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Dedicated to the independent study of monetary history, theory, and reform

THE DEVELOPMENT OF UNITED STATES MONEY From Colonial Times to the Federal Reserve System

Part 1: THE MONEY POWER VS THE CONSTITUTION^A

The history of American money has many outstanding examples to help understand why our money system isn't working and periodically breaks down and one need not be an economist to understand the history and principles involved. Economic jargon which muddies the waters can be avoided. When entering this field it's helpful to be forewarned by the words of the great monetary historian Alexander Del Mar, describing bad economic methodology in his classic work the History of Monetary Systems:

“As a rule political economists...do not take the trouble to study the history of money; it is much easier to imagine it and deduce the principles of this imaginary knowledge.”¹

The reader should also keep in mind that monetary history is a battleground where special interests intent on protecting modern day privileges paint the historical canvas in a manner that justifies their present political advantages; even to the point of obscuring, or misinterpreting the actual history.

So we face a twofold task: to separate out the myth and ignorance in which the subject has been shrouded; and to identify the crucial elements that are the real history.

Then, two key features of American monetary history that set it apart from all other nations soon become evident:

First, from its beginnings **the US has been a great monetary laboratory**. Most of our history is marked by monetary crises, with only brief periods of monetary peace, ***and almost every conceivable monetary solution has been tried at some time or other.***

Second, **America has been a nation of fiat paper money. Our development was inseparable from paper money**, right from colonial days. Without it there would not be a United States. The colonies relied on colonial paper money for their development. We then gained our independence and later maintained the union with government issued paper money.

I'll present in abbreviated form, the key elements of US monetary history; and then review how a forgotten, but influential 20th century British monetary writer A. Mitchell Innes, paved the intellectual way for establishing the Federal Reserve System by misrepresenting or misinterpreting (you decide) the history and nature of money.

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When presenting this history, I usually start from the viewpoint of my good neighbor, who was actually a participant in some of these events. His name was Martin Van Buren, eighth President of the US. Fortunately, he wrote us a long descriptive narration of those events. He's now at rest two miles from one of the Institute's offices. Chances are he visited our headquarters building in the 1850s when it served as a local schoolhouse. My own presentation below has been derived and excerpted from 4 chapters of my book, *The Lost Science of Money*.

Driving up McCagg Road on my way to the Martin Van Buren birthday memorial, I passed Kinderhook Creek, and a blue metal plaque appeared, marking his birth site. The original house is gone, but, even in the light rain, the site is beautiful, as it must have been when the young Van Buren was growing up in these natural and harmonious surroundings.

During the grave-site ceremony, a presidential honor guard presents arms, and wreathes are laid. Students from the Van Buren Elementary School tell us that. After serving as Senator and Governor of New York, and as Secretary of State and Vice President, Andrew Jackson's support helped him to become the 8th president of the United States.

The students are clearly proud of Van Buren, and have every reason to be. For he played a big role in the formative years of our nation, and was a conscious warrior in the battle over a Grand Theme of humanity which those early years focused on - and which continues to this day. A battle which he waged as a friend of Thomas Jefferson, James Madison, and Andrew Jackson, against what he called "THE MONEY POWER" (he always capitalized it).

THE FIRST GRAND THEME - OVER MANS NATURE

That theme is a struggle over the very nature of man. Broadly and simply stated, ***does mankind need to be ruled by authority or are men capable of self government?***

The outcome of the fight would not only determine our form of government, but would influence the way humanity would develop. For if authoritarianism were applied, distrusting men to make the correct choices, many might tend to act that way, and their spirits would be damaged. If on the other hand, self government was expected, many men could rise to it, and set an example to the world.

Van Buren gives us a compelling "blow by blow" of this battle in his book the *Origin Of Political Parties In The US*.² After the revolution was won in 1781: "It became at once evident that great differences of opinion existed ... in respect to the character of the government that should be substituted for that which had been overthrown."

The Federalist Party, which included most of the merchants and was led by the banker Alexander Hamilton, held that the British system "was the best that could be devised to promote the welfare and secure the happiness of Mankind". Although they had been "prompt to resist tyranny" and were "stung by the oppressions practiced upon the colonies by the British Government", **in theory** they "tolerated its forms and constitution". It was the Federalists who had pushed for the Constitutional Convention in 1787, to re-make the Confederation of states into a stronger national government.

Reacting to the Federalist thrust, the opposing popular viewpoint, including most of the landowning farmers, grouped into the Anti-Federalists. In their drive for a more powerful central government, Van Buren admits that the Federalists (who he generally opposed) were right. As to their opponents, "...they were too much in the habit of regarding (the federal government) at that early period, as a foreign government only remotely responsible to them."

"Their minds had become thoroughly impressed with a conviction that the disposition to abuse power by those who were entrusted with it was not only inherent and invariable, but incurable, and that

it was therefore unwise to grant more than was actually indispensable to the management of public affairs.”

The Americans were familiar with various forms of government, mostly what we now call “command” societies. From Feudal “might makes right” orders, to monarchs sanctioned by “Divine Right”, to “constitutional” monarchies. For more self regulating societies they had the distant examples of Democracy in Athens and the Republican period of Rome.

This antagonism between the two ideologies was compromised in the Constitution. While Hamilton’s open desire for a British style Monarchy had no chance of acceptance, the Constitution which was hammered out did strengthen the national government, but also put clever checks and balances into place, which when combined with Madison’s Bill Of Rights *appeared* to block authoritarian rule.

MONEY POWER LEFT UNDEFINED

But the Constitution left open a back door through which a form of authoritarian rule could enter; a form more dangerous than monarchy because it was less visible, not understood, and more threatening still because its center of power was outside the nation, to the east.

It would take Jefferson almost twenty years to understand what had been ignored in the Constitution, and he would spend the rest of his life doing battle against the money power. Jackson’s Presidency became literally a life and death struggle with the bankers. Van Buren thought he finally finished them off, in 1840, but he was overly optimistic.

What was the source of so much trouble? **The constitution had failed to adequately define the monetary power in the new nation.** Authoritarianism had been kept out politically, and religiously, but was allowed to sneak in monetarily. Van Buren recognized this years later when he wrote “The MONEY POWER ... was itself ... destined, when firmly established, to become whatever of Aristocracy could co-exist with our political system.”

But why did the framers of a document so far advanced in its day regarding the balance between legislative, judicial and executive power, not realize that the monetary power, if left unchecked, could endanger and ultimately overwhelm the whole edifice?

CONFUSION OVER THE NATURE OF MONEY

The main explanation is that as a group, the founding fathers didn’t have a good understanding of the nature of money. Even today the various schools of economics have not accurately defined, or even agreed on a concept of money. This may be the greatest failure of economics, since money is at the heart of every aspect of it. It is also the central question which Innes had to face in his 1914 work.

THE SECOND GRAND THEME - OVER MONEY’S NATURE

The battle has raged for centuries over the nature of money. Simply and broadly stated, is money a concrete power, embodied in a commodity such as gold; or is it an abstract social invention - an institution of the law? Does it obtain its value from the material of which it is made, or from its acceptability in exchanges, due to the sponsorship or even legal requirements of the government? In our comments on Innes’ work, we will also consider whether the value of money resulted from the private credit of private parties that might issue it. But historically that question was not raised, and if anything the notion that private parties would be issuing money, was purposely obscured.

The supreme importance of the definition of money will now become evident, for if money is primarily a commodity, convenient for making trades, which obtains its value out of “intrinsic” qualities, then it could be viewed more as a creature of merchants and bankers than of governments.

However, if the true nature of money is an abstract social institution embodied in law - that is, a legal institution, then it is more a creature of governments, and the Constitution had better deal with it adequately. Describing how a uniform currency is to be provided, controlled and kept reasonably stable, in a just manner. So the stakes involved are enormous - whether a nation's rule book will promote economic justice, or allow a form of slavery.

HOW TO ANSWER THE MONEY QUESTION?

There are two broad approaches to this question. A logical, or theoretical approach; and a practical approach based on experience- on the facts- what is sometimes called an empirical approach. This last was Van Buren's favored method:

"...experience, the only unerring test..." he wrote.

In the field of money this factual approach relies on history. That's where mankind's experience with money is found because the effects of monetary systems often require several generations to become apparent.

THE COLONIAL EXPERIENCE WITH MONEY

English laws forbade sending coinage to America. She didn't want the colonies to trade with each other, but to send raw materials back home. The scant coinage in the colonies came mainly from pirates or trade with the Spanish West Indies.

The colonists were in dire need of a money system and England refused to provide it, continually placing them in distress. For 10 to 20 years after 1640, more people were going back to England, than were coming here. Out of necessity, the colonies became a kind of monetary laboratory, devising several different monetary solutions.

In the "Country pay period" (1632-1692) many agricultural products were legally declared to be money, at values fixed from time to time by law. But this wasn't any more efficient than barter because everyone wanted to pay with the least desirable commodities, in the worst condition.

In 1652 Massachusetts allowed a mint for gold coinage but the coins quickly found their way back to England for re melting, hardly circulating in the colonies. Guarding its monetary prerogative, the Crown called the mint treason, and it was closed in 1685.

From 1675 to 1739 several privately owned land banks were formed, issuing paper money backed by land. But the colonists shunned this privately issued money, considering that currency should be a function of government as it was in England until 1694.

MASSACHUSETTS PAPER MONEY EXPERIMENT

Then in 1690 Massachusetts embarked on a radical experiment and began to issue "Bills of Credit"; a form of paper money not backed by any physical thing. These Bills of Credit were **spent** into circulation. Rather than a promise to pay any thing, it was a promise to accept the paper bills for all monies due to Massachusetts. At first, this paper was not made a legal tender - that is the people were not forced to accept them to settle debts, but everyone did, and the bills immediately began circulating as money, ending the colony's distress. This money didn't flow back to England like the coinage, and worked exceptionally well for two decades, so long as they were not issued in too great a quantity.

Other colonies copied Massachusetts, emitting similar bills of credit. Invariably they transformed life in the colonies, improving industry and commerce; building real infrastructure.

When the colonial governments authorized the issuance of too many bills - as sometimes occurred - their value dropped. But when the paper issues were moderate - and there was no exact science to this - they kept their value well. *Of great importance is that the colonies did not issue more bills than their legislatures authorized.*

They were learning one of the basic laws governing the value of money; that if too much money is circulating, in relation to the work it has to do, its value will start to decline.

PENNSYLVANIA'S PAPER MONEY

Thanks partly to the efforts of Ben Franklin, Pennsylvania created a different form of paper money which was **loaned** into circulation. In 1723, Pennsylvania was petitioned by a group of merchants to alleviate "the evident decay of the province ... for want of a medium to buy and sell with, and praying that a paper currency be established." A state loan office was created, authorized to loan £15,000 of paper money at 5% interest for 8 years. £250 was the maximum loan and the borrower had to pledge collateral - mostly land, and annually pay the interest and 1/8 of the principal.

The results of this circulating medium were so good that more were authorized, and as the loans were repaid, they were loaned out again to others. Pennsylvania used the interest it earned on this paper money, which it created out of thin air, for colonial expenses, thereby reducing taxes.

The LORDS OF TRADE AND PLANTATIONS, the British group charged with overseeing the colonies, had sporadically attacked the colonists paper money systems, but in 1763 they passed a general law against all of them, and in so doing, provided the main cause of the revolution.

CONTINENTAL CURRENCY - LIFEBLOOD OF THE REVOLUTION

The skirmishes at Lexington and Concord are considered the start of the Revolt, but the point of no return was probably May 10, 1775 when the Continental Congress assumed the power of sovereignty by issuing its own money.

Congress eventually authorized a total of \$200 million; and though at first, they had no legal power to do so, had no courts or police, or power to levy taxes; the Continental Currency functioned well in the early years and became a crucial part of the revolution. In 1776, it was only at a 5% discount to coinage, when General Howe took over New York city and made it a center for British counterfeiting. Newspaper ads openly offered the forgeries.

Congress did not exceed its authorized issue of \$200 million (except to replace worn out notes), but the British certainly did. We don't know how much they counterfeited - it could have been billions; and yet the Continental currency continued to function. In March 1778 after 3 years of war, it was at \$2.01 Continental for \$1 of coinage.³

General Henry Clinton complained to Lord George Germaine that "The experiments suggested by your lordships have been tried, no assistance that could be drawn from the power of gold or the arts of counterfeiting have been left untried but still the currency ... has not failed."⁴

Finally it did fail, but not before providing the foundation for delivering the nation, carrying the revolution over 5 years to within 6 months of its victory. Thomas Paine wrote:

"Every stone in the bridge that has carried us over, seems to have a claim upon our esteem. But this was a corner stone, and its usefulness cannot be forgotten."⁵

CONVENTION DOWNPLAYS U.S. EXPERIENCE

Yet by the time of the Convention, the great benefits of the Continentals was nearly ignored along with much of the rest of our hard won monetary experiences. Many wanted to emphasize that the Continentals became worthless; placed all abstract money under that cloud, and rejected the idea of paper money altogether.

They ignored the fact that paper money was crucial in giving us a nation; that abstract money usually requires an advanced legal system in place; that the normal method of assuring its acceptability is to allow the taxes to be paid in it. And then there was the little matter of a War against the world's strongest power!

Tom Paine would say it best:

“But to suppose as some did, that, at the end of the war, it was to grow into gold or silver or become equal thereto was to suppose that we were to get \$200 millions of dollars by going to war, instead of paying the cost of carrying it on.”⁶

CONVENTION SKIRTS THE MONEY ISSUE

The Convention met from May to September, 1787, but the money question was not taken up in earnest until August 16. When we think of the “Founders” at the Convention, we should remember that Jefferson and Paine were in France, and Franklin was so advanced in age that someone else had to deliver his closing speech for him. Van Buren was 6 years old.

In addition to ignoring the nation’s rich practical experience with money, the convention paid little heed to the writings of John Locke and Benjamin Franklin on money. The delegates didn’t bother to find out why in 1718, Locke wrote:

“Observe well these rules: It is a very common mistake to say that money is a commodity ... Bullion is valued by its weight ... money is valued by its stamp.”

Locke viewed money as a “pledge” for wealth, rather than wealth itself:

“For mankind having consented to put an imaginary value upon gold and silver by reason of their durability, scarcity and not being liable to be counterfeited; have made them by general consent, the common pledges ... they having as money, no other value, but as pledges ... and they procure what we want or desire only by their quantity, it is evident that the intrinsic value of silver and gold, used in commerce is nothing but their quantity.”⁷

They didn’t consider the reasons Ben Franklin gave in his 1729 “Modest Inquiry Into The Nature And Necessity Of A Paper Currency,” for agreeing with Locke’s view:

“Silver and gold...(are) of no certain permanent value...” and

“We must distinguish between money as it is bullion, which is merchandise, and as by being coined it is made a currency; for its value as merchandize and its value as a currency are two distinct things ...”⁸

THE ABUSE OF MONETARY THEORY

Unfortunately the delegates were more influenced by a crude and primitive theory which heavily supported the Bank of England, and contained several crucial monetary errors, which tended to “legitimize” the Bank’s system of finance. This metallist theory of money was part of Adam Smith’s *Wealth Of Nations*, published in 1776, and quoted by delegates to the Convention.

Smith wrote little about money, but his monetary mistakes and inconsistencies have had a very deleterious effect on mankind’s money systems. His book promoted the idea that only gold and silver are money, and never mentions the legal concept of money, as put forward by the philosophers and jurists Bishop Berkeley, John Locke, Julius Paulus, Plato, Aristotle, and many others.

In 1786, anticipating the Convention, a curious book, “*Essays On Money*”⁹ was published anonymously in the U.S. Its entire thrust was to “theoretically” attack the idea of government paper money:

“State bills are an absurd form of money and not money at all.”

Why? - no answer. It turned out to be written by the Calvinist clergyman, John Witherspoon. Referring to Locke and Franklin’s views, he misrepresented their point on money, saying:

“They seem to deny the intrinsic value of gold and silver.”

Discussion? - none.

Then, using a rhetorical device, he stated some arguments for government paper money, and stonewalled them, pretending they didn't matter. Concerning those with personal knowledge of some of the colonies paper money systems:

“We are told by persons of good understanding that (paper money) contributed to (the colonies) growth and improvement.” Rebuttal ? - none. Concerning the fall of the Continental Currency:

“(Some say it was due to the) Counterfeiting ... of our enemies”.

Disagreement? No germane discussion.

THE BANKERS UNDERSTOOD

Those delegates who understood money were mainly the bankers, Alexander Hamilton, and Robert Morris. Both had attempted to set up private banks to issue money, since 1779, even before the revolution was won. They didn't want the Nation to have the money power because their intention was to assume that power privately - to take it from the nation, as had been done in England.¹⁰

This would soon be demonstrated, when as Van Buren tells us, Hamilton and his associates put forward “a funding system, upon the English plan ... as the first great measure of the new government...”¹¹

“TO EMIT BILLS OF CREDIT”

The coveted monetary power was contained in those 5 “magic” words. They were already in the Articles of Confederation which was being supplanted. They were the authority under which the Continental Currency came to be issued. “To emit bills of credit” is what the various colonies had done when they created their paper money.

Madison recorded the arguments over this provision:¹²

Gov. Morris (Pa.) “The moneyed interest will oppose the plan of government if paper emissions be not prohibited.”

Mr.-Mason (Va.) “The late war could not have been carried on had such a prohibition existed.”

Mr. Ellsworth (CT.) “By withholding the power from the new government, more friends of influence would be gained to it than by almost anything else.”

Madison thought the power was needed for emergencies, but wanted to make its acceptability voluntary, not a legal tender.

The power to create money, long regarded as a key element of sovereignty for over two thousand years, was withheld from the new government by the “Moneyed interest”, while they proclaimed the need to strengthen the national government! They tried to get a clause forbidding it, but failed. The Constitution is silent on the power, neither conferring or forbidding it.

What would be the effect of ignoring this power? Delegate Gorham of Massachusetts sloughed it off: “The power so far as it is necessary or safe, is involved in that of borrowing.”

Really? In other words the government would be forced into borrowing “money” instead of creating it. The honest patriots would assume that the government would be borrowing physical assets - gold and silver commodities - and paying interest on it. The bankers however, knew that they would soon have the government borrowing paper bills of credit emitted out of thin air by their private bank, and paying interest on it to the bankers, as was being done in England at the time.

Their bank would be allowed to do what they had blocked the government from doing - to create paper money - their own bank notes, pretending to back them with gold and silver. The bank would be issuing paper money notes not really backed by metal, but pretending to be redeemable in coinage, on the condition that not a lot of people ask for redemption!

LIMITED U.S. MONEY “POWERS”

Having been sold the idea of money as a commodity, in particular gold and silver, the Convention took minimal monetary actions. The entire Federal monetary powers in the Constitution are:

“ Art.1, sec. 8. The Congress ... shall have power ... to borrow money on the credit of the United States ... to coin money, regulate the value thereof, and of foreign coin ... to provide for the punishment of counterfeiting.”

Regarding the individual States, the Constitution declared:

“Art.1, sec.10. No State shall coin money nor emit bills of credit, nor make anything but gold and silver coin a tender in payment of debts...”

Note that the monetary power was explicitly denied to the individual states. Alexander Del Mar, the great monetary historian and once head of the US Bureau of Statistics, described this result in his 1899 book *The History Of Money In America*:

“Never was a great historical event followed by a more feeble sequel. A nation arises to claim for itself liberty and sovereignty. It gains both of these ends by an immense sacrifice of blood and treasure. Then when victory is gained and secured it hands the national credit - that is to say a national treasure over to private individuals, to do as they please with it! ... Americans of the revolution had before them ... the historical examples of Greece and Rome. In all these states the main contention from first to last between the aristocratic and popular factions arose out of and centered in the monetary system; that greatest of all dispensers of equity or inequity. ... They had only to take care that the seed they planted was genuine and uncontaminated. Nature was certain to do the rest. Well they planted; and now look at the fruit and see what it is that they planted! They planted financial corporations ... they planted private money ... they planted financial exemptions from public burdens...In a word they planted another revolution.”

Very strong sentiments, but perhaps it was put better by Congressman Benjamin F. Butler in an 1869 speech to Congress on the money question:

“We marvel that they saw so much but they saw not all things.”¹³

Part 2: EARLY EFFECTS OF MIS-DEFINING MONEY

The Constitution by and large trusted the people with the political power; but didn't firmly place the monetary power - the authority to create and regulate the money supply - in their government. As a result the power was left up for grabs. Alexander Hamilton wasted no time in “grabbing”.

HAMILTON AND THE FEDERALISTS ATTACKED

The Constitution went into effect in 1789; Van Buren described Hamilton's first move as Secretary of the Treasury, in 1790:

“Hamilton assumed some \$15 million of the state debts...an act...neither asked nor desired by the states, unconstitutional and inexpedient, and caused as much unpopularity to his administration...as any other act it made.”

What was so bad about it?

“A large proportion of the domestic debt (was held by) the soldiers who fought our battles, and the farmers, manufacturers and merchants who furnished supplies for their support...When it became known to members of Congress, which sat behind closed doors, that the bill would pass...every part of the country was overrun by speculators, by horse, and boat, buying up large portions of the certificates for (pennies on the dollar).”

Madison attempted to have the law pay speculators less than the original holders, but was voted down. Van Buren tells us:

“(Many) believed that the scramble which ensued was foreseen and counted upon as a source of influence to enlist Congress on the side of the administration.”¹⁴

FIRST BANK OF THE U.S. ASSUMED THE MONETARY POWER

Hamilton and associates, having kept the monetary power out of government hands, moved to assume it themselves. Arguing that the already existing Bank Of North America, from the last year of the Revolution was only a Pennsylvania state bank, he suggested that it come forward if it wanted to alter itself for the national purpose. Curiously, the Bank of North America took no steps toward this obvious increase in power and profit.

In February 1791, he pushed the Bank act through Congress. The privately owned bank was to be a bank of issue, on the English model, not a bank of deposit on the Amsterdam model. This meant that it would be creating new paper money in the form of bank notes, not just holding and transferring the coinage deposits of its clients. The government was given 20% of the new bank's shares.

And we see why the Bank of North America was not put forward for this purpose: the U.S. Government had owned over 60% of its shares. Thomas Willing resigned the Presidency of the Bank of North America, to become President of the first Bank of the U.S.

In written opinions to Washington, Jefferson had tried to get him to veto the Bank bill arguing that it was unconstitutional; but Hamilton created the “doctrine of implied powers” to support the Federal government's power to charter a corporation. Hamilton had an advantage over Jefferson. His strongest arguments concern the true necessity for a monetary power in society - sudden emergencies such as war; or if the coinage had somehow been removed from a country.

Earlier, at the Convention, he couldn't think of even one reason for such a power when there was a chance it might be properly constituted in the hands of the nation. His letter doesn't seriously discuss why the government should give this power to a private group. It is assumed, because the government didn't have the gold and silver – it was in private hands; and because the holders of the metals “require” that such a private bank be established in order to be able to make “loans” to the government.

It was therefore crucial to the bankers that the Convention had embraced a commodity concept of money - Witherspoon and Smith's primitive view that money was gold and silver and the government shouldn't be empowered to issue paper money. But see what this really meant in practice:

The Bank would be issuing its own paper notes not really backed by metal, but pretending to be redeemable in coinage, on the one condition that not a lot of people asked for redemption! ***Thus the real question in practice was not whether money was a legal power or a commodity, but the unspoken question: whether private banks or the government would be allowed to create paper money.*** Will the immense power and profit of issuing currency go to the benefit of the whole nation, or to the private bankers? That's always been the real monetary question in this country, and it is still being obscured from the general public.

While gold and silver served as a smoke-screen; what the bankers really counted on were the legal considerations of the money: they knew that all that was needed to give their paper notes value was for the government to accept them in payment for taxes, as had been done in England. That, and not issuing too excessive a quantity of them. Under those conditions, the paper notes they printed out of thin air, would be a claim on any wealth existing in the society.

Even if the Bank had “faithfully” stuck to gold and silver, the nation's monetary power would still have been alienated to the east - to the European holders of those commodities. Same people we'd just fought the revolution against.

Washington signed the bill, and the Bank started in 1791, with a charter for 20 years. On the day of the offering, the Bank's 25,000 shares were over-subscribed by 4,000 shares within 2 hours. Only 1/4th of the \$400 cost of a share had to be paid in gold.¹⁵ The rest could be paid for with publicly-held government bonds. The same bonds Hamilton had used to turn the state debts from pennies into dollars the prior year, at public expense. You can see where the "money" for the bank is really coming from - from the nation.

THE BANK TREADED SOFTLY

Once established the 1st Bank of the U.S. operated conservatively, perhaps in an effort to arouse the least opposition and set down roots. However, under Hamilton, the U.S. debt to it was continually built up, and:

"It was impossible to ascertain from (Hamilton's) accounts the exact amount of government receipts or expenditures or national debt. Indeed no clear statement of the debt was ever presented by Hamilton..." wrote Studenski and Kroos.¹⁶

Owning part of the Bank was very beneficial to Government, bringing over \$671,860 into the Treasury. But in 1802 the Government was having trouble selling bonds to pay a debt to the Bank. It could only raise \$122,000 and Hamilton sold the government's entire 20% share of the Bank to Baring Brothers in London.

JEFFERSON FINALLY UNDERSTOOD MONEY

Jefferson continued to fight the Bank, aware of the danger it posed. In a December 1803 letter to Treasury Secretary Gallatin he wrote:

"This institution is one of the most deadly hostility against the principles of our Constitution....suppose a series of emergencies should occur, ...an institution like this...in a critical moment might overthrow the government."

Jefferson, Paine, and others were at a real disadvantage fighting Hamilton and the bankers. For, in their earlier years, they held a commodity view of money as gold and silver. They saw their enemies - the bankers - creating paper money, and this reinforced their view that it was evil. It took Jefferson years to realize that it was not paper money, but the private issuance of it, that was the problem. We observe his development through his letters:

In November 1798, watching Hamilton increase the national debt, he wrote John Taylor: "I wish it were possible to obtain a single amendment to our constitution... taking from the federal government the power of borrowing money. I now deny their power of making paper money or anything else a legal tender."

In December, 1803 he was asking Gallatin:

"Could we start toward independently using our own money to form our own bank...?"

By June 1813, Jefferson had figured it out, judging from his letter to John Eppes:

"Although we have so foolishly allowed the field of circulating medium (money) to be (stolen) from us by private individuals, I think we may recover it... The states should be asked to transfer the right of issuing paper money to Congress, in perpetuity.

"...the nation may continue to issue its bills as far as its needs require and the limits of circulation allow. Those limits are understood at present to be 200 millions of dollars."

Finally in October 1815 to Gallatin:

"The treasury, lacking confidence in the country, delivered itself bound hand and foot to bold and bankrupt adventurers and bankers pretending to have money, whom it could have crushed at any moment... These jugglers were at the feet of the government. For it was not, any confidence in their frothy bubbles, but the lack of all other money, which induced... people to take their paper"¹⁷

TAKING DOWN THE 1ST BANK OF THE U.S.

In 1811, thanks partly to Jefferson's influence, the Bank's re-charter was turned down by one vote. On liquidation, it was found that 18,000 of the banks 25,000 shares were owned by foreigners.¹⁸ While the revolution was fought to end foreign domination, it was being re-insinuated through the Bank. This was widely reported and harshly criticized.

But the Bank's demise was not really a great victory against the private money issuers; for by then over 100 private banks had been chartered by the state governments. While the Constitution forbade the states from issuing money, it did not stop state-chartered banks from issuing money! These state-chartered banks wanted to remove the federally-chartered Bank of the U.S. from its privileged position, so they helped put it under politically.

THE FIRST PAPER MONEY ISSUED BY THE UNITED STATES

Contrary to predictions, no financial calamity followed the Bank's demise. On Jefferson's advice the government started to issue Treasury bills in 1812, to compensate for the removal of money supply no longer provided by the Bank. The very first issue of U.S. paper 'money' was in June, 1812: \$5 million in notes. They paid 5.4% interest, were payable in metal on demand, were transferable from one party to another by assignment, and were redeemed after one year. All notes were \$100 and over.

The notes were spent into circulation by paying them to government creditors willing to accept them at full value. They were receivable for taxes and fees. Additional issues were made in February 1813, March 1814 and December 1814 with denominations as low as \$20. These notes were easier to transfer, but not easy enough for currency transactions.

This was corrected in the February 1815 issue, which were bearer certificates paying no interest and requiring no transfer formalities. These 'notes' were not given legal tender status by the Congress. They had no date for repayment, were denominated under \$100 and were very close, but not really a true money, because they were still a promise to pay "money" (gold or silver coin) later.

The amount of all such notes authorized was \$60.5 million, of which only \$36.7 million were actually issued; about \$3.5 million in small notes.¹⁹ Thus our government didn't abuse this note issuing process, and didn't even issue the full amounts authorized, but acted responsibly in its first ever creation of 'near' money.

About a hundred years later, J. Laurence Laughlin, a banker apologist professor at my Alma Mater, the University of Chicago, bitterly complained:

"Here we have an unmistakable case of 'bills of credit' intended to circulate as money... The seat of sovereignty being in the people, when did the people confer upon Congress all the attributes of sovereignty which may have been claimed by an unlimited ruler?"²⁰

Someone should have asked Laughlin when did they confer the same sovereignty he refers to - the power to create money - upon the bankers? His phrase "which may have been claimed by an unlimited ruler" is very revealing of what the bankers did.

REAL NEED FOR A CENTRAL BANK

In 1814 a large portion of the currency circulating in the U.S. were the bank notes of the then existing 208 state-chartered banks. These notes were theoretically exchangeable for coins, but the coinage was never really there, and redemption had been widely suspended since the war of 1812.

They maintained value mainly because the government accepted them in payments.

By 1814 the government had accounts in 94 banks; keeping 4 different accounts in each of them: one for local bank notes, one for out of state bank notes, and two others for US treasury notes.

Much of the treasury's revenue was useless because it was collected in state bank notes which were not accepted in other states. It was chaotic.

THE MONEY POWER BLOCKED MADISON'S "GOVERNMENT" BANK

To resolve this problem, in 1814 President Madison tried to set up a central bank of issue which would be 40% owned by the government, with currency backed by Treasury notes. But the measure, known as the Dallas plan, was defeated in Congress by one vote.

In the chaotic state bank currency atmosphere, Madison knew a central bank was crucial to the nation, and he finally signed a bill allowing another privately dominated bank – the 2nd Bank of the U.S. – with only 20% government ownership.

THE BANK FROM HELL IN ACTION

The 2nd Bank of the U.S. operated illegally from the beginning, accepting paper state bank notes instead of the required gold to purchase its shares. The bank immediately began a criminally insane monetary expansion. Beginning operations in April 1817, by July it had 19 branch offices, and had created \$52 million in loans on its books and an additional \$9 million in circulating currency, based on gold and silver coin reserves of \$2.5 million. This tremendous expansion caused a wild speculative boom.²¹

In August 1818 the bank turned abruptly, and began a criminally insane contraction, causing the panic of 1819. It cut its outstanding loans and advances from a high of \$52 million to \$12 million in 1819. Its circulating notes dropped from \$10 million to \$3.5 million in 1820.

A massive wave of bankruptcies swept the nation. The South and West were particularly hard hit. In the South, the bank undermined the feeling of national unity and must be viewed as an important contributing cause of the civil war.

Real assets which had been pledged to the bank and its branches for loans were seized, with sheriff's sales everywhere. Farmers and artisans, dispossessed of a lifetime's work, moved west. A public outrage arose throughout the land.

In Pennsylvania, Condy Raguet's legislative investigating commission harshly criticized the Bank: "A distress unexampled in our country since the period of its independence, prevails throughout the Commonwealth ... The incorporation of the moneyed interest already sufficiently powerful of itself, further created vicious aristocracies, hostile to the spirit of free government, and subversive of the rights and liberties of the people."²²

Yet instead of a debate over whether a private company should be allowed to ravage the nation's money system like that, the financial establishment managed to deflect the uproar and stage managed the debate into arguments over whether an "inflationary" policy or a "sound money" policy should be followed. The management of the bank was changed, and in 1823 Nicholas Biddle, who had been a child prodigy in Greek classics, was elected its president and ran the bank more carefully.

PRESIDENT JACKSON WANTED A GOVERNMENT BANK

Andrew Jackson considered the Bank as the main threat to the Republic:

"Ever since I read the history of the South Sea Bubble I have been afraid of banks" Jackson had written to Biddle.²³ Jackson really wanted to set up a government owned bank. Sensing that a simple deposit bank wasn't enough, he assigned some of his economically oriented associates to figure out how to do it as a bank of issue, but they failed to come up with any proposals after five months.²⁴

The abstract monetary awareness finally achieved by Jefferson was already being lost to easy-to-grasp concrete's like gold and silver. Jackson's experts told him a government bank would make political loans. But what would one call the loans made by the 2nd Bank of the U.S.? Perhaps what he

needed was not a banking expert, but a government expert, who could devise political insulation for a monetary department.

JACKSON'S WAR WITH THE BANK

Jackson had intended to let the Bank's charter expire in his second term but the Bank's activity in purchasing congressional support alarmed him as his veto could be overridden.

Once the ability to create money has been given to a bank, it can use that power to protect itself through bribery.

At one point in the fight, David Gulliver wrote to Biddle "...all hope is now in bribery!"²⁵

Biddle made huge "loans" to newspaper editors, to stifle opposition:

"Duff Green (Washington Telegraph) ceased to oppose; while Webb and Noah (New York Courier and Enquirer) became active supporters instead of bitter opponents....a \$15,000 loan did it...then another \$20,000, then another \$15,000."²⁶

EVEN THE "GREAT" DANIEL WEBSTER WAS CORRUPTED

Biddle paid Webster \$32,000 in "loans", and then stopped paying. He received this note:

"I believe my retainer has not been renewed or refreshed as usual. If it be wished that my relation to the bank should be continued it may be well to send the usual retainers, yours with regard, Danl. Webster."²⁷

In July 1832 Congress voted to re-charter the Bank. Van Buren returned from England the same day. Jackson had overtaxed his strength and taken to bed:

"Holding (Van Buren's) hand in his own, and passing the other through his white locks, Old Hickory (Jackson's nickname) said: 'The Bank, Mr. Van Buren, is trying to kill me, but I will kill it!'"²⁸

Van Buren re-told the story:

"I have not forgotten the gratification which beamed from his face when I said I hoped that he would veto it...not that he was ignorant of my views on the subject, for in all our conversations on the Bank...and they had been frequent and anxious, - my voice had been against the then existing and any other national bank."

Jackson vetoed the Bank's re-charter, and instructed Treasury Secretary Louis McLane to start removing government deposits, about \$7 million. McLane refused and had to be replaced by William Duane who also refused and was replaced by Attorney General Roger Taney. Taney slowly drew down the government funds, and deposited them in other banks.

Meanwhile the Senate refused to confirm Jackson's new appointees to the Bank's board, on the grounds that they wanted too much information about the Bank's affairs.

Biddle had been contracting the nation's money supply, and the removal of government funds accentuated that. However, "Biddle went far and away beyond anything required by conservative banking" wrote James.²⁹ From August 1833 to February 1834 he called in over \$18 million in loans. The challenge to Biddle's power may have affected his mind. He began making rash statements in letters to associates:

"(Are we) to suffer ourselves to be tramped down by the merest rabble?"

and:

"My course is decided...all the other banks and all the merchants may break, but the bank of the U.S. shall not break!"³⁰

and:

“The prospects of the bank are I think favorable. The state of the country is so bad and gets worst daily. I do not see how things can hold on in this way much longer...Congress will soon have to act.”³¹

In January 1835, an assassination attempt on Jackson failed, when two pistols misfired due to dampness!

The bank, refusing to die, was re-chartered as a Pennsylvania corporation, but was later liquidated in a cotton trading debacle. Biddle was indicted of defrauding shareholders, who lost their entire investment.

MARTIN VAN BUREN AT THE HELM

My neighbor, Martin Van Buren, had an illustrious career in public office, as State Senator, Attorney General, U.S. Senator, and Governor of New York. From the beginning, he had effectively fought against banker privilege, personally blocking dozens of proposals to form new banks in New York State. He proposed legislation limiting banker’s power, which would eventually be enacted as New York’s Safety Fund system, and later her “Free Banking” law.

He also started the movement to do away with debtors prisons, and proposed a constitutional amendment for a more direct election of the U.S. President. At nearby Lindenwald only three contemporary portraits adorn his library - one of himself, one of Jackson, and one of Jefferson.

Unfortunately neither Van Buren nor his advisors had achieved a full concept of money. Daniel Raymond correctly urged Van Buren that any central bank must be government owned but incorrectly insisted that all currency must be 100% backed by gold and silver. He was really advising setting up a deposit bank on the Bank of Amsterdam model, rather than a bank of issue. But the kind of growing money supply that the country needed required a bank of issue.

Jackson and Van Buren removed the monetary power from the private bankers but did not re-establish it in the hands of the nation. Instead, Van Buren organized the Independent Treasury System, establishing 15 sub branches of the Treasury to handle government monies. From December 1836 the government moved toward making and receiving all payments in coinage, or really convertible banknotes, starting with subscriptions for public lands. Once the state bank notes were no longer accepted by the government, their circulation was cut back dramatically.

This clearly demonstrated that the acceptability and value of the currency was dependent on government acceptance and not on the credit of the private issuer.

This was the closest our nation has ever come to implementing a real gold/silver standard. Operating under the commodity theory of money, Van Buren, one of the “good guys”, helped bring on the worst depression the Nation had ever seen, starting in 1837; reportedly even worse than that caused by the 2nd Bank of the U.S. in 1819. Bad as the state bank notes were, they had still been functioning as money.

Those who proclaim that no gold and silver money system has ever failed, should consider that whether you are a laborer, farmer, or industrialist; the money system’s success or failure is not measured by the value of a piece of metal; not when your job, or your farm, or factory has disappeared in a monetarily created depression.

Defeated for re-election, Van Buren retired to his estate, Lindenwald, here in Kinderhook and put a lot of energy into farming, as part of his core belief:

“It can only be when the agriculturists abandon the implements and the field of their labor and become, with those who now assist them, shopkeepers, manufacturers, carriers, and traders, that the Republic will be brought in danger of the influences of the MONEY POWER.”

Van Buren had devoted great effort to rescuing the nation from the MONEY POWER, and he believed the goal had been accomplished:

“The practice of funding the public debt...has long been discontinued...A national Bank has become a completely ‘obsolete idea’ among us, as thoroughly condemned in public opinion as a national debt.”³²

But the problem was far from solved; it was just beginning, and won’t be solved until an accurate concept of the nature of money as an institution of the law is properly formulated into the supreme law of our land - the Constitution.

Van Buren alleviated the problems caused by his own commodity view of money by again issuing paper money in 1837. It had been 22 years since the U.S. had issued its own notes. Congress authorized the issue of \$10 million of them. These notes were not as convenient as the earlier ones of 1815: they were denominated over \$50; paid 1/10 to 5% interest; were transferable only by assignment; and were to be redeemed in a year.

Still, they functioned excellently, with 60% of government revenue being collected and then being re-circulated in them in 1837-38. Congress authorized their re-issuance every year up to 1843 when there were still only \$10 million outstanding. In 1850 under growing influence of the bankers, Congress withdrew them.

In the brittle monetary atmosphere that followed, every minor financial problem and even accidents could develop into runs on over-extended banks and cause financial panics. One such crisis, the panic of 1857 grew out of the failure of the Ohio Life and Trust Company, caused by the sinking of the steamship Central America with a million dollars in gold and silver aboard. As a result, on October 13, 1857 many banks suspended redemption of their notes, causing business failures of \$291 million in 1857 alone,³³ and Congress had to re-authorize the notes.

So we see that from the Constitutional Convention up to the Civil war period, just prior to the introduction of the Greenbacks, the U.S. Government handled the money power well; issuing notes in an orderly, responsible manner. But as we’ve seen and shall continue to see, the performance of the private banks and their credit creation was not so honorable.

Part 3: THE CIVIL WAR AND THE GREENBACKS

The period in America before 1836 is properly designated as the “free banking period”, in the eastern part of the country. In the West “wildcat” banking continued up to about the Civil War. The records of banks prior to 1832 are poor or non-existent. In that year Congress directed the Secretary of the Treasury to present an annual report on State Banking. Fortunately there are several reliable commentaries on banking practices.

THE PRE-CIVIL WAR MONETARY SITUATION

The primary “game” of banking in this early period was not just to charge interest on the bank note money they printed, but to actually spend the bank-notes into circulation, appropriating property from the accumulated wealth of the community. The officers and directors of the banks; their friends, relatives and business associates had first claim to the paper money created by their banks and were the main “borrowers”. These notes were accepted by the public because there was very little other money in circulation; but mainly because they were accepted in payments to the government.

Historian Charles J. Bullock made these observations:

“From 1800 to 1860 bank notes were often at a discount of 50 to 68% ...”

“Banks were located in inaccessible places, on some bottomless prairie road or in the depths of forests where it would prove as difficult as possible to find the offices at which the notes were payable.”³⁴

Financial historian William G. Sumner informs us that:

“Stock of coinage in banks was insignificant and was moved from bank to bank to meet the inspector’s visits.”³⁵

However when Sumner really gets harsh, he does it by quoting William M. Gouge:

“The banking system is the principle cause of social evil in the United States.”

Gouge’s 1833 book *A Short History of Paper Money and Banking* is the definitive description of the early banking abuses.³⁶ He had been editor and publisher of *The Journal of Banking* and was a contributor to various business magazines. Some excerpts:

“The capital of banks consists of ...the promissory notes of individuals. The bank obtained these promissory notes from its stockholders, by giving them the promissory notes of the Bank..... The most prestigious Banks have formed their capitals in this way.”

“When a charter is granted, the speculators make a big show of their desire to possess the stock, creating the idea that it is very valuable. In New York, they subscribe to a much greater amount of shares than are being offered.... “The losses suffered by simple minded people, through such doings, is enormous.” (Chapter 8)

“The large extent of bank influence is not easily seen... but when questions arise which affect them, the Banks have agents at work...“They have great power over the press. Few journalists can venture to expose the money corporation system, in such plain terms as every body would understand, without risking losing their jobs. Many newspaper editors...are in debt to the Banks....” (Chapter 19)

“If the superior credit the Banks enjoy, grew out of the natural order of things, it would not be a subject of complaint. But the Banks owe their credit to their charters - to special acts of legislation in their favor, and to their notes being made receivable in payment of dues to Government.”

“As it is public credit that supports the Banks, and not the Banks that support public credit - as the deposits of the Banks are the property of the community generally, and as the profits derived from circulation come from the community generally, they ought to go to the community generally, and be used to lighten the burdens of taxation.”(Chapter 20)

THE NEW 1836 STATE BANK REGULATIONS

Gouge’s writings helped get reform legislation passed. New York’s 1836 banking act was called a “free banking” law because the requirement for a special legislative act to establish each new bank was removed. But the law’s effect was a much greater government regulation of banking. Bank reserves were strengthened, reports were required, and fraud was made much more difficult. Other states soon adopted similar legislation.

THE CIVIL WAR CRISIS

The split between North and South was a long time building and part of the reason was the financial piracy by largely northeastern elements. When Jackson and Van Buren battled the 2nd Bank of The US, it was Southern votes that helped defeat the Bank.³⁷

The War broke out in April, 1861 and it was just a matter of time before all the banks would suspend their payments and it would once again be left to the Government to rescue the situation; this time with the Greenbacks.

It was a big question just how the war would be financed. Treasury Secretary Chase’s early plan called for \$381 million to fight the war; \$80 million of it from taxes and \$300 million from borrowing. However there was only about \$100 million of available gold and silver in the country, and on December 28, 1861 all the banks suspended convertibility of their notes into coinage and the gold market was closed for 2 weeks.

CONGRESS TOOK THE INITIATIVE

Congressman E. G. Spaulding of Buffalo, New York, acting without the Treasury's support introduced a bill in Congress to create the Greenbacks. Spaulding understood money and banking:

"Gold and silver, by long practice, have become the legal money of the world in all commercial transactions. The real intrinsic value of these metals is not as great as that fixed upon it by governments... without the government stamp gold and silver would be simple commodities, depending for their value upon the demand for use in trade and manufacture. ...Why then should we go into Wall Street, State Street, Chestnut Street, or any other street, begging for money? Their money is not as secure as Government money. ... I am unwilling that this Government should be left in the hands of any class of men, bankers or moneylenders, however respectable or patriotic they may be. The Government is much stronger than any of them ... They issue only promises to pay."³⁸

In the debates which followed, Senator Howe of Wisconsin supported Spaulding's bill and attacked those pretending that the banks had sufficient gold and silver to lend to the government:

"The Government may be able to borrow from the banks, but the Government cannot borrow coinage of the banks. If it borrows anything of them, it must borrow, not their money, but their promises to pay money. Nothing is more certain than that ... We must rely mainly upon a paper circulation; and there is another thing equally certain, which is that the paper, whoever issues it, must be irredeemable. All paper currencies have been and ever will be irredeemable. It is a pleasant fiction to call them redeemable...I would not expose that fiction only that the great emergency which is upon us seems to me to render it more than usually proper that the nation should begin to speak the truth to itself; to have done with shams, and to deal with realities."³⁹

The legal tender law was passed on February 25, 1862. Previously, the treasury notes issued from 1812 and on, were always later redeemable in metal. **But the Greenbacks were not paper promises to pay "money" later. *The Greenbacks were themselves the money.* Since they were not borrowed, there was no interest payment on them and they did not add to the national debt.**

Congress authorized the Treasury to begin issuing Greenbacks; later limiting the total to \$450 million on June 30, 1864. This amount was never exceeded; although by that time \$449,338,902 had already been issued. They were receivable for all dues and taxes to the U.S., **except import duties**, which still had to be paid in coin. The Greenbacks were payable for all claims against the U.S. **except interest on bonds** which was still payable in coin. The Greenbacks were declared a legal tender for all other debts, public and private.

Holders of Greenbacks could deposit them and receive 6% compound interest bearing bonds, redeemable after 5 years and payable after 20 years. Congress initially authorized \$500 million of such bonds. **While the interest on them was to be paid in coinage, the principal on nearly all of the bonds was to be paid in Greenbacks.**

Unlike the Continental Currency the Greenbacks couldn't be counterfeited:

"As yet the counterfeiters have not met with much success...they are easily detected by the paper, printing, poor engraving, and by an entire failure to imitate the lathe - work, especially upon the back of the note" observed Wilber and Eastman.⁴⁰

GOLD ROSE AGAINST THE GREENBACKS

Greenback critics argue that they were inflationary and mistakenly measure the inflation against gold, starting at equal to a gold dollar in early 1862, and falling to 36 cents against a gold dollar by mid 1864. That's often the whole of their analysis and it's very misleading. Actually the Greenbacks did drop against gold; first to 58 cents at the end of 1862, then back up to 82 cents in mid 1863 and then down to a brief low of 36 cents on July 16, 1864.

From that point they moved up steadily, averaging 39 cents for August; 45 cents for September; and 48 cents for October, 1864. They retreated to .44 in December, and averaged .68 for December 1865. From there they gradually rose to 100, at par with gold in December 1878. Greenbacks became freely convertible into gold, dollar for dollar, in January 1879.

BUT LIMITING THE QUANTITY RAISED THE GREENBACK'S VALUE

Economists mistakenly argue that it was only because the Greenbacks were eventually made convertible into gold by law that made them hold and increase their value. However that law was a hard fought political struggle, dependent on the 1868 presidential election. The battle could have gone either way and the actual "resumption" law could not get passed by Congress until 1874, for implementation in 1879. This could not have kept the Greenback from further decline, and start moving it upward back in mid 1864.

What did occur in July 1864 was that our government put a limit of \$450 million on the Greenbacks and from that month they started rising.

THE PERFORMANCE OF THE GREENBACKS

But to simply compare the Greenbacks to gold cannot give an accurate picture. Wesley Mitchell's 1908 Greenback studies remains the definitive source. Examining the data on price rises he quickly discovered that "There was no easy explanation of prices". Many related commodities didn't move the same, such as wool and cotton. Gunpowder prices didn't rise much. The fastest rising commodities in one period were sometimes the fastest falling in another period.

Mitchell carefully constructed several price indexes as there were none in existence. Items had to be weighted for importance; averaging the data can mask really dramatic changes in particular prices. One especially volatile commodity price can throw off the whole index, such as the unique 1300% rise in the price of cotton during the war.

Mitchell's indexes started at 100 in 1860. The median of his **commodity price indexes** stood at 216 in January 1865. General Lee surrendered in April 1865 and by July 1865 the index was down to 158. It then reacted upwards briefly, and thereafter fell through autumn 1871.

Mitchell's **cost-of living index median** did not rise as much as commodity prices. It rose a maximum of 73% by 1866 in the east; 57% in the west. This is a very different picture from mere gold prices, which rose almost 200% at their highest point.

COMMENTS ON THE WARTIME INFLATION

While the Greenbacks lost substantial value for a period, the nation was engaged in the bloodiest war in its history which took the lives of 625,000, and in which 13% of the population served in the armed forces. Aside from the revolution, the only war fought on our own soil. Is it reasonable to expect any government in those circumstances could completely protect its citizens from financial and other hardships?

Unger has noted that:

"It is now clear that inflation would have occurred even without the Greenback issue."

That the Greenbacks were not accepted for import duties was an important negative factor against the currency:

"...it has been argued that the Greenback circulation...might have kept at par with gold if it, too, had been made receivable for all payments to the Government" wrote financial historian Dewey.⁴¹

Also if interest payments on government bonds had been made in Greenbacks instead of gold, a large part of the demand for gold would have disappeared.

Studenski and Kroos, in their *Financial History of the US* pronounced in favor of the Greenbacks:

“Some writers have ascribed the price inflation almost entirely to the issuance of greenbacks, but this is a mistaken view. Even if the greenbacks had not been issued and bonds had been sold at whatever price they would bring in the market, inflation would have taken place. It would merely have taken another form - that of the monetization of debt through the issue of bank currency or the creation of bank credit.”⁴²

THE CONFEDERACY’S PAPER MONEY FAILED

The Confederacy made major monetary errors in issuing paper money: **their paper money was not money in itself but was merely a promise to pay money later**. They never made their money a legal tender - a monetary/military error of great magnitude. The South eventually issued \$1.55 billion of currency, placing no limit on its issue of paper notes thereby violating another primary monetary principle. Finally when a state loses a war of existence, its nominal currency, and much other property of its citizens is lost.

THE NATIONAL BANKING ACT OF 1863/64

One may question whether the National Banking Act would ever have been passed, without the war, and the absence of the southern votes from congress. Previously only the first and second Banks of the U.S. had national charters, both by Congressional acts. The rest of the banks had state charters. Now obtaining a national bank charter became a routine matter.

The act created a system of National Banking Associations under the supervision of the treasury’s newly created Comptroller of the Currency. **The new law began to clean up the operational fraud** always connected with banking in America. Quarterly reports were required; a minimum of \$50,000 was required to start a bank; reserves were strengthened as banks had to purchase specified amounts of Treasury bonds; the comptroller of the currency now printed the bank notes, furnished to the banks with their own names on them, up to 90% of the value of the government bonds the bank had deposited with the treasury; a maximum of \$300 million of such notes, system-wide, was decreed; notes of the national banks were made acceptable for most U.S. dues, and were to be received by all member banks at full value; etc.

After a 10% tax on state chartered bank notes was decreed, their circulation dropped from \$179.2 million, down to \$19.9 million, on the effective taxation date, demonstrating the power of law to get the Banker’s attention.

But the act further entrenched structural “fraud”. For example, during the Civil War while the US Government authorized and issued \$450 million Greenbacks, under the National Banking Act the private bankers created \$1.49 in their own money for every Greenback the Government issued!

Dewey wrote:

“The banks were accused of absorbing the government notes as fast as they were issued and of putting out their own notes in substitution, and then at their convenience converting the notes into bonds on which they earned interest [in gold]. (Quoting Treasury Secretary Salmon Chase) ‘It is a struggle on the part of the banking institutions of the country to bleed the government of the U.S. to the tune of 6% on every dollar which it is necessary for the government to use in carrying on this struggle for our independence and our life.’”⁴³

THE GREENBACK BATTLES

When the Civil War ended, banker attacks began immediately on the Greenbacks, first to thoroughly rape (pardon the expression) the system, and then to remove them from circulation.

The fight against the Greenbacks was a concerted political, religious and legal effort. It was not to be allowed to be determined by the results of the money system, or its economic effects. There was no idea of letting “market forces” demonstrate the supposed superiority of banknotes or metallic money over the legally created Greenbacks. The reason was that the Greenbacks worked very well, even under crisis conditions, and could not be brought down or embarrassed by such a trial and its informed opponents knew it.

PASTOR AND PROFESSOR AGAINST THE GREENBACKS

Irwin Unger writes that:

“From the very first the ministers and the religious editors were active partisans who identified hard money with virtue.” writes Unger. “The Calvinist denominations took the lead in the religious attack on heretical financial ideas. Atwater was a Presbyterian; Bacon a Congregationalist; the Advance, the Christian Mirror as well as the Boston Recorder and the Presbyterian Banner ... were all Calvinist papers ... Other Protestant groups opposed soft money ... but throughout the debate, the Calvinist voice is heard most loudly.”⁴⁴

And:

“Allied with the clergy in the work of creating an ‘orthodox’ financial view were the academic economists. Before the Civil War the clerical influence pervaded American higher education and at most American colleges ‘political economy’ was taught by a minister, as a branch of ‘moral philosophy’ ... Pastor (and) professor ... helped erect a formidable psychological barrier against greenbackerism.”

THE GREENBACK DEFENDERS

“The Greenback appeal was more abstract than has been realized” wrote Unger, surprised. But it had to be abstract; money in its ultimate form is abstract rather than concrete. Facing religion’s pretense of morality in its attack on the nations’ money system, men of courage, understanding and patriotism put forward reasoned defenses of the Greenback system. They made proposals for its permanency; and proposals to remove the privileges granted to the Bankers by the new National Banking Act.

“Take away from gold and silver the shield of law contained in these various mint regulations in the uses of those metals” wrote **Lyman Dewolf** , “and it would be difficult to determine either their value or ultimate use.”

“The unit in money can have no invariable determinate proportion to any part of value, that is to say it cannot be fixed in perpetuity to any particular quantity of gold and silver or any other commodity.”⁴⁵

Illinois Congressman **Alexander Campbell** put forward his convertible bond plan to end special privileges for bankers and unify the currency, by making the Greenbacks into a permanent system. Campbell’s plan would eliminate private bank notes, which were to be called in over a six month period, and be exchanged for the U.S. Government bonds, which the banks already had deposited at the U.S. Treasury, as security pledges for their currency, under the 1864 Act.

Campbell’s plan called for all Government expenses, including the then existing debt, to be paid for with these new Greenbacks. The proposed greenbacks could be used at any time to buy government bonds, the interest and principle of which was to be payable in Greenbacks.⁴⁶

In a speech to the House on January 1, 1869, **Benjamin Butler** said:

“Let no man say that I desire to establish or perpetuate a depreciated currency. I think I have proposed a currency as valuable as gold and for all purposes of a circulating medium, better than gold ... But what I desire is that the currency shall not be redeemable in gold and silver”,

Butler proposed that:

“The government shall issue an amount equal to its taxes, say \$350 million of certificates of value of convenient denomination ... which shall be lawful money and legal tender for all debts, public and private, which by the law creating them are not made payable in coin and shall be receivable for all taxes ... of every kind whatsoever, to be re-issued at pleasure ... and which shall be receivable for all public loans made to the United States...”⁴⁷

BANKERS FEARED THE GREENBACK EXAMPLE

Since the Greenbacks were based on legislative authorization rather than the caprice of bankers, and created no national debt or interest payments, the world’s bankers greatly feared this example and they worked incessantly to remove them, launching several attacks between 1865 and 1878.

The U.S. had issued bonds which were purchased with Greenbacks and were supposed to be redeemed in Greenbacks, but which paid interest in gold. **The first attack was to change the law to make these bonds redeemable in gold.**

The soldiers and sailors were paid in Greenbacks for their sweat, blood and shattered bodies. Nearly 2/3 of a million died. But these bondholders, supported by preacher and professor, pretended that the honor of the United States required that they be paid in gold! They agitated and conspired to have the rules changed, but despite intensive propaganda, public opinion favored the Greenbacks:

“In 1868 (there was) strong sentiment in favor of the retention of the greenbacks as a permanent feature of our monetary system” wrote Bullock.⁴⁸

Thus it was necessary for the bankers to sabotage the Democratic party in order that it not be a vehicle for expressing the public sentiment in favor of the Greenbacks. This was done in the 1868 election, which was essentially “thrown” to Republican Grant by Democratic Party leader August Belmont, tightly associated with European banking interests.⁴⁹

When it became apparent that the Democratic Party was blocked from serving as the vehicle for establishing a permanent Greenback system, several new Greenback/populist parties formed to pursue this goal. Eventually these parties got a majority of the people on their side, but the financiers were able to keep them splintered and dominate the political process with money.

The second attack was to simply remove the Greenbacks from circulation. In December 1865 Treasury Secretary McCulloch had put through a law that \$10 million of Greenbacks received in payment to the Government, would be retired (destroyed) over six months, and, thereafter up to \$4 million more per month. He retired none for 6 months, and then removed \$10 million all at once! But this caused so many business failures it was quickly abandoned.

McCulloch’s actions were so ham handed that even businessmen began to understand:

“Businessmen generally are awakening to the fact that the real issue is between dead capital on the one side and active capital and labor on the other. They are beginning to understand that specie resumption and bankruptcy mean the same thing” wrote George Morgan.⁵⁰ The New York Board of Trade was then organized in opposition to the New York Chamber of Commerce, in order to support the Greenbacks.⁵¹

A third attack, to get rid of the Greenbacks through the law courts failed in 1871 when the Supreme Court, in *Knox vs. Lee*, ruled that the Greenbacks were legal in wartime. Then in 1884, in *Juilliard vs. Greenman*, the Court ruled that Congress had the power to create them in peacetime also.

THE ENGLISH “EXPERTS”

During the Greenback battles, English experts unsuccessfully tried to sway the Americans. For example Walter Bagehot in his 1869 supposed proposal for a union of American and British currencies. Even a crackpot like Oxford’s Bonamy Price - was sent on tour to befuddle American

minds. Price, who had been mentally ill, was given Thorold Roger's political economy professorship at Oxford after Rogers had demonstrated that the economic condition of Englishmen had been declining for over 300 years!⁵²

Bagehot condemned the Greenbacks and the United States:

"So far from its being an economic act which governments do for the benefit of their subjects it has been a political act which they have done for their own sake."

Such anthropomorphizing of government - pretending the government has desires and attributes like a person, is an essential element of the financiers attack on their main potential opponent - our government.

Bonamy Price was no match for the Daily Tribune reporter in his October 1, 1874 interview:⁵³

Price: "Inconvertible currency is so vicious, so radically bad that I feel no interest in makeshifts. There is only one step to be taken - amputation.

The Reporter: "That is to say contraction?"

Price: "That is not contraction, but the extinction of inconvertible paper. Anything short of the extinction of the currency is so radically and fundamentally bad that I have no interest in comparing the relative goodness or badness of any expedients."

The reporter: asks Price whether the U.S. Treasury's stoppage on redeeming paper money was not similar to the Bank of England's stopping the redemption of its paper money.

Price: "Ah but the motive is different. The inconvertible currency in your country is a tax. By means of this species of paper [paper money] the government has got hold of the property of the nation, and it has kept it. The property is gone and the public in the place of it has got a species of paper [paper money]. It is the government's business to restore the property."

Reporter: "Who should issue the currency the government or the banks?"

Price: "Who the issuer is, is of no consequence as to the action of the currency ... (and from a later answer) ... I believe the intermediate agency of a private corporation is the true method."

Bonamy Price, an obvious shill for the bankers, doesn't explain why its a tax and theft of property when the government does it but is not when a private company does it. And again we see the ploy of treating the government as a person.

THE RESUMPTION ACT

But the 1874 lame duck congressional session enacted the resumption act to redeem the Greenbacks in gold. The advertised intent was to assert the dominance of gold as the monetary base, but as finally enacted, the Resumption act substituted bank credit for the gold! (Much as had been done by the 1st and 2nd Banks of the US). While Greenbacks would be redeemable for gold; for every \$80 of Greenbacks retired, \$100 in bank currency was to be issued. The act would substitute banker's paper notes for the government money.

Yet there was so much popular sentiment for the Greenback that in late 1877 the House passed a bill to repeal the Resumption law but the bill was defeated in the Senate by one vote.⁵⁴

The actual "resumption" was a non-event. The Sub Treasury office at New York City had been designated as the place; but by close of the business day, only \$132,000 in Greenbacks were-redeemed and \$400,000 in gold was deposited for the more convenient bank paper! It was the same story at the banks involved in the resumption - a gigantic anti-climax.

Some bankers may have believed their own propaganda against the Greenbacks; but the Greenbacks functioned well and had been near parity with gold for some years. ***Their good performance was one reason the financiers wanted them removed from circulation, as the Greenbacks gave a daily lesson in practical monetary theory.*** The bankers finally failed in this because in the truly exhausting back and forth struggle, a law had been passed in 1878 requiring that all

Greenbacks that were redeemed would be re-issued, so that theoretically about \$346 million remain current today.

Part 4: TRANSITION TO THE FEDERAL RESERVE SYSTEM

The Greenback battles combined with the international demonetization of silver and enforcement of a quasi-gold standard created a generally deflationary environment of falling prices from the mid 1860's. England had begun her move to the gold standard as early as 1774 by demonetizing silver as a medium for settling accounts over 25 Pounds. The Latin Monetary Union (originally France, Switzerland, Belgium, Italy, and Greece) demonetized silver in 1865 - 73; shifting away from gold demonetization, originally urged upon it by those worried that the California gold discovery would lower the value of their bonds. Finally the United States temporarily demonetized silver in what was called "The Crime Of 73".

19th CENTURY DEFLATIONS

The objections that are still raised against the idea that the tone of this period was deflationary deserve little attention. Consider these comments from qualified observers:

Monetary theorist Benjamin Anderson concluded that a punishing deflation had occurred:

"Nor is the tremendous agitation over bimetallism, involving a literature so great that no man could dream of reading it all, involving great political movements, presidential campaigns, great congressional debates, repeated legislation, international conferences, etc, for 20 years, to be explained on any other ground than that the world felt practical, important, and unpleasant effects on industry and trade from the inadequacy of the money supply."⁵⁵

Economist/historian John Hicks published a chart showing that by one index, derived from the statistics of the Aldrich Report and the U.S. Bureau of Labor, the Dollar appreciated in value from 100 in 1865, to about 300, in 1895.⁵⁶

Later, economists Friedman and Schwartz established the monetary facts statistically:

"(Between 1867-1879) There are 5 calendar years in which the money stock declined and 7 in which it rose...The money stock in February 1879 was only 17% above its level 12 years earlier...One must go more than half a century forward from 1879 all the way to 1933 to find another 12 year period within which the money stock declined in as many as 5 calendar years."⁵⁷

This money supply *increase* of only 17% over 12 years, or about 1.4% a year during a period of very high growth in population and in economic activity, must be considered as *deflationary*.

The underlying reasons for the monetary constriction was that the supply of gold hardly ever keeps up with population growth, let alone the more rapidly expanding needs of commerce and industry. That is even true of the 1500-1650 period when gold and silver were being plundered by the fleet load from the Americas.⁵⁸ Secondly, after the Civil War, little or no monetary provision was made for the return of the southern states into the Union. Third, under the National Banking Act, credit creation by member banks was limited, system wide to \$300 million. This was raised very slowly.

Fortunately around the turn of the century relief appeared in the form of major gold discoveries in South Africa, Alaska and Australia; and the invention of the Cyanide leaching process which extracted a lot more gold from the crushed rock. Annual gold production more than doubled in only 8 years:⁵⁹

1890 - 5.7 Million ounces of gold produced

1896 - 9.8 " " "

1898 - 13.9 " " "

The 1900 Currency Act established the single gold standard for the US, at 1\$ = 25.8 grains.

TREASURY SECRETARY SHAW'S INNOVATIONS

From 1902 to 1906, Treasury Secretary Leslie M. Shaw faced a banking system that was limited and inflexible. Nationally chartered banks were allowed to create a system-wide total of only about \$800 million in currency, based on their holdings of government bonds as collateral. Only about 12 banks had the ability to loan more than \$ 1 million to any one firm. The system responded poorly to real business needs or to seasonal requirements for money. There was no lender of last resort when the banks got into trouble and the system was susceptible to booms and panics over minor events. Shaw initiated a program to avert banking panics by depositing government funds or bonds into banks when money was tight. Then to calm down boom periods, he would withdraw them. Shaw's final 1906 report to Congress asserted:

"If the Secretary of the Treasury were given \$100 million to be deposited with the banks or withdrawn as he might deem expedient, and if (he had) authority over the reserves of the several banks...in my judgment no panic... could threaten the U.S. or Europe that he could not avert..."⁶⁰ But the bankers had other ideas - which would not include the US government in a position to exercise such prudent controls.

THE PANIC OF 1907

With Shaw out of the way, the panic of 1907 resulted from the Bank of England's instruction in September 1906 to British banks not to negotiate American finance bills but to have them all paid in gold as they matured. The result was that about 1% of the US gold supply was shipped abroad, lowering the total US money supply about 2 ½ % - enough to create the panic of October 1907.⁶¹

But it was an unusual panic: "The Panic of 1907 was exclusively banking" wrote Studenski and Kroos.⁶² The banks refused to honor their deposits - to pay out cash to their depositors; however, all of their other financial operations continued normally.

THE ALDRICH VREELAND ACT OF 1908

That panic gave rise to the limited Aldrich-Vreeland act, scheduled to go out of existence in just six years, in 1914. A section of the act called for a national Monetary Commission to make a study and recommendations on the nation's money and banking system.

The commission issued 24 large volumes but (according to Del Mar) nowhere was the nature of money defined. The final volume called for the creation of a privately owned central bank, the "National Reserve Association" in which "Control was to be exercised completely by private bankers", wrote Studenski and Kroos⁶³. In the passage of legislation this would evolve into the Federal Reserve Act.

FEDERAL RESERVE SYSTEM

The bill passed the Senate on December 19, by a vote of 54 to 34 and the House on December 22, by 298 to 60. President Wilson signed it into law on December 23, 1913. The stated purpose of the Federal Reserve Act was:

"An act to provide the establishment of Federal Reserve banks to furnish an elastic currency, to afford a means of rediscounting commercial paper, to establish a more effective supervision of banking in the U.S., and for other purposes."

Watching how the system quickly evolved to finance World War I, cynical observers would later assert that the real reason for the act was indeed "for other purposes."

Part 5: BRIEF COMMENTS ON 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 Innes' work and theory:

First - **regarding method**, Innes' professed emphasis on and use of historical study is a refreshing departure from the typical political economist 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 the *Theory of Money and Credit* in 1912 attacked monetary theorist George 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"⁶⁴

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 *Wealth Of 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."⁶⁵

Thus Von Mises' 500 page book did not achieve the level of understanding reached by Inne's 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." (P. 386)

Del Mar referred to this period of monetary history, from roughly 1250 AD to 1450, 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 6 - 700 year old cases of monarchs "debasement" 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..." (p. 153, art. 2) 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”, (p. 391, art. 1)

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 1500 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 which he thinks he actually has, as opposed to evidence which 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.”

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 *State Theory Of Money*⁶⁶ 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 Cernushi's books: *Nomisma or Legal Tender* or his *Anatomy of Money*, published in 1877 and 1886, he would have learned a great deal about the legal nature of money.

Had Innes read Sir William Ridgeway's classic *Origin of Metallic Weights And 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."

In fact Ridgeway had found a remarkable consistency around an ancient standard of 130-135 grains, identical to Homer's "Talanton".⁶⁷ 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."⁶⁸

THE ELEVATION OF BANKERS AND BANKING

Throughout both 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 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*.⁶⁹ 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 redemption’s 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. (see below)

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.”⁷⁰

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 INNE’S 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).

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”, 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 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 far more suitable instrument for “advancing the common welfare”.

THE BELITTLING OF GOVERNMENT

Throughout Innes 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 2600 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 Mr. Innes seems to be completely unaware that these three banks were government operations - were owned by the government. Even Adam Smith knew that! ⁷¹

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 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 Counselor of the British Embassy in Washington, DC.

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.

¹ Alexander Del Mar; *History Of Monetary Systems*; 1895, A.M. Kelley reprint; p 100-101

² Martin Van Buren; *Origin Of Political Parties In The Us*; Hurd & Houghton, 1867.

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