

CHAPTER XVII.

PAPER MONEY.

175. Paper money arose from that form of credit which we have described as a **promissory note**. People became accustomed to receive the promise instead of the thing promised. The idea was understood before gold and silver were used as money. "One of the earliest mediums of exchange," says Mr. Jevons,* "consisted of the skins of animals. The earliest form of representative money consisted of small pieces of leather, usually marked with an official seal. It is a very reasonable suggestion . . . that, when skins and furs began to be found an inconveniently bulky kind of money, small pieces were clipped off, and handed over as tokens of possession. By fitting into the place from which they were cut, they would prove ownership." The common form of paper money, such as the modern bank-note, however, originated with the **deposit-banks of Italy**, established from four to seven centuries ago.† The coins of Venice and Italy were of many values, often clipped and worn. To save weighing each coin at every transaction, the coins were deposited in the banks, where they were weighed, and a credit given to the depositor on the books of the bank. Thus transfers of the metallic money credited to a depositor came to be used instead of the money itself.

* "Money and the Mechanism of Exchange," p. 196.

† Ibid., p. 199.

Moreover, so long as the **promise** is always found trustworthy, the note which promises to pay gold or silver is a **great convenience to trade**. It saves the **trouble and risk of handling large sums** of the precious metals. Any large sum of money is very bulky. In Mexico, where roads are unsafe, and where silver is the only money, a cotton-mill retains its own company of soldiers to guard the agents when they go out to collect bills. Even in more civilized countries the transportation and handling of large sums of specie is very hazardous.

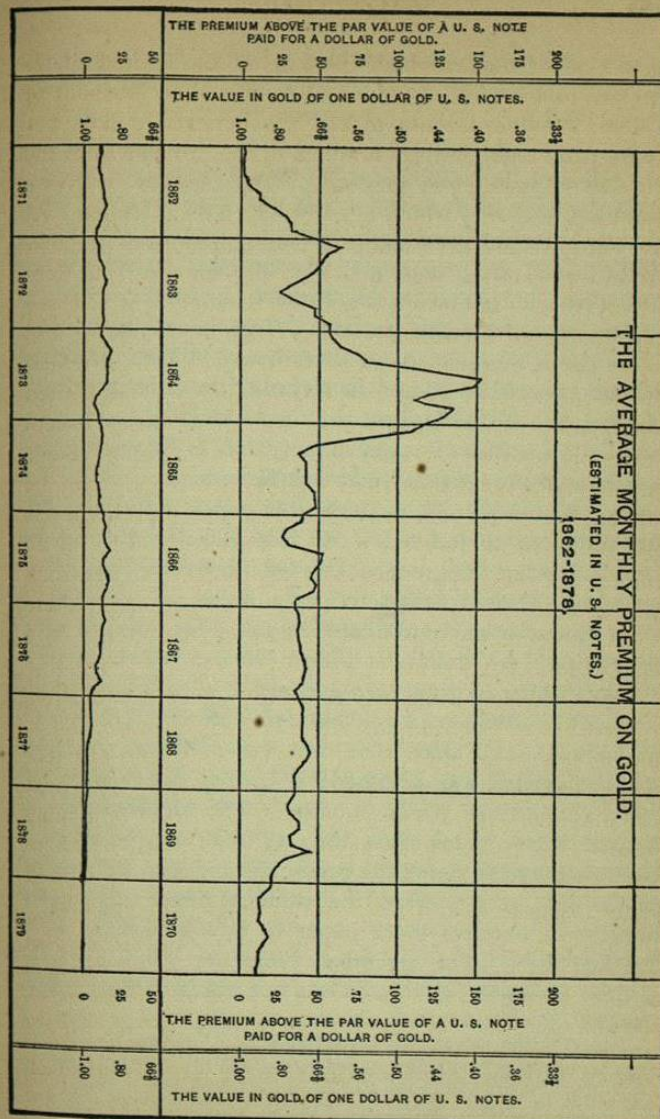
176. Paper money, for which there is not the slightest doubt that **specie can be obtained on demand, is called convertible paper**. The distinctive quality of good paper money is that it can be converted into gold or silver at any time. No paper money is good unless the promise to pay means what it says, and unless the convertibility is constantly tested. Since the resumption of specie payments in the United States on January 1, 1879, our "greenbacks," or United States notes, are examples of convertible paper money. By taking one of these notes to a Government sub-treasury, you can get gold for it, dollar for dollar. On reading the words on a United States note, you will see that it is a promise of the United States to pay to bearer a certain number of dollars (in coin). The notes issued by the national banks in this country are promises of the given bank to "pay the bearer on demand" a certain number of dollars; but in the latter case these dollars may be any kind of "lawful money" of the United States. A national-bank note, therefore, may be convertible into United States notes; but, so long as the latter are as good as gold, the national-bank notes will be also.

177. If you examine the back of a United States note, you will see the words: "This note is a **legal tender** at its face value for all *debts, public and private, except duties on imports and interest on the public debt.*" A legal tender is

that kind of money which the laws of the United States declare to be a full acquittal when offered in payment of a debt. If you promise to pay one hundred dollars five years from date, and say nothing in the promise as to the kind of payment, you may satisfy the creditor by giving any kind of money which may then be a legal tender. At present gold and silver coins of denominations of one dollar and upward are legal tender to any amount; but subsidiary silver—the fifty, twenty-five, and ten cent pieces—can be offered in sums no greater than ten dollars; and lower denominations of nickel and copper are legal tender to the amount of only twenty-five cents. The United States notes* are legal tender for all purposes except duties on imports and interest on the public debt. Some people, however, think that legal-tender money can be offered for goods in a store, and that the shop-keeper is obliged to hand over the goods. This is absurd; for no one can be obliged to part with his property in any such way against his will. Before goods are purchased there is no debt created for which money can be offered as a legal means of payment.

178. The step from the actual use of gold and silver to promises to pay gold and silver was easily made, and as long as the promise was faithfully kept such kind of paper money was very convenient and economical. The next step also was easy. The experiment was tried of issuing promises to pay without having anything with which to pay. During our civil war (February 25, 1862) the United States began to issue United States notes ("greenbacks")

* The national-bank notes are not legal tender for *private debts*, but are, in the language of the act of June 3, 1864 (section 23), "received at par in all parts of the United States in payment of taxes, excises, public lands, and all other dues to the United States, except for duties on imports; and also for all salaries and other debts and demands owing by the United States to individuals, corporations, and associations within the United States, except interest on the public debt and in redemption of the national currency."



when the Treasury was practically empty, and when there was no intention of redeeming them at that time. Such paper money is called **inconvertible paper**, and is an evidence of bad financial management. It is practically a confession of bankruptcy. When a merchant can not meet his note, it is protested, and his credit is ruined; but governments are generally given more confidence. If the notes issued are promises to pay, account must be taken of the possibility that the issuer will eventually be able and willing to redeem the promise. This possibility is connected with the quantity of notes issued. **The quantity of inconvertible paper in circulation chiefly affects its value.** If the Government is reckless in issuing unlimited quantities of paper money, that is increasing evidence that the currency may not be redeemed at its full value. Consequently, inconvertible paper is liable to **depreciate**, or to fall below its face value.* During the civil war, when the greenbacks were inconvertible, a promise of the United States to pay a dollar in gold fell in value as low as thirty-five cents in gold; for once, in 1864, it required two dollars and eighty-five cents of paper to buy one dollar of gold. On January 1, 1879, however, the Treasury had collected gold enough with which to redeem its promises, and since that time (when it was said that specie payment was resumed) a United States note has been convertible paper money. The depreciation of United States notes from 1862 to 1879 may be seen in Chart VI, which shows the premium on gold. Of course, as the line goes upward, the value of paper depreciates, because it requires more paper to buy gold than when the line falls. For seventeen years the promise of the United States to pay in coin was not worth its face value.

* In 1781 the inconvertible paper issued by the Continental Congress became worth nothing; in fact, so entirely without value was this paper money that we still have a by-word for any worthless thing ("Not worth a continental"), derived from this experience.

179. The descent to Avernus is easy. For an impetuous state, the step from putting out promises which are not redeemable to issuing a still worse kind of paper money is quite natural. The Government, seeing paper pass from hand to hand as money, conceived that the authority of the State would be sufficient to give value to paper which had no intrinsic value in itself, and which was not even a promise to pay value. It created **fiat money**. Instead of reading, "The State promises to pay one dollar," the fiat money reads, "This is a dollar." Such was the character of some of the paper money issued by the colonies. In Rhode Island the issues read as follows: "This three-shilling bill due from y^e colony of Rhode Island, &c. to the Possessor shall be equal to money," etc. This kind of paper depreciated until it was comparatively worthless. In truth, such paper money would have had no value had it not been for the fact that the laws gave it a certain power to pay debts, and that it was received by the State for taxes. No policy can be worse than that which leads a state to declare that a piece of paper shall have value when it has none. If the State is willing to take the paper instead of gold or silver, it establishes thereby a means of redeeming it to a certain extent, and, if there were little of it in circulation, it is possible that it may have full value. But, in every case in the past, this kind of paper has been issued in undue quantity, and has depreciated enormously. The finances of a State must be egregiously mismanaged if it is forced to issue inconvertible money, to say nothing of "fiat money." It is a confession that a country can not, by legitimate borrowing or by taxation, get the means of paying its expenses, and that it is necessary to resort to a trick like issuing false money.

180. From various causes, **inconvertible paper, however, often has value** to a greater or less extent. It is probably **at first issued as convertible paper**, and is received by the people as such. Thus, at the start,

there was an intention to keep its value intact. Too often, also, not enough account is taken of the **habits of a people in regard to money**. The name for a coin retains an association of value independently of changes in its weight or character. People easily fall into ruts in regard to things which are intricate and puzzling. The persistence of monetary names is shown by the fact that in the city of Boston goods are sold over counters to-day, and reckonings made with purchasers, in the names of coins (such as "ninepence" and "shilling") which have had no legal existence since 1792, and have not been in circulation for generations. So, when persons get a fixed idea of a dollar in gold, or in a sound paper money convertible into gold, and are accustomed to reckon prices in it, they are very easily led into taking inconvertible money in much the same way, because it also is expressed in terms of dollars, or the same units. Even though the paper depreciates, it will be persistently said, "A dollar's a dollar, and you can't make it anything else." It is not realized that the dollar changes in value, and that it is only a means of exchanging goods, not an end in itself. As Mr. Jevons* says: "After the promise of payment in coin is found to be illusory, the notes still circulate, partly from habit, partly because **the people must have some currency**, and have no coin to use for the purpose, or, if they have, carefully hoard it for profit or future use." Moreover, inconvertible paper is given more or less value by impressing on it the **legal-tender quality**. When the State receives it for taxes, or for customs, and when it can be used to discharge debts, it is so far put on an equal basis with good money, and it acquires some value. But in the end, when issued to any considerable amount, not even the legal-tender quality, or habit, can save it from depreciation. There is scarcely a case in history where, when

* "Money and the Mechanism of Exchange," p. 234.

once begun, the first step has not been followed by a great expansion of the issues, and a consequent depreciation. Of paper money Webster said: "We have suffered more from this cause than from every other cause or calamity. It has killed more men, pervaded and corrupted the choicest interests of our country more, and done more injustice, than even the arms and artifices of our enemy."

181. As soon as inconvertible paper has slightly depreciated, it drives out coin, or convertible money. This takes place under the principle of **Gresham's Law: Bad money drives out good money, but good money can not drive out bad money**. The manner in which it works is simple, and may be thus illustrated: Suppose that the paper has depreciated so that a dollar of it is worth only ninety cents in gold (as was the case in June, 1862; see Chart VI), and suppose also that you have a debt of \$1,000 to pay. If both gold and paper are legal payment of your debt, in which will you pay? With \$900 in gold you can buy \$1,000 in paper, and with that pay your debt; by paying the debt in gold, \$100 more of gold would be needed. There is thus a premium in favor not only of using paper, or the cheapest money, but also of selling the gold as merchandise, or exporting it. People will generally follow the easiest way of paying which is permitted by the law of the land. As now constituted, men, when required to pay one hundred cents, do not choose a dollar worth one hundred and ten cents when a poorer money serves equally well to extinguish the debt (that is, if both kinds of money are legal tender). Thus **the poorer money drives out the good**. During the whole period of the depreciation of United States notes, 1862-1879 (see Chart VI), our country was exporting its gold in large quantity. The money in general use was paper money, and gold was not in circulation (gold being used only for paying customs duties to the United States, and for interest on the national debt). The reason why

gold was exported, leaving only paper at home, was that the United States paper would not circulate beyond the limits of our own country. The paper money is a legal payment only according to our own laws, and consequently is not received as a legal payment by foreigners. Hence, when payments are to be made abroad, metallic money is always sent.

182. We have already seen that an increase of money or credit raises prices (section 169). A change in prices indicates a change in the value of money. When inconvertible paper money depreciates, paper prices necessarily rise as the paper depreciates. A pair of gloves, selling for one dollar in gold, will, when paper depreciates to ninety cents, sell for one dollar and eleven cents in paper; when the paper depreciates to fifty cents in gold, the gloves will sell for two dollars. And, since depreciated paper money drives out gold and silver, the paper will be the only money in use, and prices will be reckoned only in paper; so that, if the paper money rises and falls in value, as our United States notes did during the war, **prices will be constantly changing**. This is an evil to trade which can not be overestimated. If a manufacturer or merchant does not know what the price of his goods or materials will be a week ahead, he is cut off from any legitimate estimate of his coming receipts or expenses, and is obliged to guess at the course of the market. This, however, is mere **speculation**, and trade is consequently turned into betting and gambling as to the change of prices—one man gains at another's loss. This speculative spirit changes the whole moral tone of business, and transforms trade into a system of wagers. Then, too, speculation aggravates the changes in prices. An increase of paper money raises prices; but speculators, who believe that prices are going up because of an issue of more paper, will try to get on hand as large a stock of goods as possible before the rise, in order to sell out when the rise comes. This creates an

excessive demand at times, and under it prices are advanced far higher than they would be merely by the issues of paper. Speculation (engendered by the issue of paper) raises prices beyond the limit established solely by the extension of the quantity of paper; and so, as prices have risen in a greater proportion than the increase of the money in circulation, a difficulty is experienced in exchanging goods for money. Money seems scarce, although more has lately been issued. So it has been after an excessive issue of paper money, whenever it has been tried. The more there is issued, the more is craved, and the Government is never able to withstand the demand for more of this financial intoxicant.*

183. There is a delusion, fatal in its bad results, to the effect that a period of inflation and high prices is a period of prosperity. Those who are ignorant of the nature and functions of money think that, when prices in paper rise, the dollar is the same that it was before the rise. A farmer, for example, has a piece of land valued at \$1,000 in gold; then comes an issue of paper, and prices rise to double what they were before. Now the farmer, finding that his piece of land is valued at \$2,000 (in paper), without reflecting that the paper "dollar" is worth but one half as much as before, and that his land is worth no more

* "It is my firm belief that the issue of inconvertible paper money is never a sound measure of finance, no matter what the stress of the national exigency may be. I believe it to be as surely a mistaken policy as the resort of an athlete to the brandy-bottle. It means mischief always. If there is ever a time when a nation needs its full collected vigor, with a steady pulse, a calm outlook, a hand and a brain undisturbed by the fumes of this alcohol of commerce—paper money—it is when called to do battle for its life with superior force. It is, to my mind, the highest proof ever afforded of the supreme intellectual greatness of Napoleon that, during twenty years of continuous war, often single-handed against half the powers of Europe, he never was once driven to this desperate and delusive resort."—F. A. Walker, "Political Economy," p. 169, note.

than \$1,000 *in gold*, is often deluded into thinking that he is twice as rich as he was. Although all that he sells is doubled in price, all that he buys is likewise doubled, and the products he sells bear the same relative value to what he buys as before. He now sells his wheat for double the money he did formerly, and he gives double the money for clothing and dry-goods, so that he is just where he was before. Not understanding this, however, **people often believe that when prices rise they are richer than they were before**—that they are worth more in “dollars.” They do not reflect that each “dollar” is worth less in the proportion that the prices have risen. This delusion leads them to buy more lavishly, and display greater extravagance. This explains why the period after our war was one of only apparent prosperity, and why it generated that boundless extravagance and great extension of credit which caused a reaction in the disastrous commercial crisis of 1873, from which we were years in recovering.

184. High prices, however, seem desirable to many people for very different and for dishonest reasons. High prices and inflation, under cover of law, enable debtors to levy a forced contribution on their creditors, to **pay their debts with less wealth than they borrowed**. It would hardly seem necessary to refer to such degraded morals, were the policy of inflation not openly advocated on such grounds. To those who think stealing is no wrong, such a method of escaping from just obligations may commend itself. We have already pointed out (section 95) that long contracts should not be settled by a standard of gold, silver, or any money. The debtor should pay back just what he received—no more, no less. The farmer referred to, when his land was valued at \$1,000 in gold, may have mortgaged it for \$500. After prices have risen by an issue of paper, his products will sell for more paper dollars than they did for gold dollars, and yet each paper dollar (if legal tender)

pays off one dollar of his original loan of \$500 which he received in gold. Thus, after paper prices have risen, it will not require the sale of so many of his products to pay off his mortgage as it would have required with gold prices. This is only another way of saying that the farmer **gives back less than he receives**. It is, therefore, unjust to make inconvertible paper, which is morally certain to depreciate, a legal tender for *past debts*. A large amount of capital loaned in this country is made up of the savings of people with small incomes, and they can not afford to have the provision for their old age thus eaten up by unjust acts of debtors under the guise of legal-tender laws. It is a reason why even convertible paper should not be made legal tender, that it may in some emergency become inconvertible and depreciate, and produce the effects of robbery.

185. **Exercises.**—1. In the middle ages a twig, or a clod, was handed by the seller to the buyer as a sign that the ownership of the property was transferred. Was there any likeness to paper money in this procedure?

2. A deed is a title to a piece of land. Is a promise to pay gold on demand something of the same kind?

3. Could you oblige a customs official to-day to receive a national-bank note in payment of duties?

4. What is the advantage of having a convertible paper money?

5. Is there any cost of production (beyond paper and printing) for paper money below which its value can not fall by an increased supply of it? Is it the same with gold?

6. With the word dollar we associate some idea of value. If a paper money were printed so as to read “This is a George Washington” instead of “This is a dollar,” would it make any difference to people in receiving it?

7. President Garfield once said, in a speech, that we did not export paper money, for the same reason that we

could not export bad cheese or rancid butter. Wherein is the resemblance?

8. Men properly accumulate wealth by producing it. In what different way than this do they gain wealth by fluctuations in the prices of commodities due to changes in the currency?

9. What tendency has an era of high prices upon the use of credit? If people are really no richer when paper prices have risen, how do they get increased purchasing power?

10. Name some of the different legal ways in which you can pay a debt of \$25 to-day. What different kinds of money can you use, and to what amounts?

BOOK III.

DISTRIBUTION.