus's 1820 *Principles* can one find a single trace or developments of this central monetary issue. Ricardo's well-known critique of Sismondi bears mainly, if not exclusively, on 'pure principles'[6], not on monetary questions. Of course, many explanations are readily available and could be followed (intellectual isolation due to the war, lack of interest from English economists to Continental reflections, confidential circulation of Sismondi's pamphlet, Sismondi's lack of further interest in monetary questions, etc…) but none is really satisfactory. Some traces of connections between Sismondi and English speaking economists on monetary questions are nevertheless followed in the Geneva archives; but nothing convincing has surfaced yet.

Once again, one is faced here with an interesting illustration/demonstration in philosophy of science. This small episode at the turn of 19th century seems to confirm that multiple discoveries *à la Merton* (at least in monetary theory) are not born of chance but of necessity.

5. The art of public borrowing and the role of a well-functioning banking system

[6] In his correspondence and his diary, Ricardo mentions at least at several different occasion the nature of his dicussions with Sismondi (*The Works and Correspondence of David Ricardo*, vol. VIII, p. 376 ; vol. IX, p. 218, 220, 235-36, 243-4, 248 ; vol. X, p. 270, 278, 281).

One of the most original and novel of Sismondi's contributions to the theory of public finance is the connection he draws between a possible successful use of paper-money, the solidity of the banking system and the confidence lenders attribute to the government. *Per se* paper money is a rational way to save on real resources (gold and silver) and to raise taxes more efficiently. However, and echoing arguments already discussed in *Richesse commerciale*, « il faut pour le mettre en œuvre que la moralité du gouvernement inspire la confiance la plus parfaite, et rassure sur la crainte de lui voir multiplier le signe pour s'approprier la réalité. Or … cette moralité du gouvernement, lorsqu'elle existe, n'est point une chose inaltérable » (*Richesse commerciale*, p. 86). He goes as far as to admit that his critique of paper-money applies only partly "à l'Amérique et presque pas à l'Angleterre… parce que le principe des banques étant très bien entendu … elles évitent sur toute chose d'émettre trop de papier » (p. 304, note 25). Similarly, in his *Nouveaux Principes* (1819 and 1827), Sismondi makes England an exception to his critique of paper money financing of public debt because, in this country, "l'émission a été contenue dans de justes bornes et où un sacrifice peu considérable a suffi pour mettre la banque [d'Angleterre] en état de reprendre ses paiements" (1827, t. 2, p. 149-50)[7]. Highly critical of the use of paper money by the Austrian, Russian and Danish governments, albeit briefly, Sismondi argues in his 1810 paper that "because of a better understanding of the banking principles" England and the United States do not run similar inflationary risks[8]. By 'better understanding of the banking principles'[9] one has to understand the ability of the government to finance its deficits (and in particular those arising in Europe at the time due to the Napoleonic wars) by borrowing and not exclusively via paper money[10]. And for Sismondi, citizen of Geneva and heir to the Anglo-Dutch public finance tradition slowly built during the 17th and 18th centuries, the relative advantage of England and the United States over Russia and Austria simply arose from the fact that, in the English-speaking countries, there is a nearly perfect match between the class of people providing the money and those in charge of public affairs. Hence, "sound principles of political economy" run better chance to be upheld in countries where people

7 Ou encore, « l'Angleterre s'est donné un papier monnaie […] mais elle était trop bien avertie des dangers d'une circulation surabondante, pour multiplier ses billets au delà de ce que la circulation pouvait absorber » (*idem*, p. 144).

8 Of course, and in opposition to Ricardo's *Proposals*, Sismondi does not goes beyond generalities when discussing coins vs bullions convertibilities. And despite his perfect grasp i) of the distinction between nominal and real interest rates and ii) the convergence process of the former towards the latter, he does not enter in any discussion about Ricardo's crucial argument about the change of the quantity of banknotes which was to vary inversely with the sign of the spread between the market price of gold bullion and the legal price at which it could be obtained against notes at the Central Bank. The state of the Austrian finances and banking system were well beyond such theoretical niceties…

9 Sismondi develops again this argument in his *Nouveaux Principes d'économie politique*, t. 2, p. 149-50.

10 In fact, and for that very reason, the distinction between interest-bearing banknotes (a credit instrument) and paper-money so important to Sismondi and to most Continental economists is never properly made by no less than Ricardo. Even if the Bank of England is issuing temporarily unbacked paper-money, it is used as a means of payment and not as a credit instrument by the government.

who provide the money by subscribing to government loans are also those controlling the government. In such a political set-up, a government does not need to use paper money (i.e. to print money) because it can freely borrow on a properly functioning bond market.

Without exploring in details such a central question, Sismondi's main thesis is broadly that once borrowing could finance wars, the outlook for autocracies of the Austrian and Russian (and of course French) type would dim. Hence, when the art of public borrowing developed by Italian city-states of medieval Italy as a 'democratic' alternative to the traditional treasure chest, plunder or, of course paper-money techniques was properly understood, the autocratic regimes were doomed. Even if such a process took centuries to reach its apex with the bourgeois-rentier citizen-creditor between 1850 and 1950, Sismondi sees thus the roots of the classical 18th-century constitutional democracy being also largely explained by the rise of … the bond market: for him it is no coincidence that public borrowing and parliamentary government both originated in Europe, and more precisely in England (and, may be, on a smaller case in his beloved Geneva). Hence, and despite a collection of rather pedestrian flatteries addressed at both the Austrian and Russian emperors, the connection between political philosophy and economic theory within preferably smallish republican (but not necessarily democratic) states is central to Sismondi's argument. In other words, the interdependence between politics and the economy emerged as one, if not the central topic of political theory. Hume, Smith, Turgot or Burke, Mirabeau and Necker are obvious predecessors to Sismondi that come to mind. Further explorations in his *Italian Republics* volumes would probably confirmed his very Genevan vision of this particular connection between the way to run public finance and a Republican political regime: Sismondi's mythic *celeste Ginevra*…

6. Paper money and the social contract

Well within this 18th-century tradition, Sismondi's overall vision of a general interdependence between the various branches of what he is one of the first to call the social sciences (see *Richesse commerciale*, p. 8), led him eventually to reflect on the connection between the use and abuse of paper money and the breach of the social contract.

True to a methodology he upheld during his entire life, and after having established the 'first principles' of monetary theory (and "the immense, even incalculable pains resulting from paper-money"), Sismondi devotes the rest of his 1810 contribution to a thorough discussion of the policies to be followed in order to limit and eventually to suppress paper-money. And his propositions are very much akin to those made later in England by the Bullionists: a return to a system in which gold and silver are the only proper legal tenders (or at least in which paper money is freely convertible in coins and bullions).

And building explicitly on his earlier argument in *Richesse commerciale*, for Sismondi, this policy of a return to a fully convertible currency system is much more than a mere technical problem. Short of such a move, the Austrian and Russian governments would not work for « la félicité des peuples », for their people's happiness. As a matter of fact, and the *assignats* experience is still very vivid in his memory, debauching one's currency for financing public spending (even war financing) amounts to nothing else but to a breakdown of the social contract.

Sismondi's argument dating back to his *Recherches sur les constitutions des peuples libres* and his careful reading of Smith's *Wealth of Nations* is simple, but powerful. When the agents' interests cannot be coordinated through contracts negotiated by individual agents on markets and sanctioned by a price mechanism, the social contract on which rests the government's legitimacy has to take over. And if, as in the case of money as a social contraption, the government does not abide by this contract which obviously excludes arbitrary distributional effects between agents via paper money and inflation, then the government's legitimacy is wiped out and the social contract breaks down.

Recalling his anti-protectionist position in *Richesse commerciale* and anticipating his critique of the post-war English industrial society in *Nouveaux Principes*, the asymmetry between agents introduced by paper-money is hence, for Sismondi, yet another example of a failure of the social contract. Once again, the stability of the value of money, the sophistication of the banking system, the ability of the government to borrow on a properly organised bond market and, above all, competitive markets on which consumers are not exploited by monopolies and protectionism are all central parts of a well-functioning Republican system.

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