AMERICAN MONETARY INSTITUTE

PO BOX 601, VALATIE, NY 12184

Tel. 224-805-2200, email ami@taconic.net

http://www.monetary.org

Stephen Zarlenga, Director

Dedicated to the independent study of monetary history, theory, and reform
"Over time, whoever controls the money system controls the society."

The following critique, written in 2002, points out many of the faults with Innes' theory. This is part 5 of a 33 page essay by Stephen Zarlenga titled "The Development of United States Money." That essay plus another 45 page essay by Mr. Zarlenga from the March, 2005 issue of The American Review of Political Economy titled "Moving Monetary Reform to the Front Burner" is available from AMI on CD or DVD, postage paid, for a $28 donation. Please mail your check, or credit card info, and mailing address. You can also order it by email or telephone.

Part 5:
Critique of INNES' "CREDIT THEORY OF MONEY"

The American Monetary Institute's research (including that just presented) finds several points of agreement, and many of disagreement, with A. Mitchell Innes' work and theory:

First - **regarding method**, Innes' professed emphasis on and use of historical study is a refreshing departure from the typical political economists' reliance on mainly theoretical reasoning, or mathematics. Stressing the importance of history automatically elevates elements of the empirical approach, and ***should*** tend to ground research in fact and reality. He wrote:

"Now there is only one test to which monetary theories can be subjected, and which they must pass, and that is the test of history. Nothing but history can confirm the accuracy of our reasoning, and if our theory cannot stand the test of history, then there is no truth in it." (art. 2, p. 155).

Second - it is primarily this historical approach which allows Innes to draw the most important (and in our view the most accurate) conclusion of his work - **the rejection of Adam Smith's metallist theory of money. To his "credit", Innes realized that the nature of money is abstract, not material; that coinage, even "precious metal" coins, are really tokens.** This was no small accomplishment in 1914, when the body of political economists, as well as international monetary arrangements, were in the gold camp. But they rarely gave a theoretical justification for their definition of money; it is usually assumed, or even obscured.

For example, Adam Smith does not clearly present his position; it takes some digging to ascertain it. Indeed, Ludwig von Mises, writing in *The Theory of Money and Credit* in 1912, attacked monetary theorist George F. Knapp for clearly identifying Smith's position as metallist:

"Knapp ... describes the monetary theory of Adam Smith ... as entirely metallistic. The mildest thing that can be said about this assertion is that it is entirely unfounded."[1]

But is it really unfounded? To find Smith's definition of money, one must sift through dozens of pages of the most obtusely written passages of economics - in the section of his *The Wealth of*

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[1] Ludwig von Mises; *The Theory of Money and Credit*; 1912, Jonathan Cape, 1934; p. 474-75.

Nations on how money gets its value - and be careful not to skip over the one important sentence (and even it is not explicit enough):

"**By the money price of goods it is to be observed, I understand always, the quantity of pure gold or silver for which they are sold, without any regard to denomination of the coin."**[2]

Thus, von Mises' 500-page book did not achieve the level of understanding reached by Innes' brief presentation, as regards Adam Smith's viewpoint, and the abstract nature of money.

Third - Innes correctly understood that the period of Kingly control over coinage systems, with their frequent alterations and debasements, was not a question of cheating their subjects, but of taxation:

"But the general idea that the Kings willfully debased their coinage is without foundation ..." (art. 1 p. 386)

Del Mar referred to this period of monetary history, from roughly 1250 AD to 1450 AD, as the "period of Kingly abuse", and also pointed out that it was usually not a question of stealing from the populace through the monetary mechanism. Some market ideologues still advertise these 600-700 year old cases of monarchs "debasing" their coinage as a reason why modern governments should not control the monetary system.

BUT TOO MANY FACTUAL ERRORS IN INNES' "HISTORY"

While it would be healthy for Innes to draw on historical cases, **the way he did so is generally too loose and assumptive**. We often see phrases like this:

"To remedy this the kings of France attempted, **probably** with little success, to introduce ..." (art. 2, p. 153) or,

"And **when** we find, **as we surely shall**, records of ages earlier than the great King Hammurabi ... **we shall, I doubt not,** still find traces of the same law ..." (art. 1, p. 391)

These remarks are more than a stylistic problem, and belie a less than ideal attitude toward the facts. In our view, questions central to his theme should have been checked or answered more definitively before publishing the paper. (I have recently read and notated 1,500 pages of obscure writings on early Roman numismatics, in order to get 4 or 5 paragraphs correct in my book, and have little patience with Innes on this.)

There is also a very inadequate presentation of the evidence that he thinks he actually has, as opposed to evidence that he is sure ***will someday be found***. While the articles are brief, this should not have stopped him from presenting some of his sources, and we generally see a lack of dates and names.

But more serious are the large number of factual errors - enough to allow a critic to characterize the articles more as an abuse of history, than a use of it.

THE MANY ASSERTIONS ABOUT PRIVATE MONEY

Innes makes many unsubstantiated assertions regarding the existence of extensive private coinages. On page 382 (art. 1) he writes:

"(U)nder the Frankish Kings, who reigned for three hundred years (A.D. 457-751) ... coins ... were issued by the Kings themselves or various of their administrators, by ecclesiastical institutions, ... or by merchants, bankers, jewelers, etc. There was ... during the whole of this period, complete liberty of issuing coins without any form of official supervision ... ***There can be no doubt*** that all the coins were tokens and that the weight or composition was not regarded as a matter of importance."

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[2] Adam Smith; *The Wealth Of Nations*; (1776) Great Books Collection, Encyclopedia Brittanica, University of Chicago Press, vol. 39, 1952; p. 20.

But other than the state issuers, and the occasional ecclesiastical issuers which are encountered in historical research, none of this is grounded in fact.

Another example on page 389 (art. 1):

"…England and France (***and I think***, in all countries) there were in common use large quantities of private metal tokens."

That is the first I've heard of it, and no citations are given for such assertions. Which museum would claim to have any samples of such "extensive" private token issues?

Also, on page 393 (art. 1):

"... archeologists have brought to light numbers of objects of extreme antiquity, **which may with confidence** be pronounced to be ancient tallies ..."

Pronounced by who? No citations given.

On page 396 (art. 1):

"As a general statement ... all commerce was for many centuries carried on entirely with tallies."

I sincerely wish Innes had mentioned some sources, as I'd like to know more about this.

NOT TRUE THAT THE VALUE OF MONEY NEVER INCREASES

Innes makes the following statement on page 159 (art. 2):

"But while the monetary unit may depreciate, it never seems to appreciate. A general rise of prices ... is the common feature of all financial history."

This belies an ignorance of the history of the Greenbacks and the Greenback battles and the great 19th century deflations described above in parts 3 and 4. If Innes can be excused for this lack of knowledge about "foreign" countries, what about the ignorance of his own nation's deflation after the 1810 bullion report was taken seriously and the Bank of England adopted a restrictive monetary policy, dramatically increasing the value of the Pound for some years.

MONETARY WORKS AVAILABLE TO INNES

Knapp's *The State Theory of Money*[3] was published in German in 1905 and was not translated into English (at the urging of John Maynard Keynes) until 1924. Had Innes read Knapp, he could have seen that his "credit money" was only one among several subsets of money described by Knapp. **Innes might have realized that to conclude that this limited subset is the full definition of money, in effect, does away with the concept of money, and substitutes the concept of credit in its place.**

Other key works, which were available to Innes, were Alexander Del Mar's *History of Monetary Systems*, and his *Middle Ages Revisited*, published in 1895 and in 1900. Both works would have given Innes a much firmer grasp of the history and nature of money, as based in law. Had he found Henri Cernuschi's books: *Nomisma or Legal Tender* or *Anatomy of Money*, published in 1877 and in 1886, he would have learned a great deal about the legal nature of money.

Had Innes read Sir William Ridgeway's classic *The Origin of Metallic Currency and Weights Standards*, published in 1892 by Cambridge University, he would never have made this erroneous assertion on the early ancient coinages:

"So numerous are the variations in size and weight of these coins that hardly any two are alike."

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[3] George F. Knapp; *The State Theory of Money*; (1905), published on behalf of the Royal Economic Society by Macmillan, 1924.

In fact, Ridgeway had found a remarkable consistency around an ancient standard of 130-135 grains, identical to Homer's "Talanton".[4] In other words, Innes should not be cut much slack in his neglect of these available works on his subject, just because the economists generally avoided historical studies.

PROBLEMS WITH INNES' THEORY:

Considering the number of factual problems, it will be no surprise that we find fault with several aspects of Innes' theory of money.

CONFUSION OF THE MEASURE OF VALUE, WITH THE MEANS OF EXCHANGE

Innes confuses the standard - the legal measure of value - with the legal medium of exchange, and transfers the known inconsistencies and problems in the coinage, on to using metal for the measure:

"The monetary standard was a thing entirely apart from the weight of the coins or the material of which they were composed ..." (art. 2, p 382), and that there is "no evidence of a metallic standard of value" (art. 2, p. 385).

But he is not thinking clearly. That a coin, whether of gold or copper, is merely a token *medium of exchange,* does not mean that the Legal Standard - the *measure of value* - cannot be a designated amount of metal by law, imperfect as that system would be.

Innes argues that:

"The frequent use of the expressions 'money of account' and 'ideal money' in older writings show that the idea was familiar to many."

But historian Raymond de Roover, a specialist in the medieval period, would later write:

"The chief fallacy which pervades most of the work on money in the middle ages is the mistaken notion that 'money of account' was some kind of ideal or imaginary money which was used as a basis of the valuation of real coins. This valuation, the theory runs, could be changed arbitrarily by the monetary authorities. The 'money of account' was thus some kind of standard suspended in mid air ... In reality facts do not lend support to the theory of 'ideal' money or of an independent standard ... medieval monetary systems were pegged either directly or indirectly to gold and silver. They were based either on a real coin ... or on a coin which had ceased to circulate; but which still represented a definite weight of gold or silver."[5]

THE ELEVATION OF BANKERS AND BANKING

Throughout both Innes articles we encounter an elevation of bankers and banking:

On page 158 (art. 2), describing an inflation in England in 1810, he says that the Bank of England "having just been started" could not have been responsible. But in fact the Bank had been founded 116 years earlier in 1694, and Parliamentary investigations eventually determined that they were indeed the responsible party.

On page 403 (art. 1), claiming that banking is only a circulation of debits and credits, Innes asserts that it is "Shown to be so from the study of the ancient banks". He also claims that such studies ***would*** show that the idea that a depositor in the ancient banks could withdraw his money "is wholly erroneous". But such studies actually show him to be wrong; that withdrawals often placed

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[4] William Ridgeway; *The Origin of Metallic Currency and Weights Standards*; Cambridge University Press, 1892; pp.155-56.

[5] Raymond de Roover; *Money, Banking and Credit in Medieval Bruges*; Cambridge University Press, 1948; pp. 220-21.

these banks in trouble. See for example J. G. van Dillen's sections on the Bank of Amsterdam in his *History of the Principle Public Banks*.[6] Even Adam Smith's extensive discussion of the Bank of Amsterdam in *The Wealth Of Nations* should have given Innes pause before making this statement. Redemption in coinage at the Bank of Amsterdam was generally not practiced, because bank money was at a premium over the coinage. But when this "agio" went negative, coinage redemptions were sued for, and again given. The bank was placed in distress, until it found a way to replenish its 'reserves'. (see van Dillen)

Another problem - on page 162 (art. 2) he writes:

"The Bank of England (which is really a government department of a rather peculiar kind) ..."

But that was not really true until it was nationalized in 1946, at the urging of the Archbishop of Canterbury. Until then it was a privately owned and controlled central bank.

CREDIT ALONE IS MONEY? ALL MONEY IS CREDIT?

Our most significant disagreement with Innes' theory is his viewpoint that:

"Credit and credit alone is money" (art. 1, p. 392).

Reiterated in different form on page 402 (art. 1):

"Money then is credit and nothing but credit."

He then gives this simplification of commercial activity:

"The constant creation of credits and debts, and their extinction by being cancelled against one another, forms the whole mechanism of commerce" (art. 2, p. 393).

No one would deny that it is an exceptionally important mechanism of commerce, but Innes' intent is to exclude all else. To reach his conclusion, Innes first asserts that money is a debt:

"By issuing a coin the government has incurred a liability towards its possessor just as it would have done had it made a purchase - has incurred that is to say an obligation to provide a credit by taxation or otherwise for the redemption of the coin and thus enable its possessor to get value for its money" (art. 1, p. 402).

And again:

"A government dollar is a promise to 'pay', a promise to 'satisfy', a promise to 'redeem'; just as all other money is. All forms of money are identical in their nature" (art. 2, p. 154).

And again:

"A government coin is a promise to pay, just like a bill or note" (art. 2, p. 155).

But in fact there are very substantial differences between credit and money. That's one of the reasons we have two separate names for them. And Innes' view that coinage is a government debt results from muddled thinking (see below). In fact, he "slips" from time to time in the article, showing that he realizes there is a difference. For example:

"There is no question but that credit is far older than cash" (art. 1, p. 396). Thus he knows they are different, yet keeps asserting they are the same.

Dear readers, do you now see why it was so important to the bankers to remove the example of real money that the Greenbacks provided every day? Government money that was not debt, that was not redeemable in anything else, that was issued independently of the banks!

While we can agree that credit is much older than cash (money), and that both credit and money are abstract rather than concrete, we must disagree that bank credits are essentially the same as government money, and we disagree that they are as good as government money.

[6] J. G. van Dillen; *History of the Principle Public Banks*; International Committee for the study of History of Banking and Credit, 1934, A.M. Kelley reprint, 1965.

THIS IS ALSO A PROFOUND MORAL QUESTION

We point out that money is more than an abstract power, it is an abstract institution of society based in law. For corroboration we offer the ubiquitous historical examples of the efforts of private bankers, central or otherwise, to be sure the ***LAW*** made their private notes acceptable for payments to government. Several such cases are described in parts 1-3 above. We have seen what happened to their "money" when this privilege was revoked (in Part 2 above).

They knew Knapp's rule two centuries before his book was written!

The moral element arises because a society depending on private bank credits in place of government created money, is operating in moral quicksand. For that society has established a special privilege of power and money for bankers, which cannot but harm the population as a whole.

When monetizing private credit is done by law, it necessarily confers special privileges on those privates issuing the credit. This is contrary to the spirit of the U.S. Constitution, and if one considers that this privilege amounts to the formation of an aristocracy (as Martin Van Buren pointed out in Part 1 above), then it is also contrary to the letter of the Constitution.

This immorality leads to serious troubles. Excepting warfare, properly constituted government money tends to be spent more for those things and items of infrastructure of concern to the state - the broad interest of the citizenship such as bridge and road and water infrastructure; public health and education.

Private credit tends to go for fast profit, defined in its least productive manner. Particularly for quickly getting back more than one gives, in terms of shuffling paper instruments.

Monetizing credit - in particular private bank credit - can lead to such poor results (e.g. the Great Crash and the connected warfare, or the more recent savings and loan debacle), that it can even make the primitive practice of monetizing so called precious metals look good!

We regard the provision of the money mechanism to society by the government as a major advance over the prior private credit/barter arrangements. We'd agree with Knapp's evaluation of this step:

"The most important achievement of economic civilization, the chartalism (using tokens for money) of the means of payment."

For Knapp, the determination of whether something was money or not was:

"Our test, that the money is accepted in payments made to the States offices."[7]

Thus, under Knapp's classification, bank credit, when privileged in law, is a form of money.

But what Innes would do is substitute bank created credit for government created money. It is not difficult to see to whose benefit that would work.

WHERE INNES' THEORY RUNS INTO A WALL

One sees the cracks in his theory, and then its breakdown in his proposals that clients not be allowed to withdraw money (cash) from their bank accounts:

"Too much importance is (placed on) ... the amount of lawful money in the possession of the bank ... In fact it cannot be too clearly and emphatically stated that, these reserves of lawful money have ... no more importance than any other of the banks assets. They are merely credits like any others and it is unfortunate the United States has by legislation given an importance to these reserves which they should never have possessed. Such legislation was, no doubt, due to the erroneous view that has grown up in modern days that a depositor has the right to have his deposit paid in ... lawful money. I am not aware of any law expressly giving him such a right, and under normal conditions, at any rate, he would not have it." (art. 1, p. 403-404)

[7] Knapp; cited above; pp. 92-95.

He proposed to:

"Make everybody realize once he had become a depositor in a bank he ... was not entitled to demand payment in coin or government obligations" (art. 1, p. 405).

The bankers must have loved him! This is remarkable, but it follows directly from his definition of money: ***how will they be able to withdraw money, if in fact all money other than bank credit, has been defined out of existence?***

One could point out that this is exactly what the New York banks did, in the Panic of 1907; one could also argue that the present Federal Reserve system, when it pays cash, does not pay out coin or government obligations, but rather Federal Reserve Notes. Yet within our financial system, the law has made these notes cash. The law, and afterwards the custom arising out of that law, has made them money. This denial of withdrawal rights is where the "rubber hits the road" within his theory, and it fails.

Money is of a higher order of payment and value than credit. That it is institutional in its origins and in its present most perfect form, is obviously a thorn in the side of those intent on making money a creature only of markets. Furthermore, to distinguish between money and bank credit as "high powered money" and lesser powered money, misses their essential differences and further confuses the concepts of both money and credit.

The acceptance of private credit (unless immorally monetized by law) is conditional on the creditworthiness and liquidity of the issuer. Government money is a near unconditional means of payment; and a far more suitable instrument for "advancing the common welfare".

THE BELITTLING OF GOVERNMENT

Throughout Innes' articles one discerns, along with the subtle praising of banks, a related monetary "put down" on government. For example, on page 152 (art. 2) he asserts that the association of money with the government is a recent development:

"So numerous have these government tokens become in the last few centuries and so universal their use ... that we have come to associate them more especially with the word money."

Well, in order to make that statement he had to ignore about 2,600 years of the history of money from Greek and Roman times.

He continues on page 153 (art. 2):

"Nor did government money always hold the pre-eminent position which it today enjoys in most countries - not by any means."

He gives an undated French example of this, and relies on the examples of three banks with money supposedly superior to government money:

"In countries where there was a dominant bank like Amsterdam, Hamburg and Venice, the higher standard being known as 'bank money' and the lower standard as 'current money' ... the wholesale trade which dealt with the bankers followed the bank standard, and the retail trade (followed) the government standard."

But Innes seems to be completely unaware that these three banks were government operations - were owned by the government. Even Adam Smith knew that![8]

After Innes' many repetitions along the lines of:

"With every coin issued a burden or charge or obligation or debt is laid to the community in favor of certain individuals" (art. 2, p. 161), I realized that not only is this false for government money, **because the community first received something for that money, through their government**; but in fact, Innes' repetitions tend to rhetorically obscure that his charge does hold true when the money

[8] Smith; cited above; p. 358.

is created in the form of a long term bank credit. Because, to the extent that reserves are fractional, that almost always represents a transfer of wealth from the general public, to private parties, by private parties.

Thus, Innes' assertion that "the more government money there is in circulation the poorer we are" (art. 2, p. 161), is false, unless one has substituted banker's credits for money.

HOW THEN TO EVALUATE INNES

Remember Aristotle's admonition on evaluating a person's actions - that in order to judge correctly we must know what their intent was.

How then is Innes to be evaluated? Getting it right about money being an abstract power and Adam Smith's metallist monetary error, and the importance of history, but getting so much else wrong? Particularly troubling is that he missed that money is an abstract ***legal*** power, and thus the consequent necessary role of the government.

Well, I certainly would not cite him for support regarding either Smith, or history. Rather, I'd place Innes with the English "experts" Walter Bagehot and Bonamy Price, discussed in Part 3 above.

So with the above points made, we say goodbye to A. Mitchell Innes, then Consul of the British Embassy in Washington, D.C.

Lest the objection be made that I too have neglected to cite sources in this brief section on Innes, I can inform the reader that every point discussed here is dealt with in much greater detail, with full citations, in my book *The Lost Science of Money*, available from the American Monetary Institute, at www.monetary.org.

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