

## **The crisis of 1830 and relations between the Banque de France and the State**

I feel greatly privileged to be taking part in these two days devoted to the study of central banking, and I would like to extend my warmest thanks to the Banco de México for inviting a member of the Banque de France's Historical Research Unit.

My presentation will deal with the crisis of 1830 and relations between the Banque de France and the State. Why look so far into the past when many of those speaking here are working on periods much closer to the present day?

The 1830 crisis transformed the way the Banque de France behaved and changed its relationship with the State, to some extent foreshadowing the way that central banks have adopted unconventional measures to support government initiatives in the current crisis.

Before getting to grips with the main subject of my paper, I would like to briefly talk about the first 30 years of the Banque de France, looking at its organisational structures and operations.

When it was founded on 18 January 1800, the Banque de France had three core tasks: to open current accounts, to issue banknotes and to discount bills bearing three trustworthy, recognised signatures. This was shortly after the Revolution, and all efforts under the Directoire to set up note-issuing banks had foundered. Napoleon Bonaparte, then in power, was striving to restore confidence and was counting on the Banque de France to lower the discount rate, if only in Paris. With this in mind, in 1803 he granted the Banque de France the right to issue money in the capital. The delegation of this sovereign function coincided with the financial reforms that created the "Germinal" franc.

The Banque de France was a private institution, a joint-stock company whose two hundred largest shareholders met each year to review operations. The day-to-day running of the Bank was entrusted to a board comprising 15 regents and three censors picked by shareholders. It was not until 1806, when Napoleon feared that the Bank might distance itself from him, that the first governor was appointed.

The men who steered the Banque de France from its beginnings in 1800 were all merchant bankers. They had their own commercial and financial businesses and had all

been involved to a greater or lesser extent in attempts to set up note-issuing banks at the end of the Revolution. Alongside their duties at the Bank, they pursued their own activities. Technicians as well as practitioners, they were very much men of their time. They were the Bank's shareholders but also its clients, and presented bills for discount while simultaneously managing the institution, under the scrutiny of their peers and the State.

They brought their experience and practices to the Bank. They had their own networks of acquaintances, their own correspondents around the country and access to information they could draw on to help the Bank.

They were especially skilled in two areas: gauging economic conditions in Paris, other parts of France and even Europe, and assessing the soundness of companies applying for credit. While it may look as though the Banque de France confined its business to Paris during the first thirty years, this was not in fact the case. Although the Bank had money-issuing rights solely for Paris, it was happy to draw on intelligence from other major financial centres and from provincial towns and cities.

## **I – Risk perception and tools for creating confidence**

The Bank's first directors wanted to instil confidence in their brand-new institution, rather than pursue particular economic, financial or political concepts. They sought to build trust in the notes that the Bank issued, which were payable on sight; in its discounting operations, which had to be free of any hint of suspicion; and in its directors, who promised to practise what they preached.

This trust was a key factor in the Bank's survival and needed to be nurtured. A number of tools to prevent errors and manipulation were used to achieve this goal.

### ***a) Early steps in surveying business conditions***

People's confidence is fundamentally linked to their assessment of the economic situation. The Bank's governing body paid close attention to everything that was going on in Paris, on the stock exchange and at the large banks, all of which were located close together in a burgeoning business district.

To supplement the information that the bankers and merchants gleaned from their networks, the Bank established its own tools, on which it relied from day to day, but especially during times of crisis.

From the outset, the Bank set up a system of correspondents up and down the country and also abroad. These people, who were Bank shareholders, were responsible for collecting trade bills, but their letters also supplied intelligence on the financial situation of the cities that they operated in. In just two weeks in 1800, 167 correspondents were appointed, some in France, others abroad.

The Bank had representatives in Lyons, Rouen and Strasbourg, but also in Hamburg, Cadiz, Madrid, Barcelona and Genoa. In addition to reporting on local economic conditions, these correspondents notified the Bank about the main firms in their city and supplied information about the finances of various banks and companies. Treasury representatives, known as Receivers General, were also contacted from time to time when the Bank needed to check the creditworthiness of a name from outside Paris.

In 1809, when the Banque de France's first three discount offices opened their doors to the public in Lyons, Lille and Rouen, the managers were entrusted with the same task of keeping Paris abreast of economic conditions in their city. Through their dealings with local chambers of commerce, managers knew how companies were faring and kept a number of registers, including one of bankruptcies. In letters sent by the manager of the Lyons office, for example, we find information about the silk, hatmaking and food businesses, as well as a register of commercial and industrial transactions. <sup>1[1]</sup>

The Emperor himself instructed the bank's governing body to open up to the rest of the country and establish operations outside Paris. In a letter to his Treasury Minister, Count Mollien, written in Antwerp on 5 May 1810, Napoleon writes: Why does [the Bank] not discount in Valenciennes, Cambrai, Saint-Quentin and Lille? [...]. The Bank has no correspondent in Valenciennes. In Antwerp it has one who has done nothing for six months [...]." The Bank needed to look ahead and prepare for the new assignments that were going to be entrusted to it and, most importantly, gather intelligence.

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<sup>1[1]</sup> Cf. Banque de France *Cahier Anecdotique*, No. 29, "La difficile mise en place des enquêtes de conjoncture".

As mentioned, the Bank's directors also got information from their own networks. Every journey was an opportunity to obtain information not just for their own business but also for the Bank. In 1828, for example, when the Mulhouse financial centre was in grave difficulty, Regent Odier provided valuable data about the main firms that had defaulted on their payments. Governor Jacques Laffitte himself travelled to Mulhouse shortly afterwards to assess the risks of non-payment, acting both on his own account and on behalf of the Bank. These assessments determined whether the Bank would accept paper from struggling companies.

The process of surveying business conditions, then in its infancy, was refined over the course of the century and, by the 1860s, had become one of the Bank's key activities. Branch managers took over from the correspondents and directors, and since then they have drawn up surveys according to a precise model, passing on all the information to the General Council in condensed form.

During the period we are looking at, surveys were still in their infancy and were too imprecise and uncertain to be used in the Bank's main day-to-day business of discounting.

The Bank needed risk assessment techniques that were better suited and closer to its everyday business.

### ***b) Risk assessment and credit scoring***

The Bank strove to create confidence through its discounting business. The trade bills that made up its portfolio, which provided a guarantee to the public of the viability of bearer notes, had to be free of the slightest taint of suspicion.

Under the Banque de France's Statute, any citizen "who, by common knowledge, is solvent"<sup>2[2]</sup> had the right to present a bill for discount at the Bank. The risk of receiving "doubtful" paper was ever-present, and avoiding it was the chief concern of the Bank's governing body.

For this reason, in 1800, the Bank began to compile a register in which anyone presenting a bill for discount would be assigned a score reflecting the soundness of their company. It was decided "to open a secret registry to hold the ratings of paper presented for

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<sup>2[2]</sup> Article 5 of the Original Statute (1800)

discount".<sup>3[3]</sup> The Bank's General Council met many times to score companies, both at the beginning of each year and in extraordinary sessions. Regents were aided by representatives of the Paris business community, who assessed – doubtless in good faith – the soundness of their peers and competitors. We have found the tool they were using for this purpose in 1803. It is a trade almanac with the scores assigned to Paris merchants. (Photo) The mechanism is simple enough: "a roll call is read out, an opinion given on each individual, and credit is divided into four categories: small loan, medium loan, good credit, **prime in its class**. A zero is added for those who are not known."<sup>4[4]</sup> A sixth sign, a plus, was added to designate names to be avoided entirely.

The Banque de France scoring system was born, perhaps making the Bank the first-ever credit rating agency, well before Standard & Poor's and Moody's.

The Bank's governing body did not want to confine itself to Paris, nor only to those presenting bills for discount. So, despite the attendant difficulties, it set the goal of "gathering and transmitting information about all individuals engaged in some form of trade".<sup>5[5]</sup>

Scores were regularly reviewed, roughly every quarter. The maximum loan amount was set according to the rating assigned to each Paris firm. In this way, the Bank's governing body hoped to eliminate any risk of adding doubtful paper to its portfolio.

In theory, scores were not made public and were not supposed to be shared with rated companies. But numerous reminders about secrecy requirements suggest that the information quickly leaked beyond the Bank's walls. In 1819, Governor Laffitte said: "This extremely delicate task, which ought to be kept secret within the Bank, was soon known to most merchants, giving rise to claims of unfair treatment. The Council should consider the importance to trade and to the Bank itself that the Council be beyond reproach in this matter".<sup>6[6]</sup> The requisite discretion was so uncommon that Banque de France scores even show up in the literature of the day, Balzac being one example.

The Bank used these two instruments to implement its discount policy.

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<sup>3[3]</sup> General Council meeting, 3 December 1801

<sup>4[4]</sup> Banque de France, minutes of the General Council meeting, 12 March 1804.

<sup>5[5]</sup> Banque de France, minutes of the General Council meeting, 16 April 1804.

<sup>6[6]</sup> Banque de France, minutes of the General Council meeting, 22 April 1819.

Criticised by the Paris business community for being overcautious or working only in their own interest, the Bank's directors obeyed the prudential rules they had themselves drawn up. These rules may have ensured the Bank's survival during the first three decades, which brought crisis after crisis every two or three years.

## **II - 1830: a new kind of crisis?**

Between 1800 and 1830, France and the Bank experienced financial and/or monetary crises in 1803, 1805, 1810 to 1811, 1813 to 1814, 1815, 1818, 1825 and 1830. The only time the Bank's actual existence was threatened was when the Empire fell in 1814. The much-vaunted prudential rule that the bullion reserve, notes in issuance and the portfolio should be in constant balance was breached. With the rout of the imperial armies and the occupation of Paris, customers panicked and demanded that their notes be reimbursed, causing the bullion reserve to shrink at a time when discounts were fast drying up.

### **a) How the Banque de France viewed crises**

Political factors played their part in triggering the 1830 crisis. But the foundations were laid well before the three days of revolution.

For the Banque de France, 1818 was a singular year. It was a year of crisis, in which the Bank's directors began thinking about new approaches to discounting. Whereas most directors had defended the theory of a more or less unchangeable rate of 5 per cent and 90-day maturities, some representatives of the new generation recommended adjusting rates and maturities according to the financial situation of the marketplace.

In the end, the reformers had their way and in 1819, for the first time, the discount rate was lowered to 4 per cent for bills at 30 days or less, remaining at 5 per cent for bills with a 90-day maturity. This decision, which was hammered out over many General Council meetings, was truly revolutionary. Jacques Laffitte, a trailblazer in the banking industry and the then Governor of the Bank, had a hand in bringing about these changes.

By 1830 France had been in crisis for three years. The problems, which had originated in England, reached the Paris Stock Exchange in November 1825 and had spread far and wide by the end of 1827.

Pedro Arbulu<sup>7[7]</sup> writes that the crisis was caused by "[...] a speculative bubble [that] formed around numerous new business deals and commodities. At the same time, the French price index (based at 100 in 1801) reached all-time lows [...]. In France, discounting was hard hit [...]" The Bank monitored the level of its reserves and its portfolio but did not appear to be in any danger.

At the 1827 general meeting of shareholders, Censor Odier gave a brief review of events in the preceding two years. Speaking about the first half of 1826, he said: "Declining commodity and goods prices, falling exports – all these factors played a part in reducing overall wealth. This caused a fall in spending and hence in consumption. This is why virtually all branches of trade and manufacturing are struggling and sluggish. Surplus output is not the cause, as witnessed by the fact that many factories stand idle."

The following year, Censor Moreau, again speaking before the shareholders, painted a picture of how the difficulties were affecting contemporary society. "It was inevitable that the prolonged stagnation of industries and commercial institutions would lead to upheaval; we have seen a string of painful disruptions this year, which have taken their toll not only on individuals, but on whole swathes of trade and even on manufacturing towns".<sup>8[8]</sup> The crisis, which was chiefly caused by excess production and market speculation, dragged on. Bankruptcies mounted, as did the unpaid bills on the Bank's books.

The Bank did not act, which earned it criticism from the marketplace. It was accused, as ever, of not performing the duties for which it had been created. The value of defaults stood at 38,000 francs in January 1828. Six months later, it had risen by a factor of 14. The minutes of General Council meetings are peppered with tales of bankruptcies affecting firms in which the Bank was a stakeholder. On the question of defaulting companies, the directors, as we will see later, continued to concentrate on "philosophical" discussions of principle and refrained from taking any decisions.

The government, which was also aware of the difficulties, did little to help. The only noteworthy initiatives were taken by individual banks that joined together in an effort to halt the wave of bankruptcies.

However, and this is another modern aspect of the 1830 crisis, the economic downturn that followed the three days of revolution carried the seeds of an alliance between the Bank and the State.

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<sup>7[7]</sup> Pedro Arbulu, "Le marché parisien des actions au XIX<sup>ème</sup> siècle", in *Le marché financier français au XIX<sup>ème</sup> siècle*. Dir. Georges Gallais-Hamonne, p. 435.

<sup>8[8]</sup> Banque de France, Annual General Meeting of Shareholders, 29 January 1829.

## **b) The Banque de France and the State: a paradoxical relationship**

One of the other reasons for the existence of the Bank, which had been created at the urging of the government, was to provide services to the Treasury. Early on, the political powers entrusted the Banque de France with responsibility for annuities, pensions and the lottery. However, as part of the campaign to build trust, the Bank worked hard to create an image of autonomy, even independence, to show that political ups and downs would not be allowed interfere with trade-related transactions.

When the Empire fell, the General Council lobbied to change the Banque de France's legal status. Council members wanted to shake off the close ties to the Treasury that had gradually developed under the Empire.

The interim governor, Jacques Laffitte, appointed in April 1814, spoke for the directors who, backed by shareholders, called for total freedom of action, particularly in setting the discount policy.

The Banque de France progressively took on a new role, that of banker to the Treasury, handling payment of the Empire's debts as well as occupation compensation payments to the Allies. Advances to the Treasury were henceforth codified in agreements that were carefully deliberated by the General Council.

The history of the Treasury's account with the Bank is instructive in illustrating the paradoxical relationship between the institutions. At first, the Treasury had only a temporary account for specific transactions, such as extraordinary discounts. In 1806, when the first governor was appointed, the General Council hoped that the Emperor would give the Bank the coveted role of banker to the Treasury, in return for a degree of oversight. But this was not to be. The Treasury bypassed the Banque de France and set up its own bank, *Caisse de Service*. The Bank created an ordinary deposit account in its books in the name of the Public Treasury and ignored the Treasury Minister's regular requests for an interest-bearing account. The Bank was extremely keen to secure this role. For the record, from 1807 to 1813, the Treasury's ordinary deposit account made up over 70 per cent of the Bank's current account assets.



In 1820, the Bank, acting "in the public interest", opened another account for the Treasury, which was to contain only credits and debits relating to Treasury Bills. Every day, the Bank negotiated the amount that the State needed for the next day. Following each transaction, at the close of the day, the account had to have a credit balance of two million francs. In other words, there was to be nothing out of the ordinary – and above all nothing that might unsettle the public or shareholders. The Treasury was treated like all the Bank's other clients and, even if no one was fooled, on the surface at least there was no apparent collusion with the often unsteady political power of the time.

Personal relations also inevitably came into play in the dealings between the two institutions. People who belonged to the same political currents and moved in the same social circles were able to facilitate or prevent decisions that ought to have been taken solely in the country's financial interest.

The Governor reported daily to the Treasury Minister on the situation of the Bank's books. He did not have to obtain clearance from the Minister, but he did receive comments and suggestions. However, it is hard to say at this point which needed the other more, the Bank or the Treasury.

This union, which at the outset could only be considered as an "unholy alliance", came into its own during the crisis of 1830. The parameters changed. The Bank modified techniques that it had been honing for thirty years and looked at the economic and financial landscape in a new light.

### **1. III- The modern face of the 1830 crisis**

While the governing body of the Bank diligently put in place the tools that enabled it to avert disasters and doubtful paper, as we said earlier, the way it viewed struggling companies changed during the 1830 crisis. The nature of its relations with the State, which was a purveyor of bills when the "famine" set in but also an authoritarian manager on occasions, also changed. The balance between shareholders, trade and the Treasury, which the Bank's directors had been striving to maintain since 1800, was disrupted and transformed. And by the time the crisis was over, lending practices had been turned upside down. The Bank reconsidered its position on struggling companies and forged an alliance with the Treasury to serve the economy.

### **a) Struggling companies**

During the three days of the July Revolution, the Bank was only vaguely concerned about what was happening to companies. Naturally, it was informed about the wave of bankruptcies and it accepted – generously – to support the exceptional measures taken by the State, such as extending the maturity of dishonoured bills.

This measure, which "resulted in the sterilisation of commercial paper held in the portfolio",<sup>9[9]</sup> according to Lévy-Leboyer, was hardly groundbreaking, to say the least.

However the Bank, which had had only paltry amounts on its dishonoured bill book since 1800, saw a slight increase in that portfolio after the Three Glorious Days.

Until the 1830s, the Bank seemed to have taken absolutely no interest in struggling companies unless it held one of their bills in its portfolio. The meeting minutes of the time reveal occasional "philosophical" discussions about what position to adopt on bills whose debtors had gone bankrupt. The Bank's governing body sought to determine the boundaries beyond which the institution's "dignity" would not be impugned. Despite its claims of magnanimity, however, the Bank systematically took legal action as soon as a due bill went unpaid.

But the situation changed in 1830. Many companies whose financial position had been undermined by the 1825 crisis succumbed to the events of 1830.

Among these was the company established by Vassal, a member of the regency council, whose bank collapsed in the autumn of 1830. According to Bertrand Gille, Banque Vassal was overrated. It had been founded in 1825, but five years on, had yet to fully pay up its capital. Vassal wrote to his fellow regents at the Banque de France to announce his impending liquidation. The governors examined the balance sheet and saw that Vassal's position with the Banque de France represented 340 bill acceptances totalling more than two million francs. In accordance with its usual operating procedure, the Bank refused to offer payment facilities, on the grounds that the credit of its banknotes might come under attack and the General Council would face the shareholders' wrath.

On 14 October Vassal tendered his resignation to the General Council. "The Council took the decision to write to [Vassal], expressing its concern for his misfortunes and its regret at no longer being able to work with him".<sup>10[10]</sup>

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<sup>9[9]</sup> Maurice Lévy-Leboyer, *Les banques européennes...*, p. 480.

<sup>10[10]</sup> Banque de France, minutes of the General Council meeting, 14 October 1830.

But from 21 October onwards, the Bank was swamped with pleas for help from Vassal's correspondents. This time, each situation was closely scrutinised. And faced with the extent of the "disaster", the Bank showed some signs of giving ground.

One of the Banque de France's discount advisors, Ternaux, was also forced to resign in view of the parlous state of his own bank. This time – and for the first time – the governing body of the Bank, which classified bills as "certain for collection", "doubtful bills" and "assets beyond hope of recovery", agreed to extend Ternaux's terms of payment.

Little by little, relying on the financial intelligence gathered by the Bank and on its risk assessment tools, the General Council changed its attitude somewhat – from "either he pays or we sue" to "let's see if we can negotiate". It was even moved to pity by a debtor facing the threat of prison.

#### **b) The alliance between the Bank and the Treasury: serving the economy?**

Circulation of trade bills was suspended during the three-day July Revolution. The very first decisions – suspending non-payment protests and extending the maturity of trade bills by ten days – were the preserve of the municipal commission, not the Banque de France, as the General Council claimed.

The State was the prime mover behind measures to stem the growing tide of bankruptcies. Writing to Parliament, the finance minister, Baron Louis, said: "It is inconsistent with principles to involve the State in individual matters, whether to support trade or share profits, because very often it can harm rather than help, lose rather than gain. Moreover, such involvement is certainly not part of its mission. [...] Due to misplaced fears of the future, funds would be removed from the hands of the shopkeeper. The State, which is better able to weigh up the future and has reason not to fear it, should steer those funds back to shopkeepers by promising its guarantee to those willing to lend to trade". The State mooted a plan to make 30 million francs available to help struggling tradesmen; Parliament assented, and the decision of 17 October 1830 was enshrined in law.

By royal order, the government set up a commission, including Banque de France governors, to examine requests for loans or assistance submitted by merchants or manufacturers. Days after the order was enacted, the Banque de France granted a 10 million franc credit to the Treasury to implement its provisions.

The next stage, in which the Bank played a more active role, consisted in setting up an intermediary body to dispense loans to companies. This body, *Comptoir d'Escompte*, or discount office, accepted paper that the Bank was prohibited by its Statute from accepting, namely bills with two signatures and maturities ranging from three to six months. In fact, however, the discount was merely temporary. At the appropriate moment, when the bills were in compliance with its rules, the Bank was able to rediscount them.

The Paris discount office set up for business on the premises of the Banque de France and started operating at the end of October. The speed with which it took decisions was startling, particularly for the Bank, which, at the time, always discussed matters at length before reaching a decision.

The mechanics of the system were as follows. The discount rate for bills was set at 4 per cent for Paris and 5 per cent for the *départements*. The Bank accepted bills that had been certified by three members of the discount office, then held the paper to maturity in the

name of the Treasury before rediscounting it. The *Comptoir d'Escompte* functioned in this way until January 1833.

The discount office, described by Gille as "a substitute credit system",<sup>11[11]</sup> played its role to the full. From October 1830 to late August 1831, the commission examined 1,024 loan requests, and it discounted bills to the tune of more than 33 million francs. Though necessarily short-lived, the *Comptoir d'Escompte* system was a milestone in the history of credit. It was also a milestone for the Bank, which got fully involved in government-led operations without tarnishing its image in any way. Quite the contrary. The fact that the discount office was based at the Bank's head office helped convince the public that the institution was a stakeholder in efforts to rescue the economy.

As a matter of fact, the Bank was delighted to rediscount bills bearing a signature as solid as the Treasury's. After all, it was hardly taking a risk!

The Bank was also pleased to let small banks deal with lower-value bills and any ensuing non-payment protests.

It was also at this time, in the years following the crisis, that the Bank agreed to open an advance funding account to the Treasury, on 30 January 1832. Some members of the General Council were opposed to what they saw as something "of slight interest to the Bank, and useful only to the Treasury".<sup>12[12]</sup> In fact the account consisted simply of a permanent advance of 25 million francs granted to the Treasury against pledged Treasury bills.

## Conclusion

The people who were running the bank in the 1830s were not the same as those who had presided over its creation. They belonged to a generation of entrepreneurial bankers who were bold enough to innovate. The Bank, which had been a player in the economic life of the country since the onset of the crisis, no longer feared being criticised or rebuked by its shareholders. In the view of its directors, seeking a way to forge links with the Treasury was not an obstacle; it was actually a means to generate profits. The directors complied at all times with the law and the Bank's Statute, but they no longer balked at the idea of change or at altering their position in light of the economic context. They were pragmatists who could have adopted as their motto the words of Baron Monnier in his address to Parliament in 1830: "It is only moral principles that do not change. All the rules of political economics are subordinate to circumstances. One must recognise what they command and bow down to them".

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<sup>11[11]</sup> B. Gille, *La banque et le crédit ...*, p. 328.

<sup>12[12]</sup> Banque de France, minutes of the General Council meeting , 19 January 1832.