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Modern Politics as a Trust Scheme and Its Relevance to Modern Banking

Jongchul Kim

Abstract: The trust is, by definition, a hybrid between rights in rem and rights in personam. It is also an English legal concept that distinguishes the English common law from the Roman law tradition of continental Europe. The trust is largely absent in the classical writings of Karl Marx and Max Weber on the origins and nature of capitalism. This essay demonstrates that the trust is central to an adequate understanding of capitalism – including the capitalist institutions of modern banking, corporations, and representative democracy – and demonstrates that modern banking and politics are mirror images of each other. Before capitalism, credit economies created institutions to protect debtors or often reversed the social order by cancelling debts. The capitalist credit economy, by contrast, considers strict debt obligations a supreme moral good and a way of securing social order. It creates a political scheme to ensure that debt obligations are strictly fulfilled. This essay argues that this scheme is a trust. The trust turns the debts of individuals, whose death can cancel their debt obligations, into the debts of imaginary groups such as the modern state, whose identities and obligations are permanently maintained by replaceable trustees. The essay further holds that without the politics of the trust, modern banking could not have developed.

Keywords: banking, corporations, debt cancellation, public debt, representative democracy, trusts

JEL Classification Codes: E42, G21, K11, N23, N43

The trust is, by definition, a hybrid between rights in rem and rights in personam (Maitland 1911, 314). It is an English legal concept that distinguishes the English common law from the Roman law tradition of continental Europe. This concept of the trust is largely absent in classical works, including those of Karl Marx and Max Weber, on the origin and nature of capitalism. However, some scholars, including Ronald Stanley Neale, Frederic Maitland, and myself (Jongchul Kim), have demonstrated the central role of the trust in the origin and nature of capitalism.

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Neale argued that the class of landowners and the legal nature of their ownership of land — especially the trust — provided the legal and institutional framework “which alone made possible the development of industrial capitalism in England,” and that the bourgeoisie of the eighteenth century merely borrowed the trust from the landowners almost intact (Neale 1975, 95-101). Like Neale, I have demonstrated that modern banking emerged out of the distinctive political struggle between the Crown and landowners in early modern England, and that the trust was at the center of the custom or morality underlying that struggle (Kim 2011). In the same publication, I further argue that modern banking is, in fact, a trust (Kim 2011). Early on, Maitland (1911) claimed that the essence of capitalism cannot be explained through the concept of the contract, but through a specific form of ownership — the trust. He further specified that the effects of the trust extend across the economy and politics, from the creation of joint-stock arrangements with limited liability to the idea of trusteeship that informed justifications for imperialism (Maitland 1911). Maitland’s argument reminds one of John Locke, who argued that representative democracy is a trust.

The trust must be distinguished from the abstract concept of trust implied by the expression “I trust you.” This essay uses the term “trust” exclusively in the former sense. However, these two concepts are related to each other. The widespread use of the former type of the trust in business relations tends to depersonalize the latter — that is, to base the everyday understanding of trust on formal rules and professionalism. The settlers of the trust no longer rely on a personal relationship with trustees, or need to know them personally. Instead, the settlers rely on formal rules that bind trustees’ behavior as well as on the impersonal professionalism of trustees.

If the trust is central to understanding the capitalist institutions of modern banking, corporations, and representative democracy, the following two questions arise: First, if these three seemingly unconnected phenomena can be defined by the same concept, how similar is their nature? Second, did they evolve together and mutually contribute to each other’s evolution? No one has yet examined these two questions together. By studying these questions in conjunction with each other, one can understand the role of the state in the origins of capitalism. According to conventional wisdom, the modern state is the mere regulator of the market. By contrast, this essay conceives of politics and the modern state as the constructors of modern banking.

This study also helps understand better the nature of bailout packages that governments provide to private banks during financial crises. Through these bailout packages, governments turn the private debts of banks into the debt obligations of the state. Many scholars have regarded these bailouts as a remedy to these crises. But to meet these debt obligations, governments must cut public spending, sell off public companies, and deepen inequality in the long term, as the financial crises in developing countries over the last three decades have demonstrated. Thus, if one regards a financial crisis, not just as a relatively short-term problem characterized by bank runs and liquidity crunches, but as a long-term degradation of people’s wellbeing

and equality after the resolution of the short-term problem, bailouts can be seen as an important trigger of a long-term crisis.

This essay shows that the modern state can turn the private debts of banks into state debt obligations because the state has an abstract personality distinct from that of the state's government and population. This abstraction is the most distinctive characteristic of the modern state (Skinner 2005). When representative democracy arose, the abstract personality of the people was constructed, and the people as a whole were made liable for the obligations incurred by their individual governments. This was a historically new phenomenon. Democracy in the ancient city-state of Athens, by contrast, began with debt cancellation. That is, Solon, as statesman, cancelled the debts of the poor and banned debt bondage in 594 BC. Literature on the origin of capitalism fails to analyze how the abstraction of the state was decisive for the development of modern banking. This essay argues that, had it not been possible to transform individual governments' debts into the debts of the people and had the abstract identity of the state not been constructed, modern banking could not have developed. It further suggests that the scheme of this transformation and construction is the trust.

Arguably, it is the trust that turns the debts of individuals into the debts of imaginary groups. When individuals die, their debt obligations are cancelled as well. Through the trust, however, debts are maintained permanently because they are owed by the imaginary group of the trust, whose identity and obligations are maintained permanently through the use of replaceable trustees. This happens because the trust is not only a hybrid scheme of ownership, but also a governance mechanism. In the trust, as shall be seen, property owners create and govern a personified group by making it their moral debtor. I call this the politics of the trust. I will analyze how this politics made it possible to turn the debts of individual into the debts of imaginary groups and contributed to the construction of modern capitalism in early modern England.

The trust helps one understand how the capitalist credit economy differs from previous credit economies. These previous credit economies often accommodated reforms that reestablished debtors' status as equal to that of their creditors through the cyclical abolition of debt (Graeber 2011). A debt contract can be made between two equals, but it creates a relationship of inequality until the debtor fulfills his or her debt obligation. Historically, unpaid debts often contributed to transforming a society from an egalitarian into an unequal or hierarchical one (Graeber 2011). Thus, the cancellation of unpaid debts was often seen as recovering the relationship of equality, thereby strengthening the social order and maintaining the credit economy. For example, in the Babylonian and Sumerian civilizations, in which the credit economy was highly developed, peasant debts were cancelled by emperors in a periodic "redemption" or "Year of Jubilee" (Graeber 2011). Today, modern society considers strict debt obligations a supreme moral good and a way of securing the social order. Moreover, it creates schemes to ensure that debt obligations are strictly fulfilled. One of these schemes is the trust.

Modern Banking as a Trust Scheme

Legal textbooks define the trust in two ways. According to one definition, the trust is a double ownership that makes it possible for two exclusive ownership claims to exist simultaneously over the same asset – legal ownership claimed by trustees and equitable ownership claimed by beneficiaries. According to the other definition, the trust is a hybrid between rights in rem and rights in personam, or between property and debt. The trusted property is the trustees’ property because they obtain its legal ownership. But, at the same time, it is the trustees’ debt because they must pay benefits to beneficiaries permanently. Interestingly, the trust arose out of the violation of the Roman legal principle that strictly divided rights in rem from rights in personam. This Roman principle considers any mixing of these two rights a crime. Among the Western countries at that time, England was the least affected by Roman law, and developed its own legal tradition distinctly from that of continental Europe. My discussion of the trust helps explain why representative democracy, the modern business corporation, and modern banking originated from and has developed most successfully in Anglo-American countries, where the culture of trusteeship predominates. This essay contributes to extending the concept of the trust beyond its narrow legal boundaries, opening the door to an interdisciplinary study that crosses the fields of economics and politics.

As Table 1 shows, representative democracy, the modern business corporation, and modern banking are trusts. But how is modern banking a trust? In a previous publication, I concluded that the origin of modern bank money should be found in the innovative scheme of the trust, which simultaneously makes bank money both money and credit (Kim 2011). I further argued that the law of trusts and modern banking both originated in the same historical context and with the same motive in late-seventeenth-century England: namely, to escape interference from rulers in order to perpetuate an individual owner’s interest in property (Kim 2011).

Table 1. Double Ownership in the Three Trusts

Trust schemes	Modern banking	Representative democracy	Joint-stock company
Double ownership			
Legal owners	Bank	The state or the people (represented by elected politicians)	Company (represented by managers)
Equitable owners	Depositors	People	Stockholders

Modern banking establishes a double ownership and hybridity between rights in rem and rights in personam. As a trust, modern banking establishes a double-ownership scheme. Two groups in modern banking – the holders of bankers’ notes

and bank depositors – are the exclusive owners of one and the same cash kept safely in bankers' vaults. A single quantity of cash creates two cash balances of the same amount, one for the holders and the other for depositors. As a result, demand deposits with commercial banks, together with commercial banknotes, which are issued on the basis of those demand deposits, create money supply. This is a mechanism through which private bankers create money. As commercial bankers accept each other's notes at par, this money creation is extended further.

Modern banking finds its origins in the practices of London goldsmiths in the second half of the seventeenth century. The historical event that led to this invention (by goldsmiths) was the appropriation of cash deposited in the London Mint by King Charles I. In 1638, in order to raise funds for war, Charles I appropriated £200,000 in coin and bullion deposited by London merchants in the Mint. Even though the Crown returned the sum on the condition that the depositors would loan him £40,000, property owners sought alternatives. A number of London goldsmiths offered an alternative safekeeping service by using the scheme of double ownership. They printed additional deposit certificates and loaned them to numerous third parties, while still offering depositors the right of withdrawal on demand. This use of loans for safekeeping was not unique in history. Around the middle of the seventeenth century, bankers in Seville (Spain) loaned most deposited money to private industry and commerce to escape Charles V's attempt to confiscate the funds remaining in their vaults (de Soto 2009). But goldsmith-bankers were more innovative. Instead of emptying their vaults, they introduced transferable banknotes. This strategy was very successful in "merging" the interests of numerous third parties in the same funds. Creating simultaneous ownership interests among third parties and depositors would make it harder for the Crown to appropriate the funds and would elicit greater opposition to the Crown's further efforts to do so.

This double-ownership scheme was constructed because commercial banking is a hybrid between a loan transaction and a deposit transaction. First, it is a deposit transaction because the demand clause of banknotes allows their holder to withdraw the funds deposited in the banks' vaults at any time on demand, and thus the holder retains practical ownership of the funds. But modern banking is also a loan transaction, in which the ownership of a loan is transferred from creditors to debtors. Thanks to this transfer, banks can lend deposits in their own names to third parties as well as attain and retain ownership title to the loans.

Table 1 above reveals that depositors of modern banking are equitable owners because the deposits are repaid on demand, and thus the ownership of the deposits practically remains in the depositors' hands. However, the demand deposits of modern banks are not regarded as equity under existing law. Instead, by treating modern demand deposits as loans, the law legalizes what was considered illegal in traditional Roman and civil law.

Like the trust, modern banking arose out of the violation of the Roman legal principle that strictly separated rights in rem from rights in personam. Under the continental Roman and civil law traditions, the rights of a depositor are rights in rem – rights against a thing, because the depositor retains legal ownership over the

deposited property. A depositary should keep deposits safe and honor depositors' requests to withdraw deposits at any time on demand, and depositors are charged a safekeeping fee. In a loan transaction, on the other hand, the rights of a creditor are rights against a person – rights in personam. The creditor cedes legal ownership of property to a debtor during a specified period and, in exchange, obtains a debt claim that goes against a person. The creditor can oblige the debtor to fulfill an obligation to repay the principal and the interest. These two inherently different transactions are mixed when depositaries attempted to loan deposited funds for profit. Such an attempt – and a mixture – was considered embezzlement in the Roman law tradition. In this tradition, an honest depositary of fungible things, such as money or grain, had to keep one hundred percent tantundem of deposits. For example, in Catalonia in 1360, a banker who failed to return deposits to depositors was beheaded in accordance with the law (de Soto 2009). This rule existed even in the common law tradition. During the 1860s, in the United States, grain elevators issued deposit receipts larger than the amount they kept, and lent the receipts to speculators in the Chicago wheat market. Resultant swings in wheat prices and bankruptcies in the wheat market were settled when the act was treated as fraudulent and illegal by common law courts (Rothbard 1994). An exception was made, however, in the common law with regards to demand deposits with banks. In 1848, in *Foley v. Hill and Others*, the House of Lords finally declared demand deposits with banks to be loans to the bankers. Here, bankers legally issued additional deposit receipts of a value greater than the amount they kept.

When one conceptualizes modern banking as a trust, one can better understand the distinctiveness of the capitalist credit economy. It includes three important factors: (1) systemic vulnerability, (2) the rise of big and powerful debtors, and (3) the role of the state. First, modern banking's use of this hybridity exposes a community to a new form of risk that did not exist in either the traditional safekeeping business or credit economy: The risk of illiquidity in the form of bank runs and other types of liquidity crunches. Such risk is similar to the risk in a "pass the parcel" game, in which "the loser is the one holding the parcel when the music stops" (Horsefield 1977, 124-125). When depositors suddenly realize that the banks' loans to third parties are failing and have placed the banks at risk, the depositors initiate a run on the banks in order not to be left holding the parcel. When modern banking creates economic recessions, it generates high costs for third parties – including workers, suppliers, consumers, and peripheral countries – who are innocently involved in the transactions of bankers' paper money (de Soto 2009).

Second, utilizing the hybridity creates big and powerful debtors. To understand this process, one can compare modern banking with the Bank of Amsterdam, a highly respected continental public bank during the seventeenth century. Continental Europe under the Roman law heritage established the Bank of Amsterdam to observe the Roman legal principle: that is, to clearly distinguish loan-making and deposit-taking. Thus, the bank maintained a one-hundred-percent reserve ratio for over one hundred and fifty years after its foundation in 1609 (de Soto 2009, 99). Even with a full reserve, the bank supported trade. Merchants in Amsterdam were legally obligated

to present their bills of exchange to the Bank of Amsterdam, where the debts of the bills were cleared among merchants (Richards 1965). The financial role of public-deposit banks on the continent was to clear the creditor-debtor relations created by bills of exchange, while modern banking extends creditor-debtor relations. Modern bankers can collect a large amount of deposits and issue a large amount of banknotes because they can make the two discrete promises. One promise is made as depositaries – payable on demand – and the other as creditors – interest payment. When modern banks issue additional deposit certificates, they do so by loaning them to third parties. Thus, these third parties become debtors to the banks. At the same time, these banks become the debtors of those third parties because the banks maintain only a fractional reserve. Thus, the more money is created, the more these banks and people become mutually indebted. This was the birth of big debtors and the beginning of society's indebtedness to big debtors.

Because the debtors do not all withdraw their money simultaneously, a portion of the debts remains in the hands of bankers. This debt is transformed into permanent capital which bankers use for profitable long-term investment. This capital has often been invested massively in public debt, which has mainly been required for warfare. This is where the alliance between financiers and warriors began (Graeber 2011). For example, prominent goldsmith-bankers, such as Alderman Blackwell, in the seventeenth century earned record profits from their investments in the Crown which urgently needed money for warfare. Long-term investment in the Crown was the only exception to the usury law that prohibited interest rates above five or six percent, although prominent bankers charged an interest rate of ten percent or more on loans to the Crown.

A debt crisis in the capitalist credit economy is a crisis of not only individual debtors, but also of big and powerful institutional debtors. In traditional ancient credit economies, by contrast, a debt crisis was a crisis of small and weak peasants who were forced to sell their daughters into slavery to pay their debts, or to submit themselves or their wives to debt peonage or prostitution. Developed countries have devised various means of keeping big and powerful debtors safe from bankruptcy, especially by establishing a central bank as a lender of last resort and by creating deposit insurance. After a financial crisis occurs, governments provide private banks with bailouts at taxpayers' expense. As soon as taxpayers' money is used for bailouts, the fictionally created money of the banks becomes real money, cash.

Third, as David Graeber (2011, 213) excellently describes, in Eurasian history over the last five thousand years, there has been a broad alternation between a credit economy and a money economy. The money economy predominated in periods of widespread war and plunder or of ruthless materialism and self-interest, while the credit economy tended to dominate in periods of relative social peace or across networks of trust without the violent intervention of the state. But the capitalist credit economy is an exception, because it is characterized by widespread war, plunder, ruthless materialism, and self-interest that were characteristic of the money economy. Graeber brings this exception to the reader's attention but fails to expound it. This exception can be explained through the trust. The capitalist economy is basically a

money economy where the reserve currency is gold and silver or fiat money. At the same time, however, it displays hybridity in the sense that it has various institutional trust schemes which make credit instruments something like money. For example, banknotes are credit instruments but simultaneously made into something like money because the notes are convertible to cash at any time on demand. Gary Gorton and Andrew Metrick (2010) demonstrate that other money-like debt instruments, such as repurchase agreements and Money Market Mutual Funds' shares, were devised in the twentieth century and caused the financial crisis of 2008. Due to this hybrid nature, modern bankers have not been trustworthy from their inception. Because war and sheer violence predominated in the early modern period, distrust pervaded society and created tension even between political authorities and property owners. The next section examines how it was that untrustworthy modern banking could be established as a social institution.

Modern Politics as the Constructor of Modern Banking

As mentioned earlier, goldsmith-bankers were supposed to embed the interests of numerous third parties in the same fund in order to safeguard that fund. To this end, paper money had to circulate widely beyond the circle of the bankers' depositors. Goldsmith-bankers achieved the widespread circulation of paper money in the late seventeenth century, and the Bank of England subsequently pushed their enterprise even further. However, the bank monies issued by both goldsmith-bankers and the Bank of England were unreliable in early modern England. In the first case, this was due to the goldsmith-bankers' frequent insolvency and bank runs and, in the second case, to the Bank of England's series of suspensions of specie payment. For example, in May 1696, the bank suspended specie payment and only resumed it two years later. Immediately after the suspension, its notes depreciated severely. According to Murray N. Rothbard, they promptly fell to a twenty-percent discount against specie (Rothbard 2008, 180). The bank was also plagued by periodic specie suspensions and bank runs, such as in 1720 with the crash following the "South Sea Bubble," and in 1745 with the rise of Bonnie Prince Charlie in Scotland. This raises a question. How could have bankers' unreliable paper money circulated so widely among a public that perceived it as untrustworthy?¹

Simply stated, paper money could circulate widely because the English state supported modern banking in order to use it as a way of extracting war resources. War-making by sovereign kings in the seventeenth century created an urgent need for funds. Around the time of the Glorious Revolution of 1688, the English state's foreign policy was imperialist, eager to expand colonies and trade advantages. A major barrier to this imperialist policy was France. The huge accumulation of short-term debt – almost £6,000,000 – after the Glorious Revolution threatened to overwhelm the government's credit system (Carruthers 1996, 73). To fund wars against France

¹ The goldsmith-bankers' low fractional reserve of ten percent further accentuated the impression that they were untrustworthy (Horsefield 1977, 122).

after the revolution, Parliament needed to move in the direction of long-term borrowing that did not require quick repayment. This need was satisfied by the proposal offered by some financiers and a City group in 1693 to institute permanent loans (Clapham 1958). These individuals proposed to incorporate public debt. The Crown organized a group of its creditors into corporations, including the Bank of England (1694), the New East India Company (1698), the United East India Company (1708), and the South Sea Company (1710). The loans to the state were securitized into these companies' stocks. The loans were pooled into these companies and, in turn, these companies sold claims on the pool to investors in the form of shares. This securitization allowed the state to use the loans permanently without repaying the principal as long as the companies remained incorporated. In return for permanent loans to the state, the bank was granted the right to create paper money and to have this money accepted in payment of taxes.

Because citizens who had tax obligations to the state could use the bank's private money in settling these obligations, they accepted the money as a means of payment.² Furthermore, in 1697, forgery of the bank's notes was punishable by death. From then on, the deal between the bank and the state became the central node in the history of modern paper money. In 1833, the English state made this paper money legal tender, which forced the public to accept the private banker's money. Thus, private paper money, if it was legal tender, had to be accepted by a creditor when it was offered to him in payment of a debt. The bank's notes were not the king's money, but private money, because they were a promise to pay issued by the privately owned Bank of England. "But they were getting near to [king's money]" (Clapham 1958, 50). They were public currency. However, this privilege of the bank's money was realized, as shall be seen, through the ongoing struggle and compromise between the Bank of England and the state. In spite of the proposal from financiers to offer a permanent loan, the government incorporated the bank, initially for only eleven years, and required the renewal of its charter to extend its incorporation.

Had the state not been continuously engaged in war, the Bank of England may have been abolished in its early days. Had the state not needed to collect long-term public debt, it would no longer have granted bankers and financiers the privileges of money creation and chartered incorporation. Parliament, especially MPs representing landed interests, was hostile to the moneyed interest of bankers and financiers that emerged in the latter half of the seventeenth century. MPs often depicted bankers as "upstarts who had been born in relative poverty but now flaunted their wealth," or referred to them as usurers. MPs reproached bankers for plunging the landed class into a permanent depression in the late seventeenth and early eighteenth centuries

² Goldsmith-bankers made their notes acceptable in payment of taxes. This achievement looks mysterious at first because the Tellers of the Exchequer, the cashiers of the English government, accepted only specie in payment of taxes during the late seventeenth century. A prominent goldsmith-banker among the first generation of goldsmith-bankers, Edward Backwell, contrived a detour. Backwell made his banknotes acceptable in payment of taxes by forging a private connection with Richard Mounteney, a tax receiver and Cashier of the Customs Revenue for the Port of London (for a detailed discussion, see Stephen Quinn, *Banking Before the Bank: London Unregulated Goldsmith-Bankers, 1660-1694* (Ann Arbor: University of Illinois at Urbana-Champaign, 1994)).

(Jones 2001, 71-72). During the several decades that followed the Glorious Revolution, the tension between the two interests – the landed interests, dominating Parliament, and the moneyed interests as the government's major creditors – became one of the central themes of English society (Carruthers 1996, 202).

The Bank of England was rechartered nine times between 1694 and 1844. Every time rechartering came up, ministers or Parliament threatened to review the statutory arrangements for the bank's operation. They threatened, for example, to dissolve the bank's incorporation or to establish other competing banks (Bowen 1995, 17). In fact, Parliament in 1696 authorized the Land Bank to serve the landed interest, hoping to create a competitor to the moneyed interest of the Bank of England. Even though the Land Bank failed instantly, this challenge prompted the Bank of England to negotiate the recharter of 1697. This negotiation extended both the fiscal capability of the state and the privilege of the Bank of England. The government was offered additional loans, and, in return, the 1697 Continuation Act proclaimed that "no other Bank or Constitution in the nature of a bank be erected or established, permitted or allowed by Act of Parliament during the Continuation of the Bank of England" (Clapham 1958, 47). However, in spite of such a proclamation, the state remained omnipotent in constitutional theory. Another statute could have been enacted at any time to suspend what had been contracted (Jones 2001, 83). In other words, Parliament could have set up another competing bank even after the 1679 Continuation Act. In fact, in 1800, after more than a century, the Bank of England had to negotiate an early recharter because of parliamentary pressure to establish a rival public bank (Bowen 1995, 8-9).

Arguably, this tension between the state and business corporations – the former being indebted to the latter – constitutes the politics of the trust. The corporate ownership of British public debt held by the Bank of England, the East India Company, and the South Sea Company rose to eighty percent by 1720 and then slowly declined to twenty percent by the late 1750s (Quinn 2008, 2-3). In spite of this decline, the politics of the trust, which maintained the tension between the state and business corporations, remained an important tool for restructuring public debt because the bank's role as an administrator of public debt continued. The Bank of England has not been rechartered since the Continuation Act of 1844. As the landed class, beginning in the middle of the eighteenth century, effectively extended its investment into intangible property (such as governmental and commercial stocks and debentures, along with other forms of transposable goods), the distinction between landed and financial interests became blurred (Jones 2001, 90). However, the politics of the trust remained an important governmental tool in nineteenth-century England (Alborn 1998).

Public debt was war money. According to Michael Mann, British government expenditures between 1700 and 1815, most of which were funded by public debt, grew fifteenfold (Mann 1986, 485-486). This unprecedented rate of increase was due primarily to a large increase in military expenditures. Huw V. Bowen argues that,

[b]etween 1688 and 1815, England or Britain was involved in seven extended wars ... It was this continuing element more than any other single factor that defined the Bank's term of reference and the scope of its different forms of banking activity. This meant that public finance and the institutional mechanisms designed to service the spiraling national debt were forged in an atmosphere of ongoing conflict and crisis. (Bowen 1995, 5)

One may speculate that, without the recurrent wars and war-related crises of the eighteenth century which generated the government's urgent need of funds, the hostility of Parliament to bankers might have led to the abolition of the Bank of England early in its existence. In 1702, a strong section of the Tory Party opposed the renewal of the bank's charter and claimed that large-scale continental campaigns only served the selfish interests of sectional groups and financiers by binding Englishmen to large and long-term debt obligations. This group of Tories insisted that England should first concentrate on naval and colonial campaigns, and that the wars could then be financed exclusively by taxes and limited short-term borrowing (Jones 2001, 84-85). Without English involvement in large-scale continental wars, this Tory policy would have been realized.

The Bank of England began as a makeshift project to support the state temporarily during the war against France. So, initially few, if any, expected its huge success in mobilizing resources for large-scale wars. The financial revolution,³ however, triggered by improved government access to credit, allowed England to defeat France and to emerge as a dominant power in the West by the late eighteenth century. This unexpected success made the bank an indispensable long-term project for modern England. This explains why English banking, rather than continental public banking, became the dominant form of modern banking. Because English banking played a role as the provider and administrator of public debt, it became an effective means of supplying the state with war resources. By contrast, the continental public-deposit banks at that time were forbidden to provide loans not only to private parties, but also to the public sector.⁴

³ Peter Dickson (1967) argues that improved government access to credit formed the basis of financial markets' development, where the stocks of chartered corporations, the Bank of England's banknotes, as well as bills of exchange and perpetual annuities issued by the government, were traded. Dickson calls this development a "financial revolution" which formed a national credit economy in late-seventeenth-century England (Dickson 1967).

⁴ In this and subsequent sections, the essay discusses early modern banking, focusing on the development of the Bank of England. Even though, until the 1826 Bank Act, the bank was the only joint-stock bank, country banks that issued their notes with a fractional reserve increased rapidly in the second half of the eighteenth century, numbering more than 780 by 1820 (Richards, *Early History*, 193). The essay's focus on the Bank of England is justified, however, because the development of the bank's money served as a basis for the English national banking system. Private country banks "increasingly used Bank-of-England notes as reserves and pyramided their own notes on top of them" (Rothbard 2008, 182).

Modern Politics as a Trust Scheme

This military-banking complex was possible because of politics centered on public debt. This politics can be characterized as a trust. The trust is a governance mechanism that creates and governs a personified group by making it a moral debtor. But how does this process occur? A trust makes it possible for the individualistic purposes of property owners to endure permanently, beyond a life span, and this is possible because the trust constructs a personified group independent of its constituents. Since the early thirteenth century, and increasingly since the second half of the seventeenth century, the landed class had used the trust – and its feudal form, the use of land – as a device to make its interest in property endure when endurance was impossible (e.g., after death or due to external interference, especially to evade taxation by the rulers or the state). Even in the present day, tax avoidance is the motive that “dominates all others in the context of the creation of trusts in modern law” (Martin 2001, 43). To avoid all legal responsibilities as an owner, the owner transfers legal ownership to trustees but retains equitable ownership. Noticeably, the owner transfers legal ownership to a group of replaceable trustees and, in doing so, solves the problem posed by the death of an individual trustee, which can terminate a trusted interest. Here, the group personality of a trust is created by the group of replaceable trustees who are obligated to promote the will of the settler.⁵

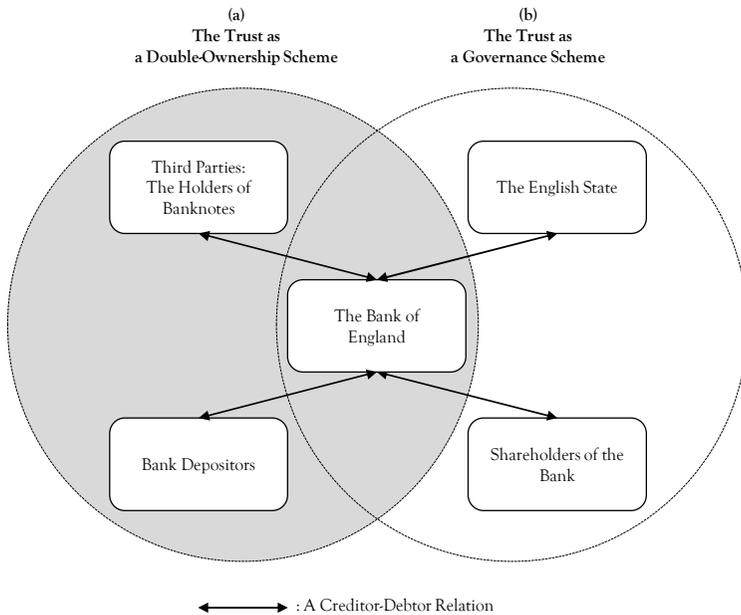
Similarly, the Bank of England’s joint-stock banking was a governance mechanism between two personified groups – the bank and the English state – and the bank’s shareholders (see (b) in Figure 1). As shall be seen, there are close links and the mirror image between modern banking ((a) in Figure 1) and modern politics ((b) in Figure 1), so that the governance mechanism of the trust scheme – modern politics – enabled the development of modern banking. This specific governance mechanism emerged when the relations between a community (a group) and its individual members took an entirely novel form. I specify two such novelties: (1) the personification of groups – the modern nation-state and the business corporation, independent of their constituents and (2) the establishment of these personified groups’ indebtedness to their constituents. The blending of these two factors institutionalized the trust because the trust is the combination of the personification of a group and indebtedness. In the trust, an independently personified group is constructed, and this personified group becomes permanently indebted to its beneficiaries because it must be of benefit to them in perpetuity. As with the double ownership of modern banking, in modern politics the two groups – the people and people – are exclusive owners simultaneously, as Table 1 shows.

Public debt – a state’s indebtedness to its citizens or groups of citizens – is a modern and Western European phenomenon. It existed neither in ancient Greece nor in Rome (Hamilton 1947, 118). Traditionally, sovereign kings did not tolerate being indebted to their subjects because this indebtedness contradicted their supreme

⁵ In trust settlements, the group personality of the trust is not explicitly stated, but implicitly generated through the group of replaceable trustees and by the transferability of beneficiaries’ rights.

authority. Medieval English monarchs thus preferred to borrow money from foreign bankers, including from Siena and Florence, rather than from their own subjects. The medieval monarchs of other countries in the West did the same.

Figure 1. Early Modern Banking as the Combination of Two Trust Schemes (a+b)



Public debt has intrinsic problems. First, it defines the relationship between a community and its members as a creditor-debtor relation. That is, it considers a citizen’s contribution to a community to be the debt that the community must repay in the future. This is an extreme case of individualism. Second, public debt requires the state to be more than a simple collective. Instead, the state and its members must be treated as separate persons since only separate persons can make debt contracts with one another. Public debt is incurred when a state becomes indebted to its subjects and when the responsibility for repaying this debt lies on the state itself rather than on each individual subject. In the term “public debt,” Maitland (1911) argues, the “public” is not so much a sum of individuals as a personified group that is separated from the personalities of individual members. As I try to show, this separation happened first in early modern England.⁶

⁶ Following its creation, public debt has been often owed to foreign entities. Even in this case, the state is separated from its citizens’ personality, and the responsibility for repaying the debt lies with the state, not with each individual subject.

The independent personality of the state can be regarded as growing out of the traditional body politics. The political relationship between the sovereign and its subjects in England has been instituted since medieval times as the relationship between two corporate actors – the Crown as a corporation and civil corporations. Since medieval times, various sectors of the population had been organized into corporations. Cities and boroughs, guilds, universities and colleges, hospitals and other charities, and bishops, deans, chapters, abbots, convents and other ecclesiastical bodies were corporate persons. In relation to these permanent corporate persons, the Crown, too, was a corporation. The king or queen in succession was a member of the Crown as a corporation. A corporation having a single member at a given time was called a corporation sole, in contrast to a corporation aggregate which was comprised of many members. This relationship between two personified groups, the Crown as a corporation and civil corporations, was called the body politic. When the English state organized a group of its creditors into the Bank of England in 1694, it continued the traditional governing method of organizing a group of its subjects into a corporation.

The incorporation of the bank, however, had novel elements, too. First, the state began to involve itself in permanent creditor-debtor relations with the corporate persons into which its subjects were incorporated. Second, the bank as a corporate person also began to involve itself in permanent creditor-debtor relations with its individual owners. I conceptualize this as the combination of the personification of a group and indebtedness – the trust.⁷

The corporate state's permanent indebtedness to its constituents should be understood as a result of the political struggle in seventeenth-century England that revolved around the question of who was the sovereign that imposed tax and accumulated the sovereign debt. The Glorious Revolution resolved the question by creating a new personality of the state – the people, an entity that was sovereign over the Crown and Parliament and was responsible for public debt. Governments were no longer sovereigns but mere representatives of the interest of the people. Sovereign debt was not the debt of the Crown now, but public debt – the debt of the people. This innovation increased the government's credibility in regards to its debt obligations. Previously, sovereign debt had been the personal debt of kings, and thus went bad when kings died or their royal privilege allowed them to easily repudiate debt obligations. For example, Florentine bankers the Bardi and the Peruzzi went bankrupt when King Edward III repudiated his war debts in 1345. In 1672, King Charles II defaulted on the money that goldsmith-bankers had loaned him. This default, called the Stop of the Exchequer, resulted in the failure of many London goldsmith-bankers and made their notes unacceptable during the 1670s. However, after the revolution, the people became liable for the debt obligations of the government regardless of who the king was. This political change enhanced the government's commitment to and credibility in being able to repay its debt. This became the basis for developing the financial system in early modern England.

⁷ See the latter part of this section for the difference between the trust and traditional corporations.

Public debt first appeared in the medieval Italian city-state of Venice in the twelfth century, and later in Genoa and Florence. Because public debt presupposed the corporate personality of the state, there was an important development in political theory. For the first time in history, there emerged the modern conception of the state. During the thirteenth and fourteenth centuries, commentators on Roman law in Italian city-states, especially Bartolus of Saxoferrato and Baldus de Ubaldis, regarded the state as an abstract entity, distinct from its government and its members (Canning 1983, 23-24).

However, the indebtedness of Italian corporate city-states to their citizens was not public debt in the strictly modern sense, because the rights and responsibilities of a republic and its citizens were not fully separate. When a republic could not repay its debt, its creditors could claim repayment against a few of its wealthy citizens. The republic often forced its citizens to buy public debts. England was the first to fully develop the separate group personality of the state. Private property rights, which had been developed since the Middle Ages and were settled by the Bill of Rights after the Glorious Revolution, prevented the state's creditors from claiming repayment against individual citizens, and thus assigned the debt obligation to the state itself.

Modern business corporations have also become like a trust. Incorporation is generally understood to create a group identity. In traditional corporations, however, the personality of the group was not clearly separated from the identities of its constituents. As Georg Simmel writes,

[t]he medieval guild included the entire person; a weavers' guild was not an association of individuals that only pursued the mere interests of weaving. Instead, it was a living community in occupational, social, religious, political and many other respects. ... [I]ts members ... were absorbed in it without rights of their own. (Simmel [1896] 1991, 18)

Peculiar to the evolution of a separate group identity in England is the fact that the trust was a more popular scheme for group identity. With the Bubble Act of 1720, the English state forbade all corporate forms of joint-stock companies that were not authorized by statute. However, until general incorporation was made possible by statute in the nineteenth century, trust schemes were widely used to create joint-stock companies. Corporations were traditionally a governing tool of the state to regulate civil activities such as trade. Thus, the group personality of corporations was granted, from the top down, by the Crown. By contrast, trusts were a tool for individual freedom to avoid the interference of the state, and they were organized autonomously, from the bottom up, by private property owners. Thus, the group personality of the Bank of England was a hybrid between a trust and a corporation. It had to be chartered by the Crown but, at the same time, depended upon the limited liability and transferability of its ownership. When the Companies Act of 1862 permitted the establishment of business corporations without a charter from the state, the traditional form of corporation was transformed into a trust scheme.

The first joint-stock company, the Dutch East India Company, emerged in the Netherlands in 1602. When the company borrowed money from its constituents –

stockholders – in the name of the company, it could be regarded as a person possessing an identity distinct from the identities of its constituents. However, the independent personality was not fully formed in the strictly modern sense because the rights and responsibilities of the company and its constituents were not fully separated. The stockholders were less the owners of the company than its creditors. They could not control the company's business because the directors of the company were elected by city councils, not by its shareholders (Neal 2005). One can thus regard the separation of the rights and responsibilities of the company and its stockholders as the traditional separation between debtors and creditors rather than between the company and its constituents. By contrast, the stockholders of the Bank of England were owners and thus had the right to vote to select directors as well as decide important managerial issues. The directors, in turn, were accountable only to the stockholders. At the same time, the stockholders had limited liability. Due to this limited liability, the responsibilities of the Bank of England became separate from those of its constituents. Thus, the personality of a business group, understood in the strictly modern sense, was first formed in England.

Representation and the Trust

Representative democratic government contributed to the origins of public debt in two ways. First, it created the group personality of the state independent of the personalities of the rulers and the ruled. Second, it contributed to the conceptualization of the state as a moral debtor to its citizens. The same logic of representation applies to business corporations.

As Thomas Hobbes and John Locke argued, representation makes the impossible possible. A state cannot achieve unity or uniformity because its constituents – people – are diverse. However, representation transforms diversity into unity, and people into *the* people. Here, the interest of the people that representative government puts into practice is not the interest of the majority of people. Rather, it is the interest of *the* people distinct from the interests of people (Runciman 1997).

Representation is a mythical concept. Tracing the semantic development of the term representation helps one understand how representation creates the myth of group personality. The verb “repraesentare” in Latin originally implied that “something absent is being represented to the gaze” (Skinner 2005, 160). For example, representation refers to the asserted magical potency of aesthetic acts. A successful painting or sculpture, according to this understanding, does more than produce resemblance. It represents actual things or persons so that someone who sees the work of art will believe that he or she is seeing the things themselves, and not merely their resemblance (Skinner 2005, 160-161).

From about the fourth century of the Christian era, the terms “repraesentare” and “repraesentatio” included references to speaking or acting in the name of someone else (Skinner 2005, 161). Here representation revolved around the term “persona,” from which the English term “person” originated. The public role of magistrates was to represent, or bear the personage of the city (Skinner 2005, 162). In

England, Queen Elizabeth I as a public person was considered to represent the personality of the English state. This idea of representing group personality in a public person prevailed in Protestantism. “The idea that Adam and Jesus Christ are representatives of the whole of mankind was adopted by a large number of Protestants from Luther onwards, though the phrase is not Biblical in any of its variations” (Hill 1986, 300). An English innovation was to adapt this mythical idea of representation to democratic ideology. The radical propagandists of the 1640s began to claim that Parliament represented the people.

This doctrine had a serious flaw, however, and this problem was solved by the idea of the trust. As Hobbes and Locke correctly claimed, a collective consisting of the diverse interests of people cannot be considered a person who has one interest, and thus there is no preexisting personality or identity of the people that a parliament can represent. Hobbes and Locke thus argued that representation creates the personality of the people when each individual citizen entrusts his liberty and power to rule himself (by elections or through other voluntary means) to a king or parliament. By this trust, a unity or uniformity becomes possible in one body, whether that of the king or parliament. People are numerous and diverse, but a king or a parliament is a singular or small body that can achieve unity more easily (Hobbes 1651, chapters 16, § 13; Locke [1690] 1988, § 212).

This trust added a new characteristic – a creditor-debtor relation – to the relationship between representatives and people and, by doing so, contributed to conceptualizing the state as a moral debtor. According to the modern doctrine of public trust, a small group of representatives brings about the interest of the people, and the power of trustees to govern people according to this interest is supreme. Unless this created interest betrays the good of the people, the people cannot overthrow a representative government (Goodhart 1948, 677-678). However, the power is entrusted by – or borrowed from – people. Public trustees have been charged with a moral and legal obligation to exclude their own interest and promote the purpose of the people. As a result, under the doctrine, the power to rule people is a hybrid, double-ownership scheme. On one hand, it is the trustees’ property because the body of the trustees brings about the united interest of the state. On the other, it is borrowed power that belongs to people. It is also in the doctrine of the public trust that the two ideas of group personality and indebtedness converge.

The doctrine contributed to enhancing the government’s commitment to the repayment of public debt. The creditors of public debtors pressed the state to honor its debt obligations, and this pressure caused the state to undertake administrative reforms in the late eighteenth century. For example, the Reports of the Commissioners for Examining the Public Accounts (1780–1787) brought about one of the significant administrative reforms of the English government to improve the transparency and accountability of the government. In these reports, the doctrine of the trust is used as a central argument in favor of the administrative reform (Torrance 1978).

In modern politics, the politics of the trust allows politicians to disguise their imperial ambitions as the universal interest of the people. The invasion of Iraq in

2003 was condemned as illegal by Kofi Annan, the Secretary General of the United Nations, but the invasion was disguised as the universal interest of United States, even though American opponents to the war have outnumbered supporters since the summer of 2005. This construction of the universal interest of the people by representation has been criticized by postmodernists. Their main objections are manifold. First, the people and the interest of the people do not really exist because people are diverse in reality. Second, the creation of an imaginary entity of *the* people is anti-democratic. Third, representative politics comes from the desire to reduce diversity and creativity to sameness. As postmodernist Simon Tormey argues, “[w]hat The People want,’ is not what people want, but rather what it is that someone thinks the people want. It is what the ‘representatives’ of The People’s interests want” (Tormey 2006, 144). This construction of the interest of the people is a means for the representatives to project class interest as universal interest.

Concluding Remarks

Douglass North received the Nobel Prize in 1993 for his research, which demonstrates that the British government’s commitment to repaying public debt after the Glorious Revolution contributed to economic growth. His historical research has often been used as a theoretical justification for “first-world” countries forcing the government of a “third-world” country to bail out its private banks and repay their debts to the banks of creditor countries, thus effectively turning private debts into the debt obligations of the people of the country. This policy was implemented by the IMF during the “third-world” countries’ debt crises in the 1980s and the Asian financial crisis in the late 1990s. The argument typically is that this commitment to repayment will improve the credibility and stability of the debtor country’s national financial system and contribute to the long-term economic growth, even if this debtor country needs to adopt austerity policies in order to make the repayment. However, the long-term result of IMF policy has diminished wellbeing and equality for the people of many debtor countries.

This essay challenges North’s reasoning. It has critically discussed the nature of modern banking. What the banks from “first-world” countries supposedly offered to private banks of the “third-world” countries was cash. But due to the fractional-reserve system, what the banks effectively offered was only credit, a mere additional creation of titles and claims from one and the same amount of property. This created conflicts with the foundation of liberal democracy – the principle of property. According to this principle, it is deceptive for someone to create additional deposit certificates (i.e., additional titles and claims, from one and the same amount of property). Ultimately, the crises were caused when the funds that the developed countries offered were suddenly withdrawn from the developing countries both in the 1980s and (from the Asian countries) in the late 1990s. This sudden withdrawal occurred mainly because of the vulnerable nature of modern banking in the “first-world” countries rather than because of their supposed corruption.

The risk that a debtor will go bankrupt is, after all, what a creditor must endure in return for earning high interest on its loan. Nevertheless, during the crises of the

1980s and the 1990s, the IMF forced the government of developing countries to bail out their private banks and repay their debts to the banks of creditor countries. In the modern international state system, such behavior is based on the modern idea of the state, where the people of developing countries as a whole have been made liable for the obligations incurred by their often despotic governments.

Something similar seems to be currently happening. The global financial crisis of 2008 began as a banking crisis in the United States. To stabilize their financial systems, governments in the European Union (EU) provided large bailout packages to their financial sectors. Due to these bailout packages, and the subsequent global economic slowdown, the average fiscal deficit in the EU grew to 7.0 percent during the financial crisis, from only 0.6 percent in 2007, before the crisis (Économistes Atterrés 2011). For example, Spain and Ireland had successfully maintained the deficit threshold of 3.0 percent of the GDP, as required by the EU fiscal rules, and they had usually even maintained a surplus (Park 2013). These two countries' public debt crises resulted from their bailout programs, which turned the debts of private banks and financiers into the debt obligations of the people of Spain and Ireland.

As the essay argued, this socialization of debt is possible because the politics of the trust creates an immortal debtor – the people. With immortality, the debt obligations of this imaginary group are maintained permanently, and creditors are strictly guaranteed that they will be paid back. This politics of the trust helps one understand how the capitalist credit economy differs from previous credit economies. Previous credit economies often accommodated reforms that reestablished debtors' status as equal to that of their creditors through the cyclical abolition of debt since unpaid debts contributed to rising inequality in society. The hybrid, double ownership of modern banking has led to unprecedented expansion of creditor-debtor relations. Concomitantly, the scale of debt crises has also become unparalleled. The politics of the trust has secured creditors' rights to save modern banking, but it has now increased inequality between people and between developed and developing countries. This same inequality will destroy the social foundation of the credit economy because, to work, debt contracts require that they are made between equal persons. In the current global financial crisis, the question is one of survival of our civilization.

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