CHAPTER V: A First Look at the New Model

In this chapter we outline, in broad strokes, a schematic trade cycle model based on confidence and its fluctuations, and we support the basic points with evidence from economic history.

SECTION A: THE ACTORS.

There are three sectors (or groups of agents in the economy) interacting in our model:

1. Investors willing and able to place some of their wealth in shares and bonds of risky enterprises, in return for the promise of a future cash flow.
2. Company promoters and other entrepreneurs engaged in enterprises with significant amounts of time between commencement of the project and eventual financial returns. Many, but not all, of these projects involve the production of capital goods, such as railways and canals.
3. Everyone else.

In the Britain of the nineteenth century the comfortable and rich classes accumulated income so rapidly as to exceed all available possibilities of spending it on consumption, and to strain all modes of investment. [1] No doubt feudal and aristocratic societies would have succeeded in throwing away a great deal of this surplus in riotous living, luxury building, war and other uneconomic activities. A modern welfare society might attempt to distribute some of these vast accumulations for purposes of social amelioration. [2] In the nineteenth century neither course of action was even considered seriously.

Who was in this investor class? Jenks says: [3]

"It was the country investor who was looking about most earnestly for reproductive investments. And by

[2] It would succeed, undoubtedly, in wasting much of the surplus on a topheavy and inefficient bureaucracy.
the 'country investor' is meant the totality of persons whose fortunes had been enhanced by the industrial changes of the preceding fifty years. These persons were by no means all engaged in manufacture or trade. Many had been so, but had purchased a country estate and were in a fair way to become swallowed up in the country families. Others, and those with large fortunes were of this sort, had been the fortunate proprietors of land upon which new factory towns sprang up or in which lucrative mining operations were carried on. High as their standards of consumption were, these magnates could not find use for the inflated rent rolls with which the Industrial Revolution had dowered them. It was from Lancashire, from Ireland, from the eastern and midland counties where the rent of land accumulated in sums which were not spent nor profitably invested locally that balances flowed constantly to the London bill-brokers."

Walter Bagehot remarks in "Lombard Street" that agricultural areas of Britain were normally creditors, and the industrial areas normally debtors in the London money market: [4]

"Commerce is curiously conservative in its homes, unless it is imperiously obliged to migrate. Partly from this cause, and partly from others, there are whole districts in England which cannot and do not employ their own money. No purely agricultural county does so. The savings of a country with good land but no manufactures and no trade much exceed what can be safely lent in the county. These savings are first lodged in the local banks, are by them sent to London, and are deposited with London bankers, or with bill brokers. In either case the result is the same. The money thus sent up from the accumulating districts is employed in discounting the bills of the industrial districts. Deposits are made with the bankers and bill brokers in Lombard Street by the bankers of such counties as Somersetshire and Hampshire, and those bill brokers and bankers employ them in the discount of bills from Yorkshire and Lancashire. Lombard Street is thus a perpetual agent between the two great divisions of England — between the rapidly-growing