The Spontaneous Issue of Lancashire Bills of Exchange as Money

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This is an exploration into an episode in British industrial history where banks did not exist, at least not in their present form. Although their modern formation had just started, the payment and credit mechanism for trade flourished. Lancashire bills are a great example of spontaneous money. More importantly for the greatest industrial city of the world at that time, they were preferred over any other type of money. They would still also exist today except tragic state interference.

Professor Jesús Huerta de Soto inspired me to look at money, credit and banking in a different way. For that I am grateful. It is a privilege to learn under one of the great teachers of the world.

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Early Banking in Manchester

The first Manchester Bank, was called Byrom, Sedgwick, Allen and Place. It opened in 1771. It was not the only Manchester banking business. In Liverpool, at this time, merchants were also establishing banks. The majority of trade was conducted via the medium of bill discounting. Due to Liverpool being a port, marine insurance was also allied to banking (Redford, 1934, p. 248). The first banks in the UK's main industrial area were nearly one hundred years behind the establishment of the Bank of England and the Scottish banks.

Crick and Wadsworth (1936, pp. 142–43) note the significance of Manchester and the close by City of Liverpool, by observing that the more agricultural the area, the more likely small circulation note issued by banks were to be established. The theory is that the industrialists have more developed capital structures, need money for longer, and sell things less frequently. For the farmers the opposite was true. Farmers produce fresh product all the time; selling to many different people in small and regular quantities which made a note an easier method to facilitate trade than gold, silver, or bills. However, Crick and Wadsworth also suggest bills in Lancashire issued in smaller quantities performed the same role. Lancashire was attracting produce from around the Empire to process into finished goods and sending it out to the four corners of the world. This would mean it would have counterparties with no knowledge whether a small county bank in region X or region Y of the world was commercially sound or not. Therefore, either credit granted to receive money upon the sale of the goods at their final sale to the consumer, supported by a bill, or money received (gold or silver) from a bill discounter, who may have better local knowledge, taking the counterparty risk, would be one way they choose bills over notes as a medium of exchange. Confidence in the fellow industrialist, supplier or customer was higher than that of the local bank.

As the industrial revolution was maturing we can see that bills were used as the primary medium of exchange across the whole country as the preferred facilitator of exchange. This part of our country's history is one of the UK's finest, as banking approximated a free system. Money, especially bills of exchange circulating as money, had arisen from the market to solve the problem of exchange, and was doing a good job.

Ashton (1934) picks up the story of the Lancashire bills and asserts that two papers written by Henry Baker of the Manchester and Salford Bank infer that (1) agricultural areas had more residents and more banks and (2) the industrialists were less thrifty than farmers.

We note the inference that the Lancastrian industrialist was less thrifty than his agricultural counterpart. However, leaving aside the issue of who was or was not thrifty, to build these great pioneering enterprises, you needed savings, [1] or other people's savings, in substantial amounts. So, I think it is more an issue that they saved and invested all they could and needed more! To deepen and lengthen their capital structure to produce more, they needed to save to invest. We must also remember that the industrialist's inventory of surplus goods is his savings, as that is what he, in the future, will part with for other goods and services via the medium of money. Bills not yet matured and inventory will also be savings. Aston (1934, p. 104) overlooked this point. However, promisingly, he develops the point that bills by their nature were more conducive to international trade than notes issued via a county bank. As bills were issued, backed by physical items of manufactured goods, in international trade, they were deemed better security than a promissory note issued by a local county bank. Ashton also gives us clues as to why they have almost vanished today from the commercial realm as the stamp duty applied to them was less advantageous than that on notes or a cheque, as the latter provided quicker redemption in money.

Digging a bit further into the historical record, we see that these bills arose spontaneously to fulfill a need to be able to facilitate the smooth transmission of trade. A perceptive book written by Wadsworth and Mann (1931) documents this history. They explain (pp. 37–38) how in the early 1600s cotton production was used to spin into working men's garments in the first industrial processes. This was facilitated by bills which made sure the cotton was paid for, by raising a "bonde" or bill obligatorily "payable at four months." As a result, bonds and bills facilitated the early start of the industrial revolution. They helped fill the time gap between having to have the cotton and then manufacturing into a garment and selling it for cash. A bill signed over for discounting to cash would give the owner of that bill the right to that eventual produce should the producer not pay (pp. 91–92). Credit was granted and discounted bills accepted and paid with *specie*, not with notes or other such fiduciary credit. The Crown

[1] Pressnell and Orbell (1985, p. xix) write that "The historic role of the bill broker was to facilitate the movement of bills from area where industry was developing rapidly, and which consequently was short of cash, to agricultural areas which had a large surplus of savings."

accepted these bills for tax purposes, leading them to function broadly as money.

How the Lancashire Industrialist Understood Money

It would seem that the industrialists knew the distinction instinctively between a claim and credit transaction. They only dealt in *specie* and bills of exchange. Specie always gave ability to the owner to make actual claim transactions with money *on other goods and services* until paid, as opposed to a credit transaction where you only have a right to get the *loaned money back at a certain time* in the future. A discounted bill could then function like a credit transaction as the owner who provided the specie to pay for the original goods now waits until the final goods are sold and paid back in specie with a premium, but they always had recourse, in the eventuality of non-payment, to assert their ownership right over the goods. With bank runs being reasonably frequent, they viewed it better to own a right to the final payment of goods and services, from people they knew and conducted business with, than hope that the notes they owned could be redeemed in specie at a county bank.

These Lancashire bills were money. We can see that Ashton (1939, p. 104) looked at the activities of a number of bills and noted *that bills passed from person to person*, in exchange for goods and services *prior to* the ultimate payment of the goods when the original goods that were discounted against were sold. This is how a good proportion of bills functioned at the time.

What Happened in Manchester? Why Did These Lancashire Bills Decline?

Samuel Oldknow and the Arkwrights (Unwin et al. 1924) is a most spectacular historical investigation into one of the pioneering mill owners of the day. It points out that even after the 1793 panic and collapse of many businesses and then moving on to the outbreak of the Napoleonic War, while other parts of the nation were allowing notes to be issued, Manchester was having nothing to do with this: A meeting at Manchester resolved that *during* the emergency it could not be considered disreputable for houses to make payments in their own notes, payable in three months with interest. (Unwin et al. 1924, pp. 179–80).

In the absence of banks, they continued to issue their own bills against goods sold. In general, the industrialists remained deeply suspicious of anything to do with county banks and note issuers. The authors (Unwin et al. 1924, p. 190) note that the bills that the Oldknow company issued started to decline in value as there was a general inflation in the late 1790s. Holding bills of a fixed nominal sum while inflation increasing decreased the real value of the bills. This general inflation was not helped by the suspension of specie payments in 1797, brought about by the Napoleonic War. Therefore, it would be more sensible to move to holding notes which could circulate more quickly as the merchant deleveraged from any inflationary effect on trade.

Another reason for their demise what the imposition of a stamp tax (1815) on bills. Wright (1913, pp. 69–70) notes:

> On May 27th, 1815, a petition was signed for the presentation to the " Rt. Hon. Nicholas Vansittart, Chancellor of the Exchequer, etc., etc., etc.," in which it was stated that the Directors of the Chamber felt much alarm and uneasiness at the proposed increase of the taxes on stamps and inland bills of exchange and promissory notes, and at the multiplication of the classes thereof."

The stamps on bills were unusually large which encouraged people to issue them for long periods rather than short periods, generally making them less attractive vis-a-vis notes and slowing trade considerably.

We can see the problem as section XIV of the Stamp Act 1815 allowed notes, once the tax had been paid, to circulate and be reissued with no extra tax paid, unlike bills that needed to pay the tax each time. Conversely in Section XX, the Bank of England exempted itself and its notes from anything so inconvenient as tax except for one modest annual payment (see also section XXI of the Stamp Act). No bill issuer could compete with the Bank of England under such conditions.

It would seem that this Act coupled with inflationary forces allow us to understand why the Lancashire Bills of Exchange—indeed all bills at the time—entered a rapid period of decline, allowing us to enter into the age of the note issuing banks.

Thornton (1939, p. 214) commenting on the demise of bills in favor of notes, also supports this view, as does Redford (1934, p. 209). The final blow seems to have come when in 1825 the Bank of England expanded its operations to the Lancashire area. Hitherto its notes were, in the main, limited to London and its immediate neighborhood. Now it could press its paper into Lancashire and crowd out the bill system.

What Lessons Can Be Learned Concerning the Manchester Bill Period?

During the dawn of the Industrial Revolution, there is little evidence in Manchester of booms and busts. As the banking system elsewhere becomes established, there is more evidence of boom and busts. In Checkland (1975) we can see in the Scottish banking system busts in 1760s, 1772, 1778, 1793, 1797, 1802–03, 1809–10, 1810–11, 1818–19, 1825–26, 1836–37, 1839, and 1845–47. During these periods, the Scottish banks were free and more innovative in contrast to their English counterparts. However, as Sechrest (2008, p. 83–84) points out, critiquing White's interpretation of Pressnell and Orbell's (1985) data, the English and the Scottish systems had nearly identical failure rates, at 14.90% and 14.88%. In other words, they were equally unstable. This contrasts with the relatively tranquil non-bank credit system in the most industrialized city in the world: Manchester.

When businessmen were settling their accounts via the use of bills against the sale of these goods with *specie* being advanced, the people and businesses of Manchester could save without having their money intermediated by the banking system creating more notes and liabilities of the system. This ensured that only those savings put forth to go into investment for industry and more productive activity were made. This, in Lancashire, naturally helped create a much more stable and prosperous community, indeed, the most industrial in the world at the time. What is more, it was done largely without bank credit with its ability to over issue notes in relation to specie. Capitalist savings in Manchester was done via the bill system. This period in history shows us how a non-bank generated credit system could work to the satisfaction of the most industrious citizens of the world at the time. This contrasts with the county bank system, which was credit driven and more prone to boom and bust. The Lancashire traders were clearly weary of stepping into the county bank note issuing environment due to the potential instability in them manifested by periods of bank runs and banks going bust. With regard to the current advocates of fractional-reserve free banking, I urge them to consider the theoretical implications of this, based on the supporting empirical evidence of Manchester and its bill system: that full-reserve banking was a success in the first industrial city of the world. This would set free banking on a much more stable financial system, as we have seen in Manchester.

With the invention of the blockchain and the various coins that exist on the blockchain, while none are the final good for which all goods and services exchange, that is, money, some of those coin products may well achieve that status in the coming years. As we approach this next stage of the technology revolution, like those Lancashire industrialists, we may well see the birth of spontaneously issued money to facilitate the ongoing decentralized finance boom. We have started to witness the emergence of 100% reserved banks in the State of Wyoming, called Special Purpose Depository Institutes (which are the only banks I am aware of) that can hold cryptographic assets, which, by their nature are unique code that can't be co-mingled as fiat money can be in a conventional fiat banking system. We may come full circle to the start of the Industrial Revolution where the full-reserve bank was the preferred banking system, at least in the greatest city of the Industrial Revolution.

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