

A CRITIQUE OF JOHN LOCKE AND THE VALUE OF MONEY

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In this paper, Oisín Gilmore places the monetary theory of John Locke in the context of late seventeenth century England. He argues that to understand Locke's theory on money it is necessary to take account of the economic crisis and subsequent recoinage debates that England faced during the 1690s. Such an approach allows us to understand Locke's endorsement of an increase in England's stock of money at the time.

Introduction

Locke's economic works were not primarily academic like his other more famous works; the *Treatises on Civil Government* and the *Essay concerning Human Understanding*. However, their aim was not to lay down base principles. Rather they were entirely practical in intent. They were attempts at theorising the economy in a way that would lead to action.

As such, I believe it is necessary to study Locke's monetary theory in the context in which it was written. It is important to understand the economy he was describing and how his works helped determine subsequent events. It is therefore my intention in this essay to contextualise Locke.

The Context

Interest Rate Debate

The majority of Locke's economic writings stem from a short piece written between 1668 and 1674. In particular this work formed the basis of the section on interest in *Some Considerations of the Consequences of the Lowering of Interest and Raising the Value of Money* (Kelly, 1990:3-4). It arose from a controversy over the regulation of the rate of interest. The background to this controversy lay in the difficulties which confronted the English economy at the end of the Second Dutch War. Some of these difficulties were short term; the liquidity crisis caused by the difficulties of financing war and those arising from the Great Fire of London of 1666.

Others were more long-term. Perhaps most significant was the loss of the traditional markets for woollen produce on the continent. At this period and up into the eighteenth century, woollen industries were still by far the most important source of employment outside of agriculture in England. By 1667, there had been a major fall in woollen exports. Sailors and dockyard worker's wages were twelve to eighteen months in arrears (ibid:47-49). The need for the government to pay for its debts incurred during and before the war led to such a demand for money that it drove interest rates up from 4% to 6%.

In these dire economic circumstances, investment opportunities that offered a high return were few and far between, even fewer still had a rate of return higher than 6% (ibid:51). Also with interest rates at 6%, most investment opportunities were not viable because the investors would not be able to pay the interest on any capital they borrowed. High interest rates were seen to be the cause of much of England's woes, as they excluded Englishmen from trades where the rate of return was low, which in turn exacerbated the already existent unemployment problem. Many people blamed this state of affairs on London bankers who were often seen as nothing more than usurpers. However, what was at issue in the controversy that Locke engaged in was not the advantage of low interest. Low interest was almost universally desired as a means of stimulating economic activity by ending the shortage of capital available. What was at issue was whether or not the law could be effective in ensuring the redeployment of capital (ibid:51-53).

Although the basis of Locke's section on interest in *Some Considerations of the Consequences of the Lowering of Interest and Raising the Value of Money* was written between 1668 and 1674, the book was not published until 1691 by which time Britain was rapidly heading into yet another major economic crisis, ultimately leading to the Recoinage of 1696. Locke's place in economic history is perhaps most firmly secured by his role in the debates about this Recoinage.

What caused Locke to finally publish this work was that Josiah Child, the leader of the move to have the interest rate legally reduced to 4%, was yet again lobbying for this law. William Letwin writes, "On the 10th of October, 1690, the House of Commons gave leave to bring in a Bill for reducing the rate of interest from 6 per cent to 4 per cent" (Letwin, 1963:166). The impact of the book was such as to cause one Member of Parliament to write to Locke saying, "all that have read the *Considerations* are clearly of the opinion the arguments therein are abundantly sufficient to destroy that Bill and all future attempts of the like kind" (ibid:167).

Devaluation Debate

Some Considerations of the Consequences of the Lowering of Interest and Raising the Value of Money is a work of two parts. The first and longest part is that dealing with the question of lowering the interest rate and the second shorter part deals with the issue of devaluing the currency, what Locke refers to as ‘raising the value of money’. The reason he refers to devaluation as raising the value of money is because it entails raising the denomination of the coin, lightening its weight, or debasing its alloy; leaving the silver coin with less silver in it (devaluing it) though keeping its value nominally the same (raising its value relative to the amount of silver contained). In order to understand the context of the ideas contained in this second part of *Some Considerations*, it is necessary to give a consideration of the economic crisis that England faced during the 1690s.

The economic crisis England faced in the 1690s, much like the economic crisis it faced in the late 1660s and early 1670s, was caused largely by war. In the case of the 1690s it was the Nine Years War (the part fought in Ireland is better known in Ireland as the Williamite Wars) that was largely responsible for England’s problems. The ways in which the war affected the English economy were many. Profitable trade with France was ended. Trade with the colonies in America and the East Indies was reduced as was trade with the Baltics. Most significant however, was the huge level of spending the war required. Annual government expenditure in the peacetime of 1687-8 was a mere quarter of that in 1695-6, when it reached 8.1 million pounds. Total war expenditure was 49 million pounds. (Kelly, 1990:55-56)

How did England survive this economic crisis? The massive payments England was making to fund the war should have brought her to her knees. There simply shouldn’t have been enough money to keep the British internal market functioning. The quantity of money leaving Britain during this war was extremely large. From 1688-95, £2,127,000’s worth of silver left the country. Of this, as much as £698,896’s worth left in 1694 alone. (Jones, 1988:131)

According to D.W. Jones, the answer as to how England survived to 1694 is clear – she clipped coins. Normally the level of bullion export that England was engaging in would cause an intense monetary squeeze but in the early 1690s it didn’t. Up to late 1694 clipped coins passed at face value, leaving the total face value of the money stock unchanged. Thus, it was by clipping that England obtained the bullion needed to pay her debts (ibid:228).

Ultimately things came to a head when the difference between the actual bullion content of the coin and its nominal face value became too large for credence. By late 1694, coin collected in tax was worth only 60%

of its face value (ibid:235) and confidence was gradually lost in the coin (Jones, 1972:317-318). By late spring of 1695 widespread refusal to accept clipped money had become evident. By now there was a necessity for Recoinage. This sparked debate about how exactly this should be carried out, or more specifically whether to devalue the coin while recoining it.

The argument in favour of devaluing the coin was essentially that it would be less deflationary; there would be less of a monetary squeeze. The most popular argument for devaluation was that made by William Lowndes in his *Report Containing an Essay for the Amendment of the Silver Coins*. Lowndes' plan was that the degree of devaluation be equal to the extent to which current money had depreciated in general. Locke strongly disagreed saying that there was a need for the silver value of the coin to return to being at its face value.

In order to understand this and other arguments by Locke it is necessary to look at his entire economic theory as, although it is far from systematic, its various theses do co-inform each other.

The Economic Theory

Rate of Interest

To begin I return to the first section of *Some Considerations*, that on lowering the rate of interest. Locke begins with a refreshing clarity stating, "The first thing to be consider'd, is, Whether the Price of the Hire of Money can be regulated by Law" (Locke, 1990:211). That is, can the rate of interest be set by law? He answers clearly in the negative "'tis manifest it cannot" (ibid). He argues that "it will be impossible, by any Contrivance of Law, to hinder Men, skill'd in the Power they have over their own Goods, and the ways of Conveying them to others, to purchase Money to be Lent them at what Rate soever their Occasions shall make it necessary for them to have it"(ibid). He holds that if people need to borrow money they will borrow money regardless of what the rate of interest is. He reminds us "That no Man borrows Money, or pays Use, out of mere Pleasure: 'Tis the want of Money drives Men to that Trouble and Charge of Borrowing" (ibid). People borrow out of necessity for money and so will accept it at the cheapest interest rate available, that interest rate set by market forces, not by law.

Locke holds that the interest rate is the price of money which "depends on its 'true and natural value'." (Kelly, 1990:72) What nature of this natural value is explained by Locke when he writes "The natural Value of Money, as it is apt to yield such any early Income by Interest, depends on the whole quantity of the then passing Money of the kingdom, in proportion to the whole Trade of the Kingdom, (i.e.) the general Vent of all the

Commodities.” (Locke, 1990:262) In other words, the rate of interest is set by the quantity of money available and the quantity sold.

Interest Rate and Money Supply

To reiterate the point of why it was believed desirable to have lower interest rates; lower interest rates correspond with a higher availability of money. Locke, along with all the other mercantilists, believed that a higher supply of money in the economy was a good thing. Why was it beneficial? It implied political power. Locke wrote that:

Riches do not consist in having more Gold and Silver, but in having more in proportion, than the rest of the World, or than our Neighbours, whereby we are enabled to procure to our selves a greater Plenty of the Conveniences of Life than comes within the reach of Neighbouring kingdoms and States, who, sharing the Gold and Silver of the World in a less proportion, want the means of Plenty and Power, and so are Poorer. (ibid:222)

Put simply, England having a greater supply of money meant that everyone else had less, making England relatively stronger.

The other reason according to Eli F. Heckscher was because the mercantilists identified money with capital. (Heckscher, 1994:199) In this belief, Heckscher is not alone. Jacob Viner writes “the mercantilists, either identified or failed clearly to distinguish between money, on the one hand and capital or ‘stock’...on the other...This confusion...contributed directly to the attachment of great importance to the size of the national stock of money” (Viner, 1937:31-32).

Locke does distinguish between the function of money-as-capital and money-as-general means of exchange. He writes

In Money there is a double Value...first as it is capable by its Interest to yield us such a yearly Income: and in this it has the Nature of Land, (the Income of one being called Rent, of the other Use). (Locke, 1990:246)

and second,

Money has a Value, as it is capable by Exchange to procure us the Necessaries or Conveniences of Life, and in this it has the Nature of a Commodity; only with this difference, That it serves us commonly by its Exchange, almost never by its Consumption. (ibid:248)

As can be seen clearly here, Locke does draw the distinction but he still treats both money-as-capital and money-as-general means of exchange as one and same thing, albeit a thing with a 'double Value'. Heckscher notes in this passage, "Money is considered partly...a factor of production...and partly a means of general exchange" (Heckscher, 1994:204).

How this confusion leads to the mercantilist 'love of money fear of goods' is now clear to see. As Heckscher writes, "If a greater quantity of money was to have the same importance to the economic life of a country as an increased amount of land or other natural materials, then obviously no other further proof was required as to its desirability" (ibid).

Then how is it, if Locke thinks the central aim of an economy is to increase its share of money, that he supported a Recoinage without a devaluation which caused a major monetary contraction? The answer is in his belief that the means of exchange must be something valuable. He argues that "'tis Silver and not Names that pay Debts and purchase Commodities" (Locke, 1990:312). He held that property, money and value came before government and the state and that it was not for the state to declare what was valuable and what wasn't (Locke, 1988:265-429). It was important to him to maintain the pre-governmental status of money (Caffentzis, 1989:115). George Caffentzis writes that:

For Locke, the main function of metallic currency was to stabilize and preserve a relation between present possession and future pleasure; and the State's function was to guard and guarantee this objective, nature-given connection for each individual. Gold and silver thus created the conditions for future accumulation, and the State was to assure the individual possessor the right to enjoy it. (ibid:89)

Locke highlights his beliefs clearly on this matter when he writes "Money is the measure of Commerce, and of the rate of every thing, and therefore ought to be kept (as all other measures) as steady and invariable as may be" (Locke, 1990:326). This was the reason he didn't want to devalue the coin, he felt the state's role first of all was to maintain money as a measure and store of value. He did not believe that you could increase the money in a country by 'raising the coin'.

He was quite clear on how you could increase the money in England and that was "by force, borrowing, or trade" (Locke, 1990:299). He wrote that "All the imaginable ways of increasing Money in any Country, are these two: Either to dig it in Mines of our own, or get it from our Neighbours. That Four per Cent is not of the nature of the Deusing-rod, or Virgula Divina, able to discover Mines of Gold and Silver, I believe will

easily be granted me. The way of getting from Foreigners, is either by force, borrowing, or trade” (ibid). Locke, throughout his economic writings, maintains the increase of England’s money at the centre of his mind, he is the perfect mercantilist.

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