

CHAPTER V.

INCONVERTIBLE PAPER MONEY.

205. In monetary science, the true entrance to paper money is through seigniorage. If we have rightly apprehended the relations of seigniorage to the circulation of coin, and to prices, we need have no difficulty in dealing with any question arising under the present title.

"The whole charge for paper money may be considered as seigniorage." This remark of Mr. Ricardo is true and very significant. We have seen that the State may withhold from the coin one per cent. of the pure metal, to cover the cost of coinage; that it may withhold ten per cent., as a means of securing revenue for the treasury; that the State may go further and, by successive invasions of the coin, take out two-thirds of the money metal, as in the case of the English pound sterling, or all but three per cent., as in the case of the pound Scots; that it may even go further still and substitute copper for gold, as in the case of the Spanish maravedi.

Now let the last step be taken in the same direction, and, instead of pieces of metal, let the public treasury issue pieces of paper bearing the names of the superseded coins, and we shall have a body of money governed by precisely the same principles, alike as to circulation and as to the resulting prices of commodities, as a debased coinage. Paper money is money upon which the seigniorage charge is one hundred per cent.

206. **Historical Instances of Inconvertible Paper Money.**—The invention of paper money, like many another great discovery, is traced to the orient. When Marco Polo visited China in the twelfth century, he found in circulation a money consisting of pieces cut from the inner bark of the mulberry tree. These were issued "with as much solemnity and authority as if they were of pure gold and silver." A century later, one of the rulers of Persia introduced paper money in direct imitation of the Chinese, the imitation extending even to devices and names; but the experiment here was less fortunate than the Chinese experiment, since, after two or three days of enforced circulation, the markets were closed, the

people rose, the officials were massacred, and the money disappeared. A century later, we hear of paper money in Japan.

It took the duller-witted races of Europe some centuries more to comprehend the mysteries of paper money; and meanwhile princes had to content themselves, when hard-up, with operating upon the coin, swearing their coiners not to divulge the secrets of the mint, and juggling their people just as far as the omnipresent scales and acids of the banker would permit. But when paper money became once fairly introduced into Europe, it was, like some of those other inventions and discoveries referred to, rapidly improved in its details and extended in its applications.

An eminent writer on finance, M. Wolowski, claims for his native country of Poland the proud distinction, as he regards it, of having been the only nation in Europe which has given no example of the issue of paper money; but it is to be remembered that Poland lost her independence a long while ago. Had she survived to the present time, it is not unfair to believe she would have her paper money history equally with the gigantic neighbors who crushed out her national life.

Of the present States of Europe, all which border on the Mediterranean, excepting France and Italy, have inconvertible paper money, issued by government. Russia, though both a northern and a southern State, casts in its lot with the Mediterranean nations in this respect. The northern tier of countries, Great Britain, France, Belgium, Holland, Germany, and Scandinavia, have paper money, indeed, but of that class which we shall describe, under a subsequent title, as Bank Money.

207. **Characteristics of Inconvertible Paper Money.**—The kind of money of which we are writing may either be issued originally by the State, as in the case of the present paper money of most of the southern States of Europe already mentioned; as in the case of the "assignats" and "mandats" of the French revolutionary epoch; as in the case of the "Continental currency" of the American revolution, and of the "Greenbacks" and "Confederate notes" of the war of

secession ; or, secondly, it may result from the degeneration of bank money, originally issued with the character of convertibility, but, by some exigency of government or stress of commercial misfortune, losing that character, and protected in its inconvertibility by law, as in the case of the English Bank money of the "Restriction" (1797—1821), as in the case of the notes of the Bank of France during the revolution of 1848, and, again, during and after the war of 1870-71, and as in numerous other cases of minor importance.

Generally speaking, forced circulation is an attribute of this sort of money, though that character may be disguised, especially in the case of degenerated bank money, by one artifice or another. For instance, the money may not be made legal tender, but all remedy at law may be taken away from creditors who refuse to receive it.

Paper may be declared to be redeemable in coin ; that promise may even be borne upon the face of the paper ; but if provision be not made so that, in fact, every holder of a note can obtain coined money therefor at will, the paper is inconvertible. If any conditions to redemption are interposed, it is none the less inconvertible than if redemption were not even promised.

The pledge of public lands or stocks for ultimate payment, makes no difference, in this respect. No paper money is convertible, the full, immediate and unconditional redemption of which is not, at all times, within the choice of the holder.

208. Is this Properly Called Money?—American economists have generally agreed to deny the title, money, to such issues. Indeed it is as much as one's reputation for economic orthodoxy is worth, to concede that inconvertible paper may become money.

If we seek a reason for this attitude of the economists, we find that it is because they deprecate the use of such a "circulating medium," deeming it mischievous, pernicious, destructive of industrial and social well-being. But, as I have ventured elsewhere to remark, it would be as reasonable to deny that whisky is drink, because we deprecate its use as drink, as to deny that inconvertible notes are money because we deprecate their use as money.

The economists have dealt with the subject as if the question were necessarily this, money or not money ? money being assumed to be, not only a good thing in general, but always beneficial, in all relations and under all circumstances. And, inasmuch as they think they have shown (in which I fully agree with them), that the use of inconvertible paper produces very injurious effects, they deny that it is entitled to be called money.

According to the views presented in this treatise, the sole test of money is the performance of the money function. As has been said, that which does the money-work is the money-thing. If it does this work well, it is good money ; if it does this work ill, it is bad money.

209. May Paper Money Serve as the Common Medium of Exchange?—About this there can, I conceive, be no doubt whatever. Take the United States "Greenbacks" of 1862 to 1879. Did producers accept them readily in full payment for goods ? Yes, with the utmost readiness. Did men resort to barter to avoid the use of this medium of exchange ? No. Did men refuse to produce, or contract their production, or modify it, lest they should have to receive those circulating notes in payment ? Again, no.

There never had been a period in our history when the division of labor was carried further ; when the differentiation of industry and the diversification of production went on more rapidly. This is the sure test of the performance of the money function. The differentiation of industry and the diversification of production involve increasingly the use of money. Whenever production is being enlarged and diversified, there, without any question, something is acting successfully as the medium of exchange.

Observe that it is not now a question of prices, of how many dollars in greenbacks were required in 1864 or 1874 to buy what ten dollars in gold would have purchased in 1860, or would purchase at the present time. That, as we have seen, is a matter of the volume and rapidity of circulation. The question now, is simply as to the freedom and fullness of circulation.

It is not asserted that such paper is always and everywhere money. It becomes money when it begins to do the money-work; it remains money as long as it continues to do that work; it falls out of the category of money when it ceases to do that work. After the American Congress had issued the "Continental" money in such quantity that even the treasury ceased to keep a record of the issues, and the value had sunk to 200:1 of silver, there is no question that, for a short period before the notes finally disappeared and silver came back, the notes ceased to be money. Men would not take them; modified their production, or curtailed it to avoid the necessity of taking the discredited paper; resorted increasingly to barter, in spite of all its inconveniences. The same fate befell the French "mandats" after the revolutionary authorities had issued "assignats" to an amount popularly stated at forty-five thousand millions of francs. The Confederate notes ceased to be money upon the collapse of the government that issued them.

210. May Paper Money serve as the Value Denominator?

—It is at this point that the economists appear to me most deeply in error, insisting, as they do, that here is something which metal money does, but paper money can not do.

It was said, in the last chapter, that money, in performing the function now in question, is commonly spoken of as the "Measure of Value." Now, what money does in this connection is no more than to serve as the common denominator of values, as described by Prof. Jevons, in par. 182. It was shown in the pages immediately following, that this function is not a separate and independent function of money, but a purely incidental and subordinate function; that not only is any thing which is competent to serve as the general medium of exchange, adequate also to serve as the common denominator of values; but that any thing which does, in fact, serve as the medium of exchange, must, in the very act and part of doing so, create the price-current, which is what is sought under this title.*

* The idea that values are "measured" by money, has a great deal of tenacity. A somewhat more extended discussion of this question will be found in my work on Money, Chap. XIV.

If corn, beef, wool, potatoes, coal, and all other articles in the market are daily exchanged for that one article—money—no matter of what it consists, or why it became money, we have, as the direct result of those transactions, the means of comparing the values of corn, beef, wool, and all other articles: that is, we have our price-current. If all those articles are exchanged against pieces of paper, we obtain their exchanging proportions just as really, just as accurately, readily and intelligibly, as when they are exchanged against pieces of gold, silver or copper. If one article brings three pieces of paper, another ten, another eight, we learn the comparative value of those articles as quickly and easily as if the first brought three pieces of silver, the second ten, and the third eight.

211. May Paper Money Serve as the Standard of Deferred Payments?—We have seen that paper money may become the general medium of exchange, being taken as freely and eagerly as money of silver or gold. We have also seen that whatever serves as the general medium of exchange does, by that very fact, serve, also, as the common denominator of values, furnishing the price-current from which are determined the exchanging proportions of all commodities in the market.

That paper money may serve as the standard of deferred payments goes without saying. As was stated under a previous title, forced circulation is generally an attribute of this sort of money, and where that is the case, such money becomes, by definition, the standard of deferred payments. By it the obligation of the debtor, the claim of the creditor, is measured, as of course. Even where paper money is not made legal tender, it is almost, if not quite, as likely to become the standard of deferred payments as a money of silver or gold. The tendency to express the consideration of all sales in terms of that which is the current money of daily use, is so strong that few persons, even of those who are acting as trustees, will take the trouble to make leases, rents, annuities or interest upon loans payable in any thing but the ordinary circulating medium of the time.

The notes of the Bank of England were not legal tender, in the ordinary sense, during the period of the "Restriction"; yet, though they ceased to be convertible in 1797, the first instance, so far as I am aware, of a refusal to accept such notes in payment of debts, was that of Lord King, in 1811; and this refusal took place, as Lord King claimed, not from any selfish motive, but purely in order that, by strongly attracting public attention to the unfortunate monetary condition of the kingdom, he might promote the resumption of specie payments.

During the circulation of the legal tender greenbacks in the United States, every person who wished to make contracts for future payments in terms of gold or silver, was at liberty to do so; yet it is notorious that few took advantage of their legal right in this respect. That which had become, no matter how, the current money of daily use became, for that reason alone, the almost universal standard of deferred payments.

It is another question whether paper money performs this function with justice to debtor and creditor, or with advantage to the general community. That question we shall meet further on.

212. What Determines the Value of Paper Money?—What determines the value of any kind of money? What determines the value of any thing? Demand and supply. The demand for money is, as we saw (par. 170), the amount of money-work to be done, the amount of exchanging requiring to be effected through the use of money. The supply of money is the money-force available to do the money-work. It is compounded of the volume of the circulating money and the rate of circulation. Supposing the occasion for the use of money—the demand—to remain the same, and the rate of the circulation of paper to be the same as that of metal, the value of a body of paper money would be the same as that of a body of money consisting of as many pieces of metal as there were pieces of paper, the pieces being of the same "denominations," whether stamped with the mint-press or the printing-press.

We said: "Supposing the rate of circulation of paper to be the same as that of metal." I am aware of no reason for supposing that any difference in the rate of circulation of metal money, on the one hand, and of paper money on the other, would exist, if all other conditions were alike, of sufficient importance to be taken into account. The paper would, of course, be handled somewhat more easily, would be remitted by mail or parcel-delivery somewhat more readily and safely, and thus a thousand dollars, so-called, in paper would do somewhat more money-work than a thousand dollars in metal. The difference in that respect would, however, not be important.

We may accordingly drop this proviso. We also said: "Supposing the occasion for the use of money—the demand—to remain the same." Will the demand for money be affected by the substitution of paper for metal? The popular opinion undoubtedly is that the mere fact of the emission of inconvertible paper produces discredit, so that such money, irrespective of any excess, at once becomes distrusted and avoided.

213. Depreciation not a necessary consequence of Inconvertibility.—The opinion above stated is unfounded. We saw (par. 201) that depreciation is not a necessary result of debasement of the coin. Not only will the same line of reasoning establish the proposition that depreciation is not a necessary result of the issue of inconvertible paper; but historical instances not a few exist of such paper money maintaining itself for a time in circulation without discredit and without depreciation. It is undoubtedly true, as Prof. Bonamy Price asserts, that "experience has proved that it need not of necessity suffer any depreciation of value."*

* On a point so vital it may be well to add authority to reason, especially as current American literature misrepresents the real purport of economic opinion on this subject.

Mr. Thomas Tooke, the most eminent economic statistician of the world, explicitly and repeatedly states that depreciation is not a necessary consequence of inconvertibility.

Mr. James Wilson, founder of the London *Economist*, and a states-

214. Inconvertible Paper always issued as Cheap Money.

—The moving cause in the issue of inconvertible paper money has been its cheapness, as compared with the metal money which it has replaced. Whatever excellencies may have been reflectively discovered in such money after it had come into circulation, I am not aware that the institution of such money has been due, in an individual instance, to any other virtual reason than that which has been expressed.

We saw that the sovereign first pinched the coin, say, one per cent., under the name of seigniorage, to meet the cost of coinage, and then, finding the opportunity too tempting, took out it might be five, it might be fifteen per cent., or even more, for his own benefit. The issue of paper money, is in effect, the exaction of a seigniorage of one hundred per cent. At times, that exaction has been made in cold blood, at the dictate of avarice; at times, and indeed, more often, the exaction has appeared to be justified, if not sanctified* by some great exigency of national life.

man and financier of wide experience, declares that if the amount of inconvertible paper be properly regulated, "there is no reason whatever why such notes should suffer depreciation."

M. Courcelle-Seneuil, a French writer on Finance, whose views are entitled to much consideration, expresses the opinion that if the emissions of paper money be moderate, they may have the same value as metallic money.

I have made use of three names of the first rank in the economics of finance. Let me now quote, at greater length, the most illustrious writer known to monetary science.

"The whole charge for paper money," says Mr. Ricardo, "may be considered as seigniorage. Though it has no intrinsic value, yet by limiting its quantity, its value in exchange is as great as an equal denomination of coin, or of bullion in that coin. It is not necessary that paper money should be payable in specie to secure its value; it is only necessary that its quantity should be regulated according to the value of the metal which is declared to be the standard."

*Hence the phrase the "the blood-stained Greenback." Lest I should be misunderstood, let me say that 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

215. Without any such stress of fiscal necessities as those caused by war, paper money has been frequently issued by governments as a fiscal resource, to enable public works to be created, to meet an unexpected deficiency of revenue, or even, as in the case of some of the early American colonies, to set bounties on manufactures or the fisheries. There is always a great temptation, to statesmen and to people alike, in times of emergency, in the knowledge that it is possible to replace a money of high cost by a money of low cost, of cost, indeed, so small that it may be called no cost.

216. Is it really Cheap Money?—That depends on whether it be good money or not. The money function is so important, so vital, in the industrial system, that there can be no true economy in any money but the very best. If the first cost of money can be saved, in whole or in part, without loss of efficiency or safety, that course is unmistakably dictated by the same law of the human mind which impels the individual to go to his object by the shortest path, or to buy in the cheapest market. To use a money which has to be dug out of the depths of the earth, drilled and blasted out of rock, perhaps at the depth of two thousand feet where water almost boils from internal fires, when a money in every way as good could be made from paper-pulp and printed with a steam press, would be the extreme of wastefulness. On the other hand, to use any but the best money, that which will perform the money function in the most perfect manner, would be economy

its full collected vigor, with a steady pulse, a calm outlook, a firm hand, 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 of the supreme intellectual greatness of Napoleon, that, during twenty years of continuous war, he never was driven to this desperate and delusive resort. I hold any man to be something less than a statesman, in the full sense of that word, who, under any stress of fiscal exigency, supports or submits to a measure for the issue of paper money not convertible, at the instant, on demand, without conditions, into coined money. The political arguments by which such measures are always supported, on the outbreak of war, seem to me the veriest trash, due half to ignorance, and half to cowardice.

of the same sort and degree as putting rotten timbers into a bridge because they were cheaper than sound timbers.

217. Is it, then, Good Money?—I know of nothing in the history of inconvertible paper money to indicate that such money, when issued of a denominative value not to exceed the mint-value of the coin which would have circulated in the community under the law for the territorial distribution of money which has been stated (pars. 176–80), may not serve as the general medium of exchange, so far as the internal* trade of a country is concerned, in every way as satisfactorily as the coin itself. Indeed, if any preference exists, it will be in favor of the paper money, as more convenient to handle, more readily transported, more successfully concealed.

Moreover, it has, I think, been sufficiently shown that whatever acts as the general medium of exchange, in the very act of doing this performs the function of a common denominator of values, furnishing a price-current in which the values of all commodities are expressed in terms of that one article.

But as regards the function of a standard for deferred payments, a wide difference may exist between two articles which might, with equal convenience, be used as the medium of exchange. It might happen that an article having a decided preference in the latter function would be found far inferior in the former function; might even be miserably deficient in the requisites of a standard of deferred payments. Let us, then, inquire further respecting inconvertible paper money, on this score.

218. Inconvertible Paper Money as the Standard of Deferred Payments.—In the fact that this money has no natural cost of production, lies the possibility, not merely of gross injustice as between individuals and classes of the community (which is not an economic consideration), but also of grave industrial evils, and even disasters of the most appalling character. Mr. Ricardo has rightly said that, by limiting the supply, any degree of value can be given to the money of a country, be it of gold and silver or of paper; but in the case

* The relations of inconvertible paper money to foreign trade and international exchanges will be spoken of in paragraph 220.

of the last no limitation of the supply is set by natural forces. Paper money has no cost of production. The expense of printing a dollar bill is so small, that, for purposes of economic reasoning, it may be disregarded altogether, while the expense of printing a ten-dollar bill or a hundred-dollar bill or a thousand dollar bill is no greater. The limitation of supply in the case of such money, therefore, must be left to law, convention, or accident.

We have seen that it would require many years of highly stimulated production to affect appreciably the world's stock of the precious metals, and, by consequence, the value of those metals. The cereal grains, indeed, being consumed in one or two years after their production, may be increased in quantity more rapidly, say, twenty or thirty per cent. in a year, as the result of exceptionally abundant harvests; yet even here human volition only controls the elements of production to a limited extent; and increase on such a scale could not be carried forward more than two or three years at the furthest. In the case of paper money, however, the stock may be increased, at the will of the issuer, to any extent, within the briefest period. The quantity may be trebled, decupled, centupled, by the operations of the printing-press.

219. Domestic Effects of Inflation.—The value of money depending, as has been shown, upon the relation of supply to demand, an increase of issues implies a loss of value in each given quantity of money. This involves a corresponding loss to all creditors, and a corresponding gain to all debtors. That result, being brought about by legislation or by the act of the prince, is properly termed confiscation. So far as it concerns only the existing body of debts, the question of confiscation is of interest only from the point of view of political equity. But such a measure also becomes a highly destructive force within the field of present and future industry, dealing a grievous blow at the instincts of frugality in the individual, and at the organization of the industrial body for the purposes of production and exchange.

Such a blow once dealt might in time be recovered from; but if new fiscal exigencies of the government, or the political

pressure of the debtor class draw out other issues of inconvertible paper, not only will the value of the money continue to sink, through excess of supply, but another cause will begin to work in the same direction. The money demand will receive a shock such as has been described in par. 200, which may operate slowly and continuously, or may produce a sudden collapse of the circulation, the treasury crowding out the paper upon a reluctant and indignant people, who will none of it; who, through experience of grave losses in the past, shun it as they would the plague, contracting their industry, or changing its form at whatever sacrifice, or resorting to barter in spite of all its inconveniences, to avoid the use of the detested money. This was the fate, at the last, of the American "Continental Currency," and of the "Assignats" and "Mandats" of the French revolution.

Such are the possibilities attending the issue of paper money by the government. It may be asked what are the probabilities of the case? As we have here reached the limit of strictly economic inquiry, I prefer to postpone our answer to this question to Part VI., where, under the title "Political Money," the subject will be briefly treated in its political and historical aspects.

220. Inconvertible Paper Money and Foreign Exchanges.

—But before we leave the topic of inconvertible paper money, we have to view another phase, *viz.*, its relation to International Exchanges. Thus far, we have spoken of the issue of paper money by government, only in its effects upon domestic trade and production. We are now to consider its influence upon the commercial relations of the issuing country with foreign countries.

By the mere fact of the adoption of this kind of money, a country loses all the advantages of an automatic regulation of the money supply through the normal movements of trade. Paper money finds no outlet in international commerce. It can not be exported and retain its value. Hence its regulation becomes purely mechanical. Having no natural cost of production, it will not, if in excess in any country, flow away in obedience to the law which governs the distribution of a

money having acceptance abroad equally as at home. If issued in excess, it can only be removed by being pumped out by the same force which originally issued it.

Even where the excess of such paper money, over what would have been that country's distributive share of the world's money, be not enough to produce grave disturbances of domestic industry, the effect on foreign trade will yet be momentous. The immediate result of any excess must be to establish a premium upon that metallic money in which alone foreign balances can be paid.

To one who is not familiar with the largest operations of commerce this may seem a small matter; yet, if we may trust those who are best qualified to decide such questions, the money of a commercial state can not depart, by the narrowest interval, from the money in which international balances are discharged, without creating obstructions, exciting apprehensions and even occasioning losses, to which modern trade, with its highly developed and acutely sensitive organization, will not submit, or will do so only upon the payment of heavy fines by the offending community.

During the German war, and for some years after, *viz.*, from 1871-1877, the notes of the bank of France were inconvertible; yet such was the sagacity and prudence of the directors of that institution that at no time was there any considerable discount on that money, the premium on gold being often but a small fraction of one per cent. Yet, slight as was the disturbance of the domestic circulation, Mr. Bagehot, in his standard work, *Lombard Street*, written during the period of suspension, attributes to it the most momentous consequences.

"The note of the bank of France," he says, "has not, indeed, been depreciated enough to disorder ordinary transactions. But any depreciation, however small, *even the liability to depreciation, without its reality*, is enough to disorder exchange transactions. They are calculated to such an extremity of fineness, that the change of a decimal may be fatal, may turn a profit into loss. Accordingly London has become the sole great settling-house of exchange transactions in Europe, instead of being, as formerly, one of two."