

THE GOVERNMENT'S LICENSE TO CREATE MONEY

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Hence, the power of saying what shall be money, at what rate money shall be taken, and what it shall be worth, has, in all civilized countries . . . been deemed one of the badges and attributes of sovereignty, and assigned to the central and supreme authority of the state, as that which may indeed be perverted or abused, but which, yet abused or not, must be exercised uniformly, and according to some common rule, in order to be of utility to all.

—Judge J. Hare¹

The erroneous belief that it is a duty of the state to regulate the value of money is the parent of all the vicious monetary legislation in the world; born of an old superstition that a mysterious power of sovereignty imparted to coin an added value, it has obstructed the growth of money at every stage of advancement. . . . Bi-metallism, monometallism, fiat money, and the notion that the supplying of money is a function of government are all the logical outcome of the false premise that the state can impart value to money.

—William Brough²

The Contemporary Monetary System in Contrast to the Constitution

A summary foreshortened view of the U.S. monetary system, as it has emerged from the constitutional principles that sought to shape it to the institutional forms it has assumed today, can only occasion an exclamation of disbelief. Congress does make other things besides

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¹Cited in Hunt (1903, p. 101n.).

²Brough [1896] 1969, pp. 133–34).

gold and silver coin “a Tender in Payment of Debts” in outright violation of Article I, Section 10. Furthermore, the other things it makes legal tender are Federal Reserve “bills of credit,” which also violate Article I, Section 10. True, the proscription was aimed at state governments, not at the federal government. The state governments, however, were regarded as superior to the federal government, so any power denied the former was also denied the latter by the 10th Amendment. The debates over the “money” clauses left no doubt that “Bills of Credit” were the paper money issued under the authority of the state and continental governments during the pre-constitutional era (Siegan 1987, pp. 22–27). As though to flout these proscriptions of the Founding Fathers, the present-day monetary system in the United States has *no* gold or silver in it, on it, or backing it; and all of the fiat paper currency is full legal tender for both private and government debts and payments.

This state of affairs suggests several questions: How did we ever get from there to here? What were the critical legislative, administrative, and judicial decisions that turned a constitutional monetary system completely around from its intended path? And, finally, what are the means available, no matter how politically remote, for getting from here to there again—forward, that is, to the system intended by the constitutional creators?

Present-day monetary systems are completely managed by central banks that have no effective constraints either from the traditions of common law or from written rules of law. All modern central banks create legal tender paper money or lawful-money bank reserves at the discretion of their managers, who thereby reward themselves and their governmental sponsors with significant amounts of seigniorage revenue (Toma 1982; Timberlake 1986).

Indeed, the scene today is not significantly different from what it was 450 years ago in the England of the Tudors, particularly at the time of Henry VIII (Breckenridge [1903] 1969, pp. 39–42). Subsequent to Henry and his immediate successors, however, a sea-change in currency management took place in England. Over generations, and particularly during the 17th century, the rule of law gradually replaced the discretion and avarice of despotic monarchs. This transition manifested itself in both English and American polity and reached its zenith in the greatest political document of Western civilization, the U.S. Constitution.

Tracing the sequence of events that led, first, to a monetary system operating under the rule of law, and second, back to an unconstrained discretionary system may provide a link to understanding what form a constitutional monetary system might take in the future. The focus

of this paper, in particular, is on the antecedents and ramifications of the idea that some prerogative of sovereignty endows the state with the absolute power to proclaim the legal tender property of any monetary unit it chooses to create and issue.

Early Monetary Experience with Legal Tender

Long before the appearance of the Tudor monarchies in England, the precious metals had evolved as coined monies. Since the coins at first circulated by weight, the facility with which they were exchanged could be expedited by standardizing their size and stamping them with a seal of weight and fineness (Burns [1927] 1965, pp. 25–40). This benign function induced state authorities to assume monopoly powers over the coinage (Burns [1927] 1965, pp. 445–47).

Arthur R. Burns noted in his treatise, *Money and Monetary Policy in Ancient Times*, that the direct evidence of legal tender on ancient Greek coins cannot be seen. However, he concluded:

It is beyond doubt that legal tender regulations existed in some form or other from the earliest times. No unit of account could come into general use until it was legally defined, and this [legal specification] would involve a statement of the means by which a debt expressed in the unit could be settled. . . . The Roman state fixed the rate at which coins were to pass, and presumably at this rate they were legal tender and had to be accepted. They were at no period merely punch-marked ingots to be placed in the balance at the option of the payee [Burns (1927) 1965, pp. 378–80].

Burns's study of the evolution of coined money suggests a Jekyll-Hyde sequence. While acting in a Dr. Jekyll capacity, the state saw to the certification of the weight and fineness of coined metal, and stamped the coins to verify their material content. In time, however, the state's coinage monopoly converted it into a Mr. Hyde. Both Greek and Roman heads of state learned to obtain real returns from seigniorage, and Roman rulers routinely debased the coinage for centuries (Timberlake 1988).

The Constant Problem with Bimetallic Standards

The ubiquitous coinage of both gold and silver, in conjunction with the prerogative of coinage that states had assumed for themselves, resulted in bimetallic standards. Since the relative resource costs of producing the two metals changed over time, the relative market values of the two monetary metals occasionally diverged from their proclaimed mint values and resulted in one or the other metal being exported. "Then the legislator altered the tariff [ratio of value],"

noted W. A. Shaw, and thereby became aware of the fact that the official mint ratio was the culprit of the "seduction." As a "further defence of a particular class" of either gold or silver coins, the legislator imposed "a limitation on the tender of such," so as to prevent bullion operations whereby the coin would be melted down. "This limitation," Shaw stated, "was the first development of [an explicit] law of tender" (Shaw [1896] 1967, p. ix).

The natural practice of two coined moneys and bimetallic standards for them, together with the wear and tear on the coins and the cupidity of monarchs, resulted in constant devaluation in weight and fineness of the coins. Concurrently, the growth of parliamentary powers that limited regal discretion, plus the emergence of the rule of law in political affairs, put constraints on the magnitude of the debasement policies. Shaw stated that, by the end of the 17th century, debasement "began to be impugned on theoretic grounds and in the course of the 18th century fell into disuse. Since that time [until the late 19th century] no Mint or legislative change . . . was made on the expressed value or [precious metal] content of any European coinage" (Shaw [1896] 1967, pp. 160–61). The practice of state manipulation of the coinage to obtain revenue ended. "In the domain of financial practice," Shaw concluded, "the mercantile system . . . ceased from the moment that the Governments of Europe left their Mint rates stationary, and gave the flow of the precious metals and the declaration of the ratio to the free unhampered natural action of international trade" (p. 161).

S. P. Breckenridge, a political scientist writing in 1903, carried out a more particular investigation of legal tender as it developed in British polity. "The power over the coinage was from pre-Norman times," she observed, "a part of the royal prerogative." The coinage power included the "determination of weight, alloy, and denominative value of *new* coin; the alteration of coin *already in use*; and legitimation of *foreign coin*." The king exercised this power by royal proclamations declaring the value at which coins should pass. All lawful money as indentured (specified) at the mints was legal tender unless explicitly expressed otherwise (Breckenridge [1903] 1969, pp. 9–22).

The English experience up to the time of Elizabeth suggests that the excesses of the royal prerogative stemmed, not from the power to define coinage denominations, but from the authority to specify weight and fineness in conjunction with the monopoly of coinage. The king with both powers had an expedient means to tax his subjects by debasing the coinage (Brough [1896] 1969, pp. 15–17). Few monarchs would have had the grace of either God or man not to have

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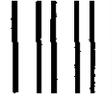
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abused these powers. However, from the time of Elizabeth's death in 1603 up to 1816, when silver was formally made a subsidiary currency, "the weight of the gold coins was altered [only] in order to secure the concurrent circulation of coins of both metals, but no change was made in the character of the silver coins" (Breckenridge [1903] 1969, pp. 43–48).

Both Shaw and Breckenridge disposed of, rather than treated, the momentous difference in polity that was a consequence of the shift in sovereignty from king to Parliament and an unwritten constitution. The prerogative of sovereignty was still there, but it was used only to secure the concurrent circulation of both gold and silver coin. When the impracticality of bimetallism finally became manifest, state policies in the 19th century swung over to gold monometallism and relegated silver to a subsidiary role (Shaw [1896] 1967, p. 164; Timberlake 1988).

Norms for Money in the U.S. Constitution

The place of legal tender in the U.S. Constitution reflects English experience, also that of colonial America and of the continental government in the post-Revolutionary era. The debate in the Constitutional Convention over the monetary powers of the states and of the federal government reflected various principles. Everyone wanted to constrain severely the issue of "bills of credit" (fiat paper money). Some delegates wanted to leave the question of their issue to the discretion of the federal Congress, but to deny such notes legal-tender status. Others wanted to prohibit them explicitly; while still others wanted to leave out reference to them altogether on the ground that if they were not part of expressed powers their issue would be severely limited but not barred entirely in case of emergency (Breckenridge [1903] 1969, pp. 76–85; Siegan 1987, pp. 23–26).

The money powers that the Constitution, as finally ratified, allowed Congress were, first, to coin money; second, to "regulate" (that is, to specify) the legal value of the coins in terms of a number of dollars. This coinage was limited to gold and silver. The Constitution also gave Congress the power "to borrow money on the credit of the United States" (Article I, Section 8). However, this power is not a "money power." For, though Congress borrows "money," the word money means "real income" or "real resources" for which the money is only a medium. In short, this power is a fiscal power and has nothing to do with creating money (Christiansen 1988, p. 427).

In the 70-plus years between the ratification of the Constitution and the first issue of U.S. notes, or "greenbacks," the federal govern-

ment on several occasions brushed against constitutional constraints with respect to the issue of currency. On two occasions it chartered Banks of the United States (1791–1811 and 1816–36). Both of these institutions were 80 percent privately owned and 20 percent federally owned, with one-fifth of their directors federal appointees. They were also much larger than their contemporary private competitors and had branches in every state where federal revenues might be collected or disbursed.

The Banks' constitutionality was a major concern in the debates over their creation and continued existence. Supporters defended them as constitutional on fiscal not monetary grounds. In doing so, they cited the first clause of Section 8: "The Congress shall have power: To lay and collect taxes, duties, imposts and excises, to pay the debts . . . of the United States." The constitutionality of both chartered Banks rested on their role as fiscal auxiliaries to the Treasury Department.

The Supreme Court upheld the Second Bank's constitutionality in the celebrated case of *McCulloch v. Maryland*, where the State of Maryland tried to tax the notes of the Baltimore branch and thereby drive it out of existence. The Court found that the Bank was a legitimate means for carrying out the fiscal powers of Congress (Dunne 1960, pp. 28–33).

Chief Justice Marshall wrote the famous majority opinion. First, he invoked the "necessary and proper" clause from the Constitution (Article I, Section 10) in order to justify the Second Bank's fiscal legitimacy. He thereby opened a Pandora's box of pestilences for future Courts to spread. Since the Bank was "necessary and proper" for carrying out the government's fiscal operations, it was constitutional. His synonyms for "necessary" included "convenient, useful, or essential," which, except for "essential," are not synonyms at all. The Bank's propriety, he wrote, rested on the argument that the ends it sought to achieve were "legitimate" and consistent "with the letter and spirit of the constitution" (Dunne 1960, pp. 29–31). That is, the ends justify the means.

If Marshall's interpretation is granted—and it certainly has arguable soft spots—it only justified the constitutionality of the Second Bank as a fiscal agent of the government, not as a central bank with positive control over the monetary system. The Bank's constitutionality, however, came again into question when it extended its fiscal operations to include regulatory powers over the banking and monetary system.

Some of those who recognized this emergence argued that such a development called for restraint rather than license. Henry Clay

stated correctly in the Senate that Congress had chartered the First Bank only to assist the Treasury in its fiscal functions. "It is mockery," he exclaimed, "worse than usurpation, to establish [the Bank] for a lawful object, and then extend to it other objects which are not lawful. . . . You say to this organization, we cannot authorize you to discount—to emit paper—to regulate commerce, etc. No! Our book has no precedents of that kind. But then we can authorize you to collect the revenue, and, while occupied with that, you may do whatever else you please!" (*Annals of Congress*, 11th Congress, 3rd Session, pp. 212–13; Timberlake 1978, p. 10).

Where the First Bank lost its bid for renewal in the Senate, the bill for renewal of the Second Bank's charter passed both Houses of Congress on two different occasions but was vetoed by President Jackson both times. Jackson may have had a prejudice against banks. Nonetheless, the reasons he gave for his vetoes had cogency. First, he contended that the monetary powers of the Bank were excessive and not restrained properly by its charter. Second, he did not admit its constitutionality through the "necessary and proper" loophole used by Chief Justice Marshall. The Bank was no longer a necessary fiscal institution at the time (1832), his veto message argued, because the national debt had almost been paid off. Therefore, the Bank could exist only for private profits, in which case government sponsorship and involvement were improper. Third, he argued that the Bank's execution of monetary powers as an agent of Congress was outside of Congress's constitutional powers. The mint was the institution to coin money, and "Congress passed laws to regulate the value thereof." In any case, the financial powers that the Constitution gave Congress had to be exercised by Congress; they could not be delegated to a corporation (U.S. Congress, 22d Congress, 1st Session, *Executive Documents*, Document No. 300, 16 July 1832, pp. 5–6; Timberlake 1978, p. 215).

Treasury Notes as Currency

Another monetary development in the first half of the 19th century was the issue of Treasury notes by the federal government. On several occasions, beginning with the War of 1812 and extending into the period between the end of the Second Bank and the beginning of the Civil War (1837–61), Congress authorized the U.S. Treasury Department to issue these notes as fiscal expedients—to meet unforeseen demands on the Treasury before revenues could be raised through conventional channels. Nominal amounts of notes appeared in the years 1812–15, again in the period 1837–42, in 1846–47, and

in most of the years between 1857 and 1861 (Dunbar [1897] 1969, pp. 302–5).

These notes were currency. They looked like conventional paper money of the period and, when issued in “small” denominations, were used as hand-to-hand currency. Because most of the notes were issued in large denominations (only rarely in denominations below \$20), and also because most of them paid market interest rates, many observers questioned whether they were money or “investments.” These features, plus the fact that they were receivable for government dues, made them very attractive to banks who used them as reserves for the expansion of their own notes and deposits, and as clearing media for adverse balances with other banks. The notes that the banks then issued were in the lower denominations that households and businesses needed for their daily transactions; so the moneys that the general public saw were commercial bank notes (Timberlake 1978, pp. 120–23).

The Treasury notes had other features that limited their monetary impact. First, they were authorized and issued in very limited quantities. In any given year, the least amount issued was around \$3 million and the greatest amount was about \$20 million. Rarely if ever did the stock of outstanding Treasury notes exceed 10 percent of the federal government’s expenditures for the year. Second, in addition to being a tender only for payments due the government, the notes were ordinarily not reissuable. Third, most of the time the acts authorizing the notes provided for their funding into long-term conventional securities. If their issue was repeatedly authorized over several years, Congress inevitably saw to their retirement by an explicit funding act (Dunbar [1897] 1969; Timberlake 1978, pp. 69–77).

These notes in their limited quantities and tenures were largely innocuous. Indeed, the circumstances of their issues tended to make them somewhat counter-cyclical (Timberlake 1978, pp. 72–73). No court cases ever tested their constitutionality for the very good reason that no one except the federal government, which had issued them, was ever forced to accept them. Banks readily held them as reserves, and their currency with the federal government gave them sufficient acceptability for virtually any private transaction.

Legal Tender Issues during the Civil War

The legal tender issues that the federal government made during the Civil War were of an entirely different genre. The most significant feature of the U.S. notes (“greenbacks”) was the provision that they be legal tender for all debts public and private; that is, they were *full*

legal tender. The second difference between them and the earlier Treasury notes was their sheer volume. All told, Congress authorized \$500 million by the Legal Tender Acts passed between 1862 and 1865. Their total outstanding dollar value in 1865, therefore, was on the order of 50 times the outstanding average volume of Treasury notes for the years in which the latter were issued. The third feature that distinguished them was that they were indefinitely reissuable; and, fourth, they were non-interest bearing. The property of being full legal tender was, of course, the most questionable aspect of their constitutionality. It was bound to be challenged in the courts, and it was, both at lower levels and in the Supreme Court (Hunt 1903, pp. 59–139; Breckenridge [1903] 1969, pp. 114–37; Siegan 1987, pp. 29–39).

Wesley C. Mitchell, in his *History of the Greenbacks*, spelled out the legislative history of the Legal Tender Acts. The bill authorizing the first Act was introduced by Elbridge G. Spaulding, a Buffalo banker. It was almost defeated in the House Committee of Ways and Means, and had other stiff opposition in Congress. In searching for arguments to justify so radical a departure from accepted practice and constitutional mores, Spaulding hit upon “the necessary and proper clause.” The bill for the U.S. notes, he alleged, “is a measure of necessity and not one of choice. . . . We will be out of means to pay the daily expenses in *about thirty* days, and the committee do not see any other way to get along till we can get the tax bills ready, except to issue temporarily Treasury notes” (Mitchell 1903, p. 47).

Spaulding and his cohorts, who sponsored the full legal tender provision, went to extraordinary lengths in arguing for the constitutionality of the notes. The substance of their case was that Congress could do virtually anything that was “necessary” to put into force its expressed powers.

Mitchell supplied evidence that soundly rebutted their arguments. He noted that “the issue of legal-tender notes, being neither a tax nor a loan, came under neither of [the] express grants” to tax or to borrow. A second argument—that the earlier issues of Treasury notes implied the right to make the notes full legal tender—was denied by the fact that previous issues of notes had been accepted without being full legal tender (Mitchell 1903, pp. 52–54).

By the time of the Legal Tender decisions, the Court also had in front of it the experience of the Treasury notes issued by the Confederate States of America. These notes had imitated the pre-1860 U.S. Treasury notes; they were tender only for payments due the Confederate government (Dunne 1960, p. 69n.). Nevertheless, they had suffered no lack of acceptance as long as the Confederate

States themselves survived, and they had depreciated less than the greenbacks.

Congressional opponents of the bill also pointed out that the resulting inflation would cause a real wealth redistribution, which in itself was unconstitutional and immoral. In addition, inflation would find the government paying substantially more to buy its war materials and services. The plea of "absolute necessity," however, won the day for the persistent proponents of the bill. It won over Secretary Chase, as well, and thereby made the bill an "administration measure" (Mitchell 1903, pp. 59–63).

"Necessity" had some validity insofar as taxation was concerned, although it was Congress's blunder in not having provided for new taxes in the special session of 1861 that rendered current tax revenues insufficient. However, the bill's supporters also dismissed the possibility of the government raising the necessary revenues by borrowing. Without even attempting to pursue this alternative, they alleged that (Horrors!) the bonds might sell below par, maybe at a discount of 25 to 50 percent (hyperbole) when issued at 6 percent interest. Mitchell observed the contradiction. "It is curious," he wrote, "to note the naiveté with which the most strenuous supporters of the legal tender bill asserted in one breath that it was a measure of sheer necessity, and in the next breath admitted the existence of alternatives" (Mitchell 1903, pp. 66–67).

Spaulding's allegation that the government would be out of means in 30 days proved to be a gross exaggeration. The Legal Tender Act did not pass until 48 days after Spaulding's ominous forecast, and no notes were issued for 34 days after the bill was signed into law (Mitchell 1903, p. 73). "Necessity" was stretched to cover any ephemeral "emergency" that would lend itself to congressional pragmatism.

The Supreme Court at the time of the first legal tender decision consisted of eight men. The Chief Justice was Salmon P. Chase, who had been Lincoln's Secretary of the Treasury at the time the Legal Tender Acts were passed. As Secretary in 1862, Chase had "reluctantly" granted their constitutionality. As Chief Justice in 1870, he led the majority of the Court that in the case styled *Hepburn v. Griswold* (8 Wall. [U.S.], 603) decided five to three against their constitutionality (Breckenridge [1903] 1969, p. 127; Siegan 1987, pp. 31–32). The *Hepburn* decision held that greenbacks were not legal tender for fulfillment of contractual obligations entered into before passage of the Legal Tender Acts. The Court did not adjudicate, and thereby it left undecided the question of the validity of such contracts entered into after the Acts (Kemp 1956, p. 26).

The Court in the *Hepburn* case held the following: (1) The power to bestow legal-tender quality on the notes was not incident to the coinage power; that is, issuing the notes did not require that they be made legal tender in the mode of gold and silver coins. They were not coined, but printed and issued as paper currency. (2) The war power requiring large expenditures of money was no more necessary for the issue of notes than any other governmental power to spend money. (In fact, in the four years between 1861 and 1865, interest-bearing debt increased by \$2,153 million, while the non-interest-bearing legal tender notes increased by \$458 million [U.S. Dept. of Commerce, *Historical Statistics of the United States* 1958, p. 721]. Thus, interest-bearing nonlegal tender debt was 82 percent of total debt and could have been 100 percent.) In so deciding, the Court observed that some notes had circulated that were not full legal tender, and these notes had not passed at a discount relative to the full legal tender issues. Therefore, the notes would have served the government's purposes just as well if they had been made a tender only for payments to the government as were the former Treasury notes. (3) Because the legal tender feature impaired the obligation of contracts, it violated the constitutional proscription against "bills of credit" (Article I, Section 10, 1) and the Fifth Amendment: "Nor shall any person be deprived of life, liberty, or property without due process of law" (Breckenridge [1903] 1969, pp. 128–29; Siegan 1987, p. 30; Hepburn 1924, pp. 275–80).

Supreme Court Reversal

Shortly after the Supreme Court ruled in the *Hepburn* case, Congress enacted a law that increased the number of justices on the Court from eight to nine. One justice had also retired, leaving two seats open. President Grant thereupon appointed two new justices who were in accord with his position that the Legal Tender Acts were constitutional.

The erstwhile minority on this question thereupon became a majority. On a motion from the Attorney General for further argument on the constitutionality of legal tender cases still undecided, the Court in 1871 in the case of *Knox v. Lee* reconsidered and subsequently reversed its previous position (Siegan 1987, p. 32; Hepburn 1924).

The five-to-four majority of the Court that now sanctioned government issues of legal tender notes based its decision on essentially the same arguments that had appeared in Congress nine years earlier. It also held that U.S. notes were legal tender for fulfillment of con-

tracts made before passage of the Legal Tender Acts (Breckenridge [1903] 1969, pp. 131–32; Siegan 1987, pp. 33–34; Dunne 1960, pp. 77–81).

A new element entered the picture here. Not only were the notes legal tender, but the Court held that the question of their issue was “political” and not judicial, and therefore depended on Congress’s estimate of the urgency of the express power it was exercising. “Thus,” Dunne noted, “judicial appraisal of legal tender began by considering it as a provisional wartime expedient and closed by investing it with a legitimacy that was both permanent and *beyond judicial control*” (Dunne 1960, p. 83; emphasis added). The Court in rendering the *Knox* decision ignored Congress’s memo to itself that U.S. notes were a temporary, wartime expedient (Hepburn 1924, p. 263), and also ruled that whatever Congress legislated as “necessary and proper” was not subject to judicial review. This ruling is all the more threatening to constitutional safeguards when the “necessities,” as Congress perceives them, prove to be nothing more than political expediencies.

A third legal tender case, *Julliard v. Greenman*, was decided 13 years later in 1884. This case dealt with the question of whether the U.S. notes made legal tender in time of war were also valid as legal tender in time of peace. The Court ruled that they were by a vote of eight to one.

In so holding, the Court argued that the legal tender power was a prerogative of the sovereignty of the federal government. The *Julliard* decision stated:

Congress, as the legislature of a sovereign nation being expressly empowered by the constitution to . . . “borrow money on the credit of the United States” and “to coin money and regulate the value thereof” . . . and being clearly authorized as incidental to the exercise of those great powers to emit bills of credit, . . . and to provide a national currency for the whole people . . . , and the power to make the notes of the government a legal tender in payment of private debts being one of the powers belonging to other civilized nations, and not expressly withheld from Congress by the constitution, we are irresistibly impelled to the conclusion that the impressing upon the Treasury notes of the United States the quality of being a legal tender in payment of private debts is an appropriate means, . . . consistent with the letter and spirit of the constitution, and therefore . . . “necessary and proper for carrying into execution the powers vested by this constitution in the government of the United States” [*Julliard v. Greenman*, 110 U.S. 421 (1884)].

Justice Stephen Field, the only justice remaining from the panel that previously held the Acts unconstitutional, wrote a dissenting

opinion in the *Julliard* case. "Of what purpose, in the light of the tenth amendment, is it, then," he asked, "to refer to the exercise of the power by the absolute or the limited government of Europe or by the states previous to the constitution? Congress can exercise no power by virtue of any supposed inherent sovereignty in the general government. Indeed, it may be doubted whether the power can be correctly said to appertain to sovereignty in any proper sense as an attribute of an independent political community" (*Julliard v. Greenman*, 110 U.S. 466; Breckenridge [1903] 1969, p. 136).

Breckenridge noted, after citing Field's correct interpretation, that "this objection . . . gains force when it is realized that for an analogous act on the part of the English government, from which American ideas of sovereign power are drawn, we should have to go back to the reign of Henry VIII" (Breckenridge [1903] 1969, p. 136).

Political Influences in the Court's Decision

Supreme Court validation of the Legal Tender Acts had many political factors supporting it. The Grant administration and the Republican majorities in Congress openly favored constitutionality. All of the Supreme Court majorities that upheld the Acts were Republican appointees, and all of the favorable decisions in state courts came from Republican judges. The two appointees of President Grant who swung the Court to a majority that upheld the Acts were appointed because their pro-legal tender position was well known from state court decisions (Siegan 1987, pp. 32–34; Breckenridge [1903] 1969, pp. 130–32).

Economic events also contributed to judicial pragmatism. By 1870–71 the notes had been in use for eight years. Prices had long since adjusted to the new money; most of the changes in real values had been capitalized. Any shift in the legal relationships of money to gold might have upset the contemporary price level equilibrium (Dunne 1960, pp. 81–83). The premium on the gold dollar by this time was only 12 to 14 percent, which might have implied that resumption of gold convertibility for paper money was imminent. Nonetheless, the Greenback Party and its sympathizers in the Democratic Party in favor of "cheaper" money had begun to make political waves. The Republicans in the face of this developing ideology did not want to jeopardize their ongoing political control. They were, therefore, handmaidens to the monetary status quo (Timberlake 1978, pp. 108–19; Unger 1964, pp. 173–78).

In succumbing to political pressures, the Supreme Court emasculated every monetary principle that the Framers had included in the

Constitution. If the justices who handed down the decisions in the latter two Legal Tender Cases had compared the character of the monetary system after their decisions with the system that the constitutional Fathers clearly had envisioned, they would have had to confess that they were guilty of blatant judicial improprieties.

Perhaps the most notorious and fallacious line of argument used to support the *Juilliard* decision is as follows:

1. The federal government through the Congress has the right to *borrow* "money."
2. It has, therefore, [a complete non sequitur] the right to *issue* paper money ("circulating notes") for the money borrowed.
3. It also has the power to coin metallic currency and declare the value thereof.
4. Because Congress has both the right to issue "circulating notes," which are currency, and the power to impress gold or silver coin as legal tender, "under the two powers, taken together [sic], Congress is authorized to establish a national currency, either in coin, or in paper, and to make that currency lawful money for all purposes" (*Juilliard v. Greenman*, 110 U.S. 421 [1884]).

Alva R. Hunt cited this argument as conclusive in his treatise, *The Law of Tender* (1903, p. 137). It is, however, nothing but fatuous nonsense parading as judicial "logic."

James Madison in *The Federalist* (No. 44) stated explicitly just what the Framers had in mind:

The extension of the prohibition to bills of credit must give pleasure to every citizen, in proportion to his love of justice. . . . The loss which America has sustained since the peace [after the Revolution] from the pestilent effects of paper money . . . constitutes an enormous debt against the states chargeable with this unadvised measure, which must long remain unsatisfied; or rather an accumulation of guilt, which can be expiated no otherwise than by a voluntary sacrifice on the altar of justice of the power which has been the instrument of it [Madison 1971, p. 227; emphasis added].

In the light of such a powerful denial, is it even conceivable, much less arguable, that the Constitution "clearly authorized [Congress] to emit bills of credit and provide a national currency . . . and make the notes of the government a legal tender in payment of private debts" as the *Juilliard* decision asserted, and as Chief Justice Chase had claimed in a previous decision? (*Veazie Bank v. Fenno*, 75 U.S. 548; Christiansen 1988, pp. 429–30). In no event did the Framers set up what they felt was an impregnable document only to subvert it

with a “necessary and proper” clause. This clause meant *eminently* necessary and *strictly* proper. It was not a license to allow future Courts a means to excise all the vital principles that protected the individual from the state (Siegen 1987, p. 38). Nor could the Founding Fathers have denied the states the power to emit bills of credit and then implicitly condoned the same power for the federal government—a political entity they trusted even less. As William Brough stated: “Had a paper circulation been contemplated, discussion upon this point, followed by the embodiment of specific rules for its regulation, would have been inevitable” (Brough [1896] 1969, p. 131).

The Relationship between Sovereignty and Money

Another economist of the era, A. Barton Hepburn, in his book, *A History of Currency in the United States*, first published in 1903, summarized the Legal Tender decisions both pro and con. He then analyzed the ultimate decision that argued the constitutionality of the greenbacks on the basis of governmental sovereignty.

If Congress had the power claimed by the Supreme Court majority, Hepburn argued, it could have issued fiat paper notes unceasingly and paid off its bonded indebtedness with them no matter how much the notes depreciated. “Why then,” Hepburn asked, “should the government continue paying interest on the bonds when the principal might be paid in a day?” He cited George Bancroft, author of *A Plea for the Constitution*, who stated that the “unalterable purpose of the framers of the Constitution [was] to prohibit legal tender paper. . . . [The federal government’s] powers were clearly *limited*. It had no inherent sovereignty, but only that delegated to it by the Constitution.” Even European sovereignties, Bancroft pointed out, “had *not* the power of making notes legal tender” (Hepburn 1924, p. 266).

Field’s, Breckenridge’s, and Hepburn’s interpretation of the quality and disposition of sovereignty concurred with that of James Monroe, a member of the Constitutional Convention and fifth President of the United States. In the book that he wrote near the end of his life, *The People, The Sovereigns*, Monroe analyzed the principles in the basic structure of American polity that served to distinguish the political culture of the United States from other republican peoples. He noted that both National and state governments were independent of each other, “and sovereign to the extent, and within the limit of specified powers. . . . Both governments rest on the same basis, the sovereignty of the people” (Monroe [1867] 1987, pp. 3–4).

Monroe’s central thesis on sovereignty is a lesson for everyone who aspires to maintain the existence of a free society. “The terms

Sovereignty and Government,” he observed, “have generally been considered as synonymous.” To Monroe and other Framers of the Constitution, however, separating the two was an essential feature for an enduring democracy. Only “by the institution of a government by compact, to which all the people are parties,” Monroe argued, could sovereignty be maintained distinct from government. “Thus the Constitution becomes the paramount law, and every act of the government, and of every department in it, repugnant thereto, void” (Monroe [1867] 1987, pp. 7–8).

Monroe offered “two great principles [that are] fundamental and invariable, in regard to government, in which the people hold the sovereignty—first, that the government be separated from the sovereignty; the second, that it be divided into three separate branches, legislative, executive and judicial, and that each be endowed with its appropriate powers, and be made independent of the others” (Monroe [1867] 1987, p. 13). The import and direction of these words from a Founding Father are self-evident. This same argument appears in Edwin Vieira’s recent study on the monetary powers of the Constitution. On the basis of much evidence, he concludes: “In America, only the people were ‘sovereign’—and, therefore, the government’s authority was non-existent in those [monetary] areas no matter what branch attempted to act” (Vieira 1983, pp. 83–85).

An even earlier writer than Monroe, Adam Smith, discoursed at length on the proper role of the sovereign. In his fundamental work on economics and polity, *The Wealth of Nations*, Smith devoted two full chapters to the functions of the sovereign and the legitimate means he had for obtaining the revenues due him.

The sovereign had three principal functions according to Smith. “First, the duty of protecting the society from the violence and invasion of other independent societies; secondly, . . . the duty of establishing an exact administration of justice; and, thirdly, the duty of erecting and maintaining certain public works and . . . institutions, which it can never be for the interest of any individual or small number of individuals, to erect and maintain.” Such works consisted of good roads, bridges, canals, and harbors (Smith [1776] 1937, pp. 651, 682).

The sovereign would get revenues primarily by imposing various kinds of taxes, by obtaining rents from public lands, and by operating post offices. In time of war the sovereign’s immediate need for resources was an excuse only to borrow in lieu of taxes, and not any reason at all to tamper with the currency. Devaluations and debasements of the currency cause “a general and most pernicious subversion of the fortunes of private people; enriching . . . the idle

and profuse debtor at the expense of the industrious and frugal creditor." Depreciation of the currency, Smith concluded, was a "treacherous fraud" (Smith [1776] 1937, pp. 883, 885). In 168 pages of text Adam Smith found no license for the sovereign either to debase or devalue the coin, or to issue legal tender paper money. The sovereign had prerogatives and rights, but none with respect to the currency.

In another section in which he discussed the gold and silver contents of guineas and shillings, Smith observed that the government's role was only that of "reforming" the coinage to adjust for wear and tear on the coin. Just two years earlier (1774) such a "reformation" of the English coin had occurred by which gold became the *standard* money metal, while silver was invested with legal tender quality only for small-sum transactions (Smith [1776] 1937, pp. 40–46). This action had included no reduction of the metallic content of the coinage (Breckenridge [1903] 1969, pp. 46–48). Indeed, the gold value of the pound at the English mint was essentially constant from 1665 to 1914 (Jastram 1981, p. 9).

Smith admittedly was not a political theorist. Nonetheless, he was a complete scholar of his time, and his exegesis therefore reflected current norms for what was regarded as acceptable practice in the sovereign's management of the state.

The alleged "prerogative of the sovereign over the coinage" had been anything but an unlimited power since the time of Elizabeth. In no sense was it the absolute power implied by the U.S. Supreme Court's decisions. It was, in fact, nothing more than a license to make minor adjustments in the mint values of gold and silver that would keep both metals current in the monetary system. The technological development of paper currency and paper checks obscured for later observers just how important marginal mint-price adjustments had been for the continued presence of both metallic coins in the payments system. These occasional and fractional changes gave latter-day 19th century jurists the false notion, or perhaps only the false excuse, that the state could do anything it wanted to the mint values of the currencies (Vieira 1983, pp. 102–18).

The Redress of Monetary Grievances

What could the Supreme Court have ruled to maintain practical monetary equilibrium in 1871, given the outstanding quantities of notes? It could, first, have avoided making "ex post facto Law or Law impairing the obligation of Contracts" [Article 1, Section 10] by acknowledging that contracts drawn prior to the Legal Tender Acts were payable in the medium stipulated by the contract, as the first

Legal Tender decision had ruled, and that contracts not specifying the means of payment were payable in whatever was current money when the contract was made (Kemp 1956, pp. 25–32). Since most of the contracts in force at the time of the legal tender decisions had been made after the Legal Tender Acts were passed, payments in depreciated paper currency would have provoked no grave injustice nor financial disequilibrium. In any event, the terms in every contract should have determined each case and thereby minimized real losses due to inflation (Brough [1896] 1969, p. 135).

The Court could have declared the greenbacks unconstitutional as a forced tender for private debts, but a valid tender for all payments due the government. Congress could then have enacted a law that had the Treasury convert all the notes into the older form of Treasury notes before reissuing them. When the government achieved resumption of specie payments (as it did on January 1, 1879), the notes would have been simply another form of limited legal tender government currency, similar to national bank notes and silver currency, maintained at par with gold by redemption on demand. Such a policy would have allowed the economy to adjust with hardly a tremor. As the episode ended, however, the constitutional barriers to government-issued fiat paper money had been breached forever.

The general thrust of policy by the three branches of the federal government at the time of the Legal Tender Cases was to work the limits and margins of the Constitution by means of any conceivable chain of reasoning in order to extend the federal government's authority and influence over the monetary system. The three branches should have sworn fealty to the Constitution and taken every precaution to preserve its original monetary principles, even in the midst of the Civil War. Instead, Congress passed laws in 1862 and 1864 prohibiting private coinage of both fractional currency and of gold and silver. It passed a National Banking and Currency Act (1863 and 1864) that effectively proscribed the competitive issue of bank note currency and severely regulated bank enterprise. The Act also specified the limit of national bank note currency (\$300 million) and set up bureaucratic machinery to allocate this total among the national banks. Finally, it "temporarily" issued \$500 million of full legal tender paper currency and kept \$347 million of it in existence forever. Congress did all these things on its assumed prerogative of sovereignty. In fact, no branch of the government had sovereignty; and even if Congress itself had had the sovereignty the Supreme Court claimed for it, it had no express power thereby to violate the monetary system. There was no precedent in Anglo-Saxon law for what was done. "Sovereignty," stated Breckenridge, "in the sense

in which it had inherited in the English kings, had passed to the people not to the government of the United States. So much of the right of English monarchs as had been derived from the doctrine of unlimited and prerogative power was wholly [beyond] the sphere of federal power" (Breckenridge [1903] 1969, p. 91).

The Government's "License" to Create Money

Economists, with a few exceptions (Kemp 1956; Christiansen 1988), have not examined the monetary norms of the Constitution, nor contrasted them with judicial interpretations that emerged following the Legal Tender Acts. They have deferred judgment to the expertise of political scientists and jurists. Most of the latter have accepted the opinions and interpretations of the Supreme Court, which extended the federal government's discretion over the monetary system. Without enlightenment to the contrary, legal analysts have implicitly and innocently assumed that a monetary system must have human design through a ruling political authority. The legal tender decisions may have stretched the boundaries of the Constitution but, they argue, this license was a necessary adaptation to preserve a viable monetary system. Thus, economists have been demure, and jurists have been pragmatic. James Willard Hurst, for example, argues that the Framers were primarily concerned with control over the money supply when they inserted the money clauses into the Constitution. His arguments, however, are *ex post*—not *ex post* the Constitution, but *ex post* the intrusions of Congress and the Executive in the Civil War era and thereafter, and *ex post* the Supreme Court's ratification of Congress's role (Hurst 1973, e.g., pp. 12–13, 35–37, 42–46, *et passim*; also Hunt 1903, pp. 61–64; and Dunne 1960, pp. 100–103). Over the decades since the 1880s, the notion that money must be formally managed—that its presence cannot be trusted to the spontaneous forces of the market—has become the conventional wisdom.

This conclusion, regardless of the majority that accepts it and its specious juridical "validation," flies in the face of money's origins. Money, like language and law, unquestionably arose as a product of human interaction in economic markets, not only without an assist from political authorities, but often in spite of them. This emergence suggests not only the possibility and feasibility of a market-determined monetary system, but also the desirability. A system that arose spontaneously is hardly likely to be improved by the coercive designs of political and judicial planners.

Nonetheless, whenever monetary systems appeared, the state was not far behind. Invariably, the state's presence and control was marked by debasements and inflations, until the momentous constitutional sea-change that took place in England in the 17th and 18th centuries. Metallic standards became the means by which constitutional norms constrained the English monarchs' monetary excesses. American experience accepted and enlarged upon the English original.

The Civil War and post-bellum adjustments proved to be too much for constitutional barriers. From 1862 on, law after law and judicial interpretations thereof constantly eroded the monetary norms of the Constitution, until today the U.S. monetary system is the complete antithesis of everything the Founding Fathers prescribed.

The evidence collected in this paper argues that the U.S. government has never had any license to create money. The alleged prerogative of the state to control the monetary system through a legal tender power is a juridical myth. Only people have sovereignty, the Founders stated; and the only way that the people can "control" the monetary system is to divest this power (without license), which the federal government has assumed, and redirect it into its proper channel by an explicit act. The sovereignty of the people is seen in free, private, competitive markets for money as well as for all other goods and services. Only economic markets operating under the rule of law can provide a vehicle of the requisite kind. Ultimately, scholars in retrospect will acknowledge this principle. "Every civilised country," they will state, "has learned to separate the production of money from the necessary and proper functions of the state."

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