Modern Money Network, The "Money Series" 2012-2013

5. MONEY, DEMOCRACY AND THE CONSTITUTION: *REVOLUTIONARY EXPERIENCE IN THE UNITED STATES*

Gillian Metzger: So we've got a great panel of speakers today. Christine Desan is going to go first, she's a professor of law at Harvard and her scholarship, she describes, explores money as legal implicable project: one that configures the market rather than simply serving as a tool for exchange. And she is currently writing a book, *Making Money Coin Credit and the Coming of Capitalism in the Anglo American World*, which will probably come up in her remarks. Farley Grubb, who will be next, is a professor of economics at the University of Delaware and a research associate at the National Bureau of Economic Research. He has published many articles on monetary regimes during the colonial and early republican periods in U.S. history and will be talking about that today. And then third is Woody Holton who is Peter and Bonnie McCoslin's professor of history at the University of South Carolina. He is an expert on the American Revolution, on which he has published several books, and he recently received a national endowment of the humanities scholarship to write a fourth book: *Liberty Is Sweet-An Integrated History of the American Revolution.* I will take this chance to remind you all to turn off beepers, phones, anything that plays music, you name it so that we're not disrupted during the presentation. And I'm going to turn it over to Christine. [1:32]

Christine Desan: Thank you. So first I want to thank Rowan and Gillian for doing this. Money is at the heart of the modern moment. It's clear that we can't resolve the financial crisis, let alone build a strong society without understanding how it works. You can't open the newspaper without reading about the Fed or the European Central Bank/Bank of Japan. The striking thing is that money has always been at the heart of the moment and the heart of the American political economy. I'm going to talk today about an even earlier Constitutional moment, earlier probably than everyone suspected I was going to talk about, as will become clear. But to come back to him and to Gillian, we've been neglecting money as a Constitutional project. We've been neglecting it as a legal institution, a matter of governance. We have to make it our focus, I'm convinced, as lawyers. It's too important to leave to another discipline, as it were. Early Americans did not, as we will see, neglect money. It was at the heart of their political debates, and very important debates. So that's all by way of thanks for creating this forum and for running it.

So I'm giving you theme for my talk today which is money as governance. I want to take that at a very elemental level so I want to talk about the creation story that's usually told about money and I want to contrast it with an alternative creation story. My claim is that these myths are enormously important. They influence the way we think about money, they make coherent money for us and therefore we make policy in their wake or by that image. I think if we want to see money as governance we have to rethink the traditional views, we have to rethink the traditional myths. So what is the traditional myth? Many narratives stage the start of money in a kind of wild, primal place with the simplicity of an early world. In that conjured space, exchange is kind of a murky broth of barter. So people barter in this primal space. People trade all sorts of object between themselves: goats, cheese, silver, labor and in this fluid mix of exchange, they increasingly find silver or gold (let's take silver) especially easy to give and take so that metal, like fat, kind of rises to the surface of this bartering society. It becomes a favored medium and marker of exchange as it's passed from hand to hand. People eventually cut silver and gold into little pieces, into little disks of commodity. Those become coin. The brokers of this commodity, buyers and sellers, converge upon these disks and use them to mediate transactions. So you've all heard the story, right? Content changes over time, government becomes involved after a while as society becomes more complicated. The government begins to mint money for people, making it more convenient, more regular for people to use. And in fact that's basically what government is doing, it's regularizing a commodity that's passing between people.

Eventually banks begin to give out paper representations of silver or gold coin. And after a bit people are willing to hold the paper and forego the gold, right the gold deposit. The government again, as a secondary agent, comes in, it gets involved to act as lender of last resort to stabilize this system that we've got going. So here's the point if you think about this story. Money is rooted in the exchange of private actors. It's either a commodity, like gold or silver, or its a convention like the agreement to take banknotes instead of demanding the gold deposit. The government is a secondary actor. It provides basically technical services not political judgment. As Karl Menger put it "No one invented it, money is a natural product of human economy" [6:01] So via this image of people trading and all converging toward the most tradeable object which was silver or gold.

Now I assume if you're in the room you've probably moved beyond this simple story. You've thought about it. The Chartalist or Modern Monetary Theory folks, I think you've heard from or have come to speak, argue that money is based on the tax obligation, that it's a kind of credit and debt. And I think that's right. I think they've got the right point, but that doesn't give us a story that attends to liquidity value, what it is, right? What it is, they haven't given us a story that tells us about the collective or constitutional work that creates liquidity. So to say tax obligation, credit/debt is to start talking about law, but we don't have the structure, the system that creating credit and debt. We don't have a story about how one makes, how a society makes a unit of account. We don't have a story about the mode of payment surely showing a legal concept. We don't have a story about how things become a medium of exchange as any of you who are in law school know, as anyone who teaches negotiability knows. That's also a legal concept. We haven't connected any of those functions which we assume and attribute to money to the tax obligation. We haven't figured out if money is tied to the tax obligation. [7:35] How early governments moved beyond money that was so tightly tied to the fiscal activity that money that would have ebbed and flowed as their spending and taxing rose and fell. We haven't explained if there is a connection between taxes and money, why it's obscured, right? Why we seem to forget about it all the time. Why then, we can revert to a story about money as barter.

So the question for me is can we tell a story of the beginning of money that reveals money as governance. So I think the answer to that is yes. Money, it turns out, is a constitutional project, constitutional small "c." We are going to get Constitutional, big "C", when these guys take over. Making money is a way to mark and mobilize material value both for the government and for individuals by their interaction. And contrary to their intuitions, making money requires less political prowess or bureaucratic capacity than coordinating inkind contributions from many participants. Making money starts in the center, not in the decentralized exchange of barter. It starts at the center, money makers can work selectively and with limited information and yet inlist the contributions of a broad group. It depends on a basic pact. So here's the pact that makes money.

Participants advance the time value of a resource to the government or to, in my story, the proto-government. In return for that actor's unique ability to create liquidity, to create a way to count value, the people will give and take in payment. So I want to try and tell that pact as a story now and hope to leave a stage for the monetary debate that the Americans carry out. So here's the setting.

If we take the beginning of money seriously, that is, if we take seriously the proposition that there's a society without liquidity. Then we arrive in a place that's dramatically drier that the broth of barter the people imagine when they start talking about money. So there's no unit of account or shared means of understanding or valuing, measuring things. There's no universal mode of settling accounts. There's no common medium. There's no activity that produces price, whether in grain or in barley or in the shadow the liquidity the imagination of silver. Nothing rises to the surface in really primitive societies, certainly not silver. We're talking here about subsistence households. When we can talk about the dark ages if you want, which I've done historical work on. If subsistence households are transferring anything or setting aside anything to transfer to each other it certainly wouldn't be silver which you can't eat, right? Which has no use value for the moments when you can't use it for exchange.

So there's no exchange outside of barter and barter is likely far from the kind of awkward triangles that economists imagine when they talk about barter. However people transfer goods and services between themselves depends not only on how they value those things, but on what practices of claiming, using, giving, and taking exist in a society. Why would we assume norms of property and contract that supported transfers of goods in a world like this if we don't have a government that's actually building property in contract. [11:15]

But, the transferring of goods between individuals that agents in the kind of liberal barter story that I told at the beginning is a far easier matter than mobilizing resources among a group. So imagine the challenge to a group in a world without liquidity so let's say it has to fight a war or defend its territory. It might do that by coordinating and redistributing many inkind contributions but that's really hard, right? You have to actually coordinate all these inkind contributions and get them where you need them when you need them. The Americans basically fought the last year of their revolutionary war on that basis and it was tremendously difficult, right? Impressing and moving goods. It was a near thing, right, a disastrous way to run a war. Compare the alternative. So the alternative is actually using money to measure and mobilize value even as it creates liquidity for individuals. So how do we do that?

We start in the same society we were in, a barter kind of society that is a society without liquidity. In this society, the only kind of contributions that a government can levy, can ask people for, are inkind contributions, right, because there's no liquidity. So everyone has to make a contribution to the society. Let's imagine that there's a council at the center or a warlord quite often, or some kind of chief at the center and within this regime every animal every family owes a month of military service or inkind service to the center. That's collected once year, we'll do it all at once to keep things simple we could have imagined a more staggered system but let's say that once a year everyone goes in and performs their work for the center. The money moment occurs when the people at the center realize that they could offer families a token that exonerates them from their inkind say military service. In return, they can offer that token in return for their military service or its equivalent, what the family is willing to give now. So let's say their military service is due in December, government realizes it can actually offer them a token if they're willing to do that now, to contribute now. The government, if the government can do that, it can spend, right, it can choose whose labor or whose goods or the equivalent, whatever people are willing to give that month of inkind work. The government can pick the goods and services it needs and it can pace its purchases. It can bring to the center exactly what resources it needs by spending. So then the question is how about the families considering the offer that's been made by the government? Why would families that owe a monthly military service or an inkind obligation like that give it to the government for a token early? What could they do with the token from the government?

So families in this world will accept the offer if they can use the token in the meantime. Between the time that the government offers them the token and the time that the military service or the inkind service is due, right, if they can use the token. If they could give it, for example, say that they go and do a month of work in January which is when the government actually wants, say, labors to build a fence, something specific, they might do that if they can give it to another family at the end of January in return for sheep. The second family might take it if they can use the token in the meantime because the second family is figuring in the meantime we could actually give this to another family because we need help in building pens for the sheep that we continue to have. That family might take the token if they can use it in the meantime, right, before next December. Families, in other words, you see where I'm going, are getting liquidity use, liquidity value out of this token, something that's otherwise nonexistent in their world. [15:42]

By the end of November, right, by the end of October, let's say, the token passes to someone right before the annual military service is due. He gives just barely more for it than he owes the government, he's right up against the deadline say he's willing to take it from the builders for 35 days he'll give them 35 days labor throughout the month of November and a little bit of October because he really doesn't want to go there in December. He doesn't want to go to the government and do his military service in December so he takes the token and he turns it into the government. He can't pass it on, right, the token's about to expire. He reminds us that a token is worth at a minimum the exoneration of the tax obligation, right? If the government gave out 500 tokens to early, it will get, in December, if all these tokens circulate, 500 tokens back, not from the families which it gave, they still owe military service. But to whoever's holding it, and it's already gotten 500 tokens worth of service and now it gets back those tokens. So the token always retains the fiscal value, the value of exonerating some of the tax obligation. And it had, during its currency, a liquidity value.

So if you notice, we have money in that situation so let's look at how we have money. The government created a common measure when it started handing out 1 token for each inkind obligation. It created a common unit of something that was not fungible, right, that other people could not trade. No one else could do that but the coordinating, right, authority. The mode of payment, this is worth another moment. You'd be right to assume that the government must work as a mode of payment to the government at the end of the period. But the government, the center, whoever this warlord is or however many people we have, will also want to enforce the use of tokens between families because the government is enforcing, as the government enforces the use of tokens, enforces these agreements, its enforcing its agreements, right? It's enforcing the agreements that allow its money to travel through society. So we have here the common law in England which enforced only those agreements that were made for monetary obligations. It was a monetary payment that settled a debt in England. And it's the common law, it's these enforcement opportunities in which the government is actually enforcing the transfer of a token in which we get the working out of concepts like property and contract. In which we get the development of those parts of law that regulate exchange. Those rules will of course influence the way people make decisions and the market that's created with these tokens. Finally, you can see that the legal enforcement and acceptance of the token that has been made allows the token to operate as a medium of exchange. So the token is supported, the government is supporting tokens in a way that allow them to travel between people who can't take for granted negotiability. In fact, what we have here is authorities that are, and have good reason to enforce negotiability. The government, at the end of this process, takes back the token without asking to whom it originally issued the token. If it did that, it would make it non-negotiable. As you know from your law classes that the plausible way to create credit is to take a token back from whom you gave it, not from anyone indiscriminately who is holding it. If the government takes it back indiscriminately it's supporting the transferability of a token. So, now if you think about this situation we have the functions that economists assume attribute to money: a unit of account, a mode of payment, a medium of exchange. They're not just natural events, they're actually legally engineered events. They're collectively orchestrated events. Notice that we also have a market. So how do we have a market? First of all we have prices. So prices are worked out for the first time these people make trades. They have no capacity, they had no capacity to do that in a way that created a common medium before. The prices are dependent on the kind of money in circulation. They're worked out in very particular circumstances, right, so we might have a situation which the government issued 1000 tokens, spent 1000 tokens that made their way to 1000 families that have that obligation to turn in a token or an inkind obligation. And all those families make the deals that they make to get the tokens from say the soldiers who initially have the tokens. So the market, evaluation on the market is determined, in many ways by those initial/starting conditions. Prices also depend, we've already mentioned, on the deals the government will enforce. So contract and property, conceptions that are developed as the government is enforcing transferability, and as the government decides which exchanges it will enforce. The market, then, is a very contingent matter so we might have a market in which a goat is worth 1 token, a cow is worth 1 token, but in no sense, in no real sense, is a cow worth a goat. They both have been rendered commensurable through a very particular medium. Take away the medium, you take away the equivalence. No one is going to give a cow and a goat, no one is going to trade them in that way.

Okay, so let's step back and just look at the phenomenon. I'm going to wrap up soon. What's constitutional about this? It's constitutional because we have this very collective engineering event. The government is able to measure and claim resources, able to spend, ultimately injecting money in what might be quite a narrow way, running through a narrow expenditure. But mobilizing a much larger catchment of contribution from people. [22:01]

People gained liquidity in return for their advance of resources. So they advanced resources before they were due, either to the government or others who held tokens before they were obligated to do so. But they got liquidity, a rare thing of this world, in return. So a last note here, and we can talk about this more in the questions, I don't want to take up more time but I do want to just flag a few things. There are lots of areas for monetary experimentation that would enrich and layer the model that I just gave you. So our money has problems that would disturb exchange if you think about the money that I laid out for you and there are different ways that societies can and have dealt with those problems. So to name a couple obvious ones, my money had a time discount, it was losing liquidity as it traveled because you had less time to send it on. Money was worth the most when it first entered circulation. There are different ways that societies have dealt with that problem. They have rolled expenditure and taxing dates or have made indistinguishable the token and the expiration date of the token. Think about silver coin, how that silver coin operates. There's a bigger problem that I'll just mention which is we had in my society very erratic spending and taxings. And the money supply depended directly on the fiscal activity of the government. But what if people want to make more trades than that? If they want more liquidity than the number of tokens than the government put into circulation? [23:33] There are a lot of possibilities that we could engineer as part of this constitutional project. They would sit on top of the fiscal infrastructure of money. They would depend on it, but they might very well obscure it.

So for example, we could sell people money to supplement the money that was in circulation. So what I would offer to you is exactly what the medieval mints were doing when they sold coin. And as an entree for Farley, it's what the land banks were doing (I don't know if you're going to talk about land banks) in the colonial world. We could also license other actors to sell money like commercial banks in the different world if we want to expand the money supply. Note that when societies do these things, when they elaborate their monetary designs, they become quite complicated, they become quite different, they become quite distinct. It's all very fertile ground for lawyers to actually think about how the monetary system is going. Each of these monetary innovations would matter enormously, each of them would distribute profits in a different way to the government's mints, to the commercial banks. Each would influence us to think about money in a different way. If the government's minting it, we think of money as sovereign. If the commercial banks started making it, we would think of money as a product of investment decision, as made by investment decisions. Those decisions about how to channel money and how to think about it were at the heart of the constitutional moment in 1789, they're a part of the constitutional moment today, and I think we are returning to them with a real sense of urgency. [25:18]

Farley Grubb: Could I get one of the technical Gods to come turn me on? Is it also possible maybe to easily change the resolution back to the original? Because I think whatever we changed that we're losing my slides. Okay, I apologize I have some slides we have a resolution problem so anyone out there who wants these slides, my name is Farley Grubb. You can Google that and you'll get me and I'll send you these slides. So let me begin, I'm going to, wow that was big Chris, I'm going to pull it down a lot smaller. So I'm going to talk about a much smaller issue, something I can wrap my brain around. I'm going to focus on legal tender laws, and I'm going to argue that legal tender laws were the core conflict over money creation in the constitutional era. That it was the one structural element in creating paper money that got debated, that got objected to, that got manipulated. In fact, in some ways it may be the only feature of money that we can talk about in that way.

We take legal tender laws for granted today. Here's a picture of our dollar bill you can kind of see, but written on our money it says "this note is legal tender for all debts public and private" [27:00] And we don't think anything about that. We don't think it affects us. It's there and we don't care because it doesn't seem to matter, right? We go back to the Constitutional era, it was a big time conflict. So let me go back in time.

We're going to the Constitutional Convention, May 1787 to September 1787. Now in terms of monetary powers, Congress had the power to emit paper money. They had done this through the Revolution, the famous continental dollar. In the draft Constitutions, up until August at the Constitutional Convention, Congress still had the power to emit paper money. This was a power listed in their enumerated powers. On August 16, Gouveneur Morris moved to strike the power to emit paper money from the list of powers, the explicit list of powers given to Congress. Again, this would be a major change. Congress had had that power. It had that power in prior drafts. In response to this, and this is a truncated discussion, you can go read the longer exchange, but I pulled out James Madison, who was no friend of paper money but opposed paper money as well, however raised an objection and he said quote "Will it not be sufficient to prohibit the making them a (legal) tender?" [28:29] Well, he says tender but he means legal tender. "This will remove the temptation to emit them with unjust views." Gouveneur Morris responds to this by saying quote "The Monied interest will oppose the plan of government, if paper emissions be not prohibited." [28:48] That deserves repeating. The monied interest will oppose the plan of government if paper emissions be not prohibited. I think that is the single most powerful most informative statement at the Constitutional Convention.

Gouveneur Morris is no slouch. We may not know of him as one of the founding fathers, but Gouveneur Morris was actually the most frequent speaker at the Constitutional Convention. Spoke more than anyone else. He was also one of the major movers of the main bank of the time, the Bank of North America. He spoke for the monied interest.

When they came to vote on this, the power to emit paper money was prohibited by a vote of 9 to 2, it's a vote of the states so it was taken out of the Constitution and it's not in the list of powers of Congress. Now, I put this up here because the objection to issuing paper money, they didn't discuss why this was bad. Everyone just knew it was bad, paper money is bad. Why?

We're not going to tell you. James Madison's the only one who raises a structural issue, he says well its legal tender laws. If we get rid of the legal tender laws then its okay right? It won't cause injustice if we issue paper money. That's really what he's saying here. And its the monied interest he says no not even then, we want to get rid of it, but they never tell us why. Most of the rhetoric that comes out of the Federalists for why they need to get rid of paper money is mostly just that, rhetoric. Their major phrase is "paper money is mischievous." That doesn't mean anything. That's like saying "dubious." That's like saying "Sir, you engage in dubious pleasures." It doesn't mean anything but it frightens you, frightens me, God, dubious pleasures. Paper money is mischievous, oh my God. If you read through the literature, that's how they talk. They don't tell you why, but they use that rhetoric to scare you. So I bring this up because Madison is the only one to say maybe it's this legal tender problem. So, let's go back and before I leave this I also have to mention George Reed from the state of Delaware at the Constitutional Convention. He also states one of my favorite lines in this debate. I don't have it printed here, but at the end of this debate before they vote, he likens issuing paper money to the mark of the beast in Revelations. That's why we should vote against it. Yeah, again that's the nature of the rhetoric that's being offered.

Okay, well I'm going to explore a little more of the legal tender issue because if we go back in the Colonial period, there was a ubiquitous use of legal tender laws. And this is the key source of conflict between Great Britain and our colonies over monetary policy. And I kind of list up here. Yeah, I guess you won't be able to read my graphs, but you'll be able to read my big print. Some of the major resolutions that came out, and most of these involved legal tender issues.

[31:52]

As early as 1740 the House of Commons passed a series of resolutions directing that paper money should not be issued by colonies unconditionally as legal tender. You know, in other words had to get the king's permission or someone else's permission, something like that. Finally, after enough objections, two currency acts are passed. These are passed by Parliament. The Currency Act of 1751 and the Currency Act of 1764. Both of these go after a single issue, and that is prohibiting legal tender laws in the colonies. They do not prohibit the emission of paper money. You can read a lot of secondary sources that say it does. These laws don't. They simply prohibit making them a legal tender. There are numerous examples of paper money being issued that weren't legal tender. And, so, that's a prohibition. So, anyway that seemed to be the key bone of attention, legal tender laws. Yeah, you can issue paper money, but you can't force people to take it. And this meant to the British you can't force British merchants to take it in payment of stuff. They didn't like doing that. So again this is a huge bone in contention. Today we don't think about it, back then that was the key conflict. The question is kind of why? Well, I can't read much but I'll just show you a couple pictures of paper money. It's New Jersey legal tender, some of the last legal tender they issued, 1763. When Parliament outlawed making paper money legal tender, some colonies stopped issuing it. New Jersey stopped issuing legal tender, or stopped issuing paper money after 1764 when the Currency Act prohibited it. Pennsylvania didn't, they still issued paper money, they just didn't make it a legal tender. I also show, I don't know how to get that off the screen, that's a, the bottom one's a Continental dollar. During the Revolution when Congress issued paper money, the Continental dollar, they didn't make it a legal tender. In fact Congress didn't think it had the power to make things a legal tender. They went through 6 emissions of Continental dollars, 6 separate emissions with separate dates on them, before they turned to the states in 1777 and asked the states "Will you make this a legal tender in your state?" [34:18] And the states obliged.

So, again we had the Continental dollar was issued not as legal tender for the first 2 years, you know, and not until 1777 is it made a legal tender and may have caused some problems. So, why is this such a bone of contention? And my argument is going to be kind of the rationale and the problems with legal tender laws in this period of Colonial paper money and Revolutionary paper money is because of the structure of this money. That it's very different than our money today. These pieces of money, this stuff here, I want you to think of those not as U.S. Dollar bills today, but more as U.S. savings bonds. Think of a world, what would the world be like if our money was a U.S. savings bond? That was the money we traded with. [35:11] Not dollar bills, a different kind of money. And that's going to argue what Colonial money and the Continental dollar really was, they were zero interest bearer bonds so they're like a US savings bond, but transferrable. US savings bonds aren't transferrable by law, but if we made them transferrable, they would be like a money.

What Legal Tender Laws did, and, you see this a lot in the literature and I think this is incorrect, Legal Tender Laws did not support the face value of this money. Benjamin Franklin was really clear on this and Benjamin Franklin's single longest speech that survived, he explained the Pennsylvania legislature in the 1760s that Pennsylvania paper money was a fraud because it didn't trade at its face value. And it didn't trade at its face value because it was a zero interest bearer bond. He didn't use that language, but it was like a savings bond. You know, so its value today is less because you're going to pay it off later. And he said if you make it a legal tender that's not going to force it to trade at a higher value. People will adjust their prices. And he says this several times in this prayer. He says if you make money a legal tender, people simply adjust their prices to reflect its value. It doesn't support its face value. Legal Tender Laws had to do something else. They weren't there to force paper money to trade higher than face value. And I'm going to argue that they were created in part, I don't think it's the only reason, but in part to solve the problem of making money trade at a comparable value when you had multiple emissions of this stuff. Now let me try to explain this. So this is where my resolution falls apart, I'm very sorry. I'll try to explain this.

The very top there is US savings bond, you can't buy paper versions anymore. You can only get them online, but here's a paper version you can get from eBay, from 2000, it says $100 on the face of it. But everyone knows it's not worth $100. You go to buy a US savings bond, you don't pay $100 for it, you pay like $50. And then in, say, twenty years, twenty-five years it's paid off and you get the $100. That's the biggest disappointment we all had as children. We got savings bonds from our grandparents. You know, right? It wasn't worth. Anyway, that's it basically looks like a zero interest bearer bond that's not tradable. And if you can see the line here, what it basically says is when the thing is issued, maybe if you, no you can't read that. The thing is issued and it's a twenty year pay-off period and the interest rate here is about 3.5%. In the first year, it's worth only $50. And then it gets worth more and more and finally, in year twenty it's worth $100. So if you're going to use that as a money, you think "Okay, we only have this as a money, how's it going to function?" And what people will do is they will simply adjust their prices to reflect the money's current present value. So they'll say, "I have a savings bond and want to buy something and it says $100 on it, but it's not $100 for twenty years, it's only $50 so I'm going to adjust my prices to reflect the fact that this is only $50. Trying to cheat me here." Anyway, so that's how it's going to work. Benjamin Franklin explained that very well. Time discounting is all that is. Now, okay maybe you can see it.

The problem's going to be created when we start using this as an ongoing form of money, not just a one shot deal. But suppose I issue this kind of savings bond as money every couple years. In this graph here I said every two years. And so every two years, I'm issuing more of these $100 savings bonds and people are using them. And the problem is is we have savings bonds from different years that are going to trade currently at different values. So like today, if someone handed you a savings bond, you'd have to look, well what's the maturity date? When was it issued? Before you'd know what the value was. If someone handed you a different one, you'd say, "Well, what date was it issued? When is it paid off?" You can't trade them one-for-one. Not in equal value. So that makes it hard to use as money. Someone walks in and you're going to have to inspect every bill to see what the date is on it so you have to determine when it's paid off so you know the price to assign to it to take it as money. That's monetary chaos. So that's kind of what I talk about here. If that's what the colonies are doing and that's what the Continental dollar was, issued between new emissions every so often that have this bearer bond discounting to them. And we're going to have, with overlapping emissions, bills are going to have different values at different points in time, depending on their remission redemption date. That's monetary chaos. It's hard to use this stuff as money. How do you solve that? Legal Tender Laws solved it. So that may be one of the justifications, not the only one. For Legal Tender Laws. So, and this was, my beautiful wickedness is just, you know.

[40:10] We can put it on the website.

Farley Grubb: I'll put it up on the website. This graph basically shows you what would happen in that world where we're issuing this kind of bearer bond money every two years under the same kind of discount rate, or interest rate. And so every time you issue it, it starts with a low value and slowly rises over time to face value, assuming we believe the government's going to pay it off. Big assumption that you would believe that. So we've got a whole series of this going on forever. Now if we pass a Legal Tender Law, what that does it says, is it makes all this fungible in terms of when they're paid off. So I get a savings bond today… I could potentially have it paid off tomorrow. Or I could potentially have it paid off in twenty years. All I know is that the government's only going to pay off a set amount each year. And what that does is it's, it makes them all fungible, it says if you give me one of these pieces of paper, it doesn't matter what date it says on it, I have an expectation of an average value. Now there's going to be a spread around that average, some are going to have higher values some are going to have lower value, but you don't know which and you don't know when. It depends on who beats whom to the government exchange door. But the expectation is going to be the same for each, each of these. And that makes, makes money useful. So yeah, you walk in, it doesn't matter what the emission date is or what, as long as it's circulating, I have to give it the same expected value as this one. And so it can function a little easier as money. It doesn't function perfectly as money because, as I said before in my graph, which you can't see, there's some spread of values around that that's not solved by this. But the expectation of the average is going to be constant across all money.

This creates a problem, however. And the problem, well I should go back one. It's mentioned here. The problem is that if you had a prior debt, say we go back to the Colonial era, and you have a prior debt in some other money. Instead of this paying off in $100, they paid it off in say one hundred silver dollars. And you say, "Okay, I contracted with someone to sell them a horse for one hundred silver dollars". And now they pass a Legal Tender Law that says these pieces of paper, the US savings bonds, is really $100 face value. And that's what you, you're supposed to take them as. Then I'm kind of stuck. Someone's going to give me this where the expected value is a lot lower. The expected value in that graph is only $72, $72.50 actually, given my interest rate, and I'm going to have to be forced to take this paper money even though it's much lower in value than the price I set, say in silver, equivalent. That's the problem. That's why merchants are complaining in the Colonial world. They have these prior contracted debts and other kinds of money like silver money, and all the sudden, the Legal Tender Laws are here to solve some of the money problems of paper money, put them in a position of having to take paper money at a lower value, lower value equivalent. But there's a solution to this. And thank goodness Benjamin Franklin kind of leads you to this solution. You know, he says, "The solution is not to quote current prices or right of contracts or issued debts in any medium other than of legal tender." Once you do that, you don't have a problem. But the British merchants would have written their contracts not in Spanish silver dollars or not in English money, but would have written it in

Colonial currency: Colonial paper money. They wouldn't have had a problem. Not with Legal Tender Laws because they would have gotten the right prices. It does mandate that you forecast the future expected value of the legal tender paper money. Now maybe merchants were too lazy and didn't want to do that or something like that. But there is a solution here and it's a solution we have today. We have a legal tender paper money today and it works because all the prices are quoted in that legal tender. We don't have prices quoted in multiple monies out there or things like that. Now, if creditors do not want to do this, write their contracts in the legal tender, forecast its value, write contracts in current prices… If they don't want to do this, and when a contract in some other money, like silver dollars, then they are potentially hurt in the case of a breach of contract. So we have, I'm going to sell you a horse, again. Here's a horse. And you're going to come buy this horse from me and it costs $100. One hundred silver dollars. And you come take the horse away and I come back for me payment and you say, "Well, I'm not going to pay you." And you say, "Well, wait a minute. I sold you the horse and you owe me one hundred silver dollars." And they say, "Well, I'm not going to pay it." And so you sue them. You sue them, "Hey, you breached the contract." And you go to court. And in court, they find the person who bought the horse guilty of stealing the horse, well not stealing, but taking the horse and not paying it off. And how does the judge or the court make the creditor whole? He says, "You owe this guy $100. One hundred silver dollars." They say, "Well wait a minute, there's a Legal Tender Law. I have to pay, I don't have one hundred silver dollars. Of course, I have to pay in the legal tender". "Okay, so you're going to pay in the legal tender, make this guy whole." That's when the courts of the judge has to decide are you going to make this person whole in terms of the present value or the legal tender or in terms of the face value? It judges and the courts use the face value. The creditor just lost money. If courts and the judge use the present value, then the creditor is made whole. So in that sense, British merchants or other people objecting to legal tender laws were objecting primarily to the problem of courts and judges making decisions on making breach of contract cases based on the face value of the legal tender, not on its present value or bearer bond status. I've got a minute left or half of a minute.

Conclusion: Legal Tender Laws were the primary, if not the only, specific structural component of monetary policy sparking objection in the Constitutional era. Removing legal tender laws resolved the British objections to Colonial paper money made primarily by British merchants. And paper money had been often omitted without legal tender laws. Functioned well, but it had (inaudible). At the Constitutional Convention in 1787, James Madison, a foe of paper money, thought that removing legal tender powers would remove the objections to legislature issued paper money. Why the monied interest opposed the whole plan of government over the single issue of paper money omissions, even when legal tender powers over that money were removed, went unarticulated and remains a thing unexplained today.

Woody Holton: [47:08] Okay. Anybody want to take an early guess about which Columbia professor's centennial, I've never dedicated a paper like this to someone, but I'm dedicating it to that guy. Who might know that guy's centennial year exactly one hundred years ago and I'll tell you in a second. But while I'm doing my trivia questions, let me give you this one. Do I just click it to go? Can you read that? All those people are referring to the same clause of the US Constitution. Which clause is it?

Raise your hand if you want to take a stab. Not only did they like it, they say if this were the only clause in the Constitution, that would be enough. Seeing Benjamin Rush saying that and James Wilson basically saying that too. All we need is one clause and we can go home. What's that clause? Yes sir?

Audience Member: [48:27] [inaudible]

Woody Holton: Nope, but you would think so.

Audience Member: [48:33] [inaudible]

Woody Holton: Nope.

Audience Member: [48:43] [inaudible]

Woody Holton: You cannot be a member of my family.

Audience Member: [48:45] Commerce Clause?

Woody Holton: [48:46] It's not the Commerce Clause.

Audience Member: [48:42] Is it Article 1, Section 8, Subsection 5, to coin money?

Woody Holton: [48:55] The Congress can coin money? No. That's not it and not anything in Section 8, if that helps. The most popular clause in the Constitution at the time it was written and sent out for ratification was this clause that nobody has named yet.

Audience Member: [49:16] Not making states be able to pay debts anything beyond legal currency?

Woody Holton: [49:18] Absolutely. Our convener gets us to Article 1, Section 10. There it is.

Farley just mentioned that the Constitution silently allows the Congress to issue paper money, but it very explicitly prohibits the states from doing so. It can't issue legal tender paper money, See that would be impairing the legal obligation of contracts. Did someone say contracts clause? I don't think anybody did. Yeah, okay, I hope I didn't miss my winner. So a) you can't issue paper money and make it legal tender for contracts because that would impair the obligation of contracts because inflation is a way of transferring wealth from the creditor to the debtor, right? So a) you can't impair contracts so you can't issue legal paper, legal tender paper money, but the states can't issue any paper money at all. Who here has used New York paper money in their pocket? Sometimes I ask that in Virginia, where I'm from and actually I do in South Carolina know a few of them that do have state issued paper money, but that's from 1861, and that's a different lecture. I want to bring to this seminar two validations of the reason that you're doing what you're doing. The first is that the number one reason the people who wrote our Constitution were there, in Philadelphia, in that summer of 1787, was to stop the states from printing paper money. That's the number one reason why there were there and you saw it in some of those quotations. So I say in this seminar series focusing on money, if I could bring you validation from the Founding Fathers, they would be thrilled. Alexander Hamilton, your fellow Columbia grad, and George Washington, the rest, would say, "Oh, you've got your finger right on the pulse."

The other reason why they'd be thrilled that you're holding this seminar series is the utter ignorance, the illiteracy of modern Americans when it comes to money. I would venture to guess that your average redneck farmer in South Carolina in 1787 understood monetary policy better than your average Ivy League law student today. And we can test that because they knew who had the power to issue paper money. You tell me somebody who has the power to issue paper money in the United States today. How many people think they know the answer to that question? So maybe people are just modest these days. So one of you raised your hand. Who issues paper money? And who in turn determines the money supply in the United States today?

Audience Member: [52:06] The Federal Reserve Bank of the US.

Woody Holton: [52:07] That's incorrect. Most, I think, Ivy League graduates would answer that. The rest of us would go, "Oh Congress, or something." At least you got as far as the Federal Reserve, but that's still incorrect. I don't know what my daughter's doing, go ahead.

Audience Member: [52:22] Big private banks.

Woody Holton: [52:24] That's actually, when you mix what he says with what you said, we're getting close to the answer. Somebody else get us just a little closer though. It is the Federal Open Market Committee. Seven of its members are from the Federal Reserve. The other five, though, are chosen ultimately by private banks because we have the twelve member banks of the Federal Reserve. They each have their board of governors. Guess who chooses the twelve members of the board of governors. Other private banks. We have privatized one of the most important decisions of a legislature of the government makes is how much money circulates. And you and I have no say in that, except for those seven members appointed by the President, but they are appointed for fourteen years. Fourteen years. So we've got, that's our representation is the people appointed by the President for fourteen years, so very indirectly. And the other five are chosen by the bankers. That's who determines our money supply today, and the larger point I wanted to make here is that you ask any ignorant farmer from western Massachusetts, like Daniel Shays, or from my home state of Virginia, and they will tell you, "Oh, the Virginia legislature can print paper money and so can Congress" because they got it in their hands. So, the Founding Fathers would be very happy about this seminar series a) because it's the reason they went to Philadelphia to write the Constitution, and b) because we are so ignorant compared to rednecks from 1787 about the money supply. Now I told you that their number one reason to go down there was to stop the states from printing paper money, but a danger remained. And the danger's one that Farley referred to and that is: Congress does, implicitly, have the power to print paper money. So if we've stopped the states from printing paper money, and that's the thing the Founding Fathers hated so much, there's still the danger that Congress will do it because it's, the

Constitution does not prohibit Congress from printing paper money. It doesn't allow the, go ahead.

Audience Member: [54:31] Are you talking about digital money or paper money? Is this paper money just a small portion of [inaudible].

Woody Holton: [54:36] That's true. That's, and let's talk about that, cause, hey, I only have to talk about the 1700s. You've got to deal with the 21st Century, and I don't because, so what does that change? But yeah, I'm talking about real money. But you know that the Federal Market Committee's dealing with that as well. Because when it's setting interest rates, well, you're looking skeptically. You talk to me about the 21st Century when I finish my twenty minutes.

Audience Member: [55:02] Is the Federal, in Washington, can compose the members of the Federal reserve or some private banks?

Woody Holton: [55:12] So no, there's the set, there's the seven members of the Federal Reserve Board and then they're five other people and those people are chosen by the member banks. And the member bank's board, it's the presidents of the member banks, they each are sort of in rotation. Let me tell you something…

Audience Member: [55:25]

Woody Holton: [55:26] Let me finish and then correct me. Those five people are presidents of the member banks serving in rotation. And the member bank presidents are chosen by their boards who are in term chosen by bankers, by private banks. Now, correct me.

Audience Member: [55:39] Okay, I thought you said that commercial banks are…

Woody Holton: [55:41] We've got it straight now? You and I are on the same page?

Audience Member: [55:44] Yes.

Woody Holton: [55:45] Okay. So let's move on. Here's the danger that remains, you put in Article 1, Section 10 and you prohibit the states from printing paper money, but there's two dangers that remain. One is that Congress will, itself, print paper money. You know, maybe Daniel Shays and his farmers will take their pitchforks down to Washington, D.C., once the capital's there, and force Congress to print paper money. How are we going to prevent that? Or, Congress will look the other way when the states print paper money, or the Supreme Court will look the other way, when the states print paper money. What do you do about that? Here's what you do. You create a federal government that is much less responsive to the wishes of ordinary citizens than any of the thirteen states. So do you remember, us with grey hair or no hair remember this very boring chart about how a bill becomes a law. Those of you under thirty of so got "I'm a bill, I'm only a bill on Capitol Hill," but it's the same thing right? That the, you've got to go through a lot, jump through a lot of hoops, to get a law passed. But here's the key thing I want to tell you, that was not the case in the Pennsylvania legislature under their constitution of 1776, or in most of the others because the, those state representatives were elected from tiny districts, so everybody knew them. And in all but two states, any state of South Carolina is always the exception where it's every two years, but every other state, oh Connecticut's the other every six months, most of the states, the Congress, the members of the legislature were elected every single year. And so they were totally accountable to their constituents. And then once you got a bill through the Lower House of the legislature, that's why I've got them in small lines on that chart that you see on the left, it is that once it's through the Lower House, it, the Senate is very weak. The Senate doesn't exist in Pennsylvania. And so the Senate can't stop it in most of the states and doesn't exist in Georgia either. And can the governor of Pennsylvania veto a law, under their 1776 constitution? It's a trick question because they didn't have a governor and neither did Georgia and the fourteenth state of Vermont. And even in the states where there were governors, the vast majority of the governors had no veto powers. We're getting close to Athens here in the sense that the people really had their state representatives under their control. And so if the people of South Carolina want paper money in 1785, they get it, and they did in that year. So did Pennsylvania, so did seven out of the thirteen states during just a couple of years between the end of the Revolutionary War, the five years, between the end of the Revolutionary War and the ratification of the Constitution. Those lines are small because it's pretty easy to get legislation passed. Contrast that to the federal Constitution, where we've got one body elected for two years, the House, but anything they initiate has got to get through the Senate, elected for six years, and not chosen by the people until 1913, right? And then it's got to get through the President, he's chosen for four years, which is a long time in their scope of things, when they believe that when annual elections end, tyranny begins. It has to get through the President, of course, and then, of course, the Supreme Court also, indirectly. Remember the Supreme Court is elected quadruply insulated from the people because in many states, early on, you didn't even get to vote for your Presidential electors. Your legislature chose that. So let's walk through it. I'm a farmer in South Carolina. I vote for my representative in my state legislature, he votes for the South Carolina Presidential electors. They vote for the President. He chooses the Supreme Court. And there are four layers of stockade full of concentric rings for the protection of me, as a Supreme Court justice, from that redneck farmer. I'm not going to do what he tells me to do. I don't have to. And that's the whole point of the federal Constitution, is, Edmond Randolf from Virginia put it really well so let me grab the quote from him. What the Constitution gives us is "checks against the popular intemperance." Think of the federal government as surrounded by one stockade fence in a circle and then another one around that and another one around that and another one around that. And the biggest one of all was just the fact that it's so big and so remote, makes it really hard for ordinary people to influence it. Who here has read *Federalist Number Ten* by James Madison? My daughter, you've read that, Beverly? They're doing that in kindergarten, first grade, sixth grade these days. But you've all read *Federalist Ten*, have you? Raise your hand. Are some people not, some people haven't? I thought they forced, you guys made them.

Audience Member: [1:00:44] Yeah.

Woody Holton: [1:00:45] Here's the private version of *Federalist*. *Federalist* has oh got, oh, we've got the presence of factions, tyranny of the majority, what are we going to do about that? And Madison has a very learned way of talking about that for public consumption in *Federalist Ten*, but here's what he said more privately, three weeks earlier, to his buddy James Madison who was over in Paris. And one of the Latin scholars can remind us what "divide et impera" means. Somebody.

Audience Member: [1:01:12] Divide and conquer.

Woody Holton: [1:01:13] Divide and conquer, that's exactly right. We want to, bear with me on this, by pulling the thirteen states together into a federal government that's going to control monetary policy, as well as taxation, a powerful word that, but by pulling the thirteen states together, by uniting them, we will divide them and prevent the people from bringing concerted pressure on their representatives. And, therefore, those representatives would be free to do the right thing. Meaning: not print paper money. And not do any of these other irresponsible things that farmers were accused of doing when they controlled the legislature for all that time. All this is necessary because independence created a problem. No more adult supervision. There's that bill. You know why he's sad? He got vetoed. Look the states, a lot of the colonies tried to print paper money during the Colonial Era, but if they printed paper money after 1751 in New

England, 1764 in the other colonies, that money got vetoed by Parliament, and, of course, the houses of Parliament were not built in the 19^{th} Century so bear with me. But the point here is, the Founding Fathers wrote the Constitution because the American Revolution created a problem and the problem the revolution created was a lack of adult supervision. If you let ordinary redneck farmers force their legislatures, who are elected every single year, to pass laws controlling the money supply, they'll print too much money. And what that will do is transfer wealth from creditors who lent money. It will transfer that money, through the process of inflation, to debtors. And we're going to shut that all down now by prohibiting in Section 10 and by having a federal government that is not responsive to the voters so it won't print paper money and it won't let the states print paper money too. Here's a way to put it. There's Dorothy on the right and Toto on the left from last Halloween. When they come back with their Halloween treats, parents, do you leave the bag of candy on the kitchen floor and say, "Oh, have as much candy as you want"? No. You take the cookie jar and you put it on a real high shelf where they can't reach it because they are children. Remember that picture girl? And they can't take care of themselves. So you've got to put that thing on a high shelf where they can't get to it. And that's the purpose of the United States Constitution: to take monetary policy away from the states, who are irresponsible, they're like children. You take it away from the states and you put it on the high shelf where they can't get to it. You put it in the hands of a federal government that is not responsive to ordinary citizens. That's what the Constitution does. And the irony of all of this, all you've got to do is read the pink part. This is Benjamin Rush writing in the *Pennsylvania Gazette*, Benjamin Franklin's old newspaper in 1786. He says there's two problems, reasons why we can't have paper money. He's admitting that paper money actually worked pretty well in Pennsylvania before the American Revolution, back when the British were ruling things. But two problems have opened up. One is we're more spread out, and I don't want to deal with that problem right now, it's a separate issue. But the problem is he has what he calls a "feeble constitution". Ten years earlier, the people of Pennsylvania created this extremely democratic constitution. Remember I said no Senate, no governor. All you've got to do is get a law through the Lower House of legislature and it's the law. And that means those legislators are beholden to the people. He says that's a "feeble constitution" and we can't have paper money anymore. And so the great irony is that having rebelled against this limited monarchy, Great Britain, and establishing a republic, there's certain things we can't allow ourselves anymore. And one of those things we can't allow ourselves is paper money printed by the states because it'll be done irresponsibly. Okay, I've got two minutes.

Here's the guy we're celebrating the centennial of. He got his Ph.D. here from Columbia and then taught here before resigning in protest, it's Charles Beard. And, thank you, one hundred years ago, he published a book that you've all, I hope, have heard of called *An Economic Interpretation of the United States Constitution*. And he looked at the fact that the Constitution shut down paper money and other protections for debtors and tax payers. And Beard's theory about this was, well of course the Founding Fathers wanted to protect creditors from debtors and wanted to protect bondholders from having tax relief, which means the bonds can't be paid off. Of course they did that. He went down to the Treasury and looked up and said, "A-ha! The guys that wrote the Constitution were bondholders and private creditors!" I think this is intriguing that somebody to be said for it but I want to disagree with Dr. Beard on this because I don't think that's the reason the Founding Fathers were, had such an animus against paper money. I think they did because they said it prevents people from lending money. Madison is a perfect example of this. In 1787 when he wrote the Constitution, he was forty-, well let's see, fifty-, fifty-three, excuse me, he was thirty-one years old and he was still living with his parents. Why? Because his effort to go set up on his own as an entrepreneur had failed. And why had it failed? I'm sorry, he was thirty-five. And he's still living with his parents. Couldn't go out on his own. What's the one thing that every business needs besides that enthusiastic entrepreneur?

Audience Member: [1:07:17] Capital?

Woody Holton: [1:07:19] And, exactly, capital. Nobody would lend him the money because, according to his friend Jefferson, who also wouldn't lend him money, the habitual protection of the debtor would be against you, would be against the creditor if they ever lent you money. It's, and they wouldn't ever get it back if you landed in court. So, we've got a horrible recession in the year of 1785 and 1786. The only way out of it is for the leaders of the country to go down to Philadelphia and write a constitution that prohibits debtors from screwing their creditors because if debtors can't screw creditors, then creditors will be willing to lend money. I will say very briefly since I'm out of time, there's another side to this story. Here's a political cartoon that later ran colorized in a Connecticut newspaper in 1787 and you've got this before the Constitution was written. So you've got the people on the left who are, were going to write the Constitution they were for shutting down paper money and had prohibited, that is they prevented Connecticut from printing paper money. They want high taxes to pay off the war bonds and so forth. But then there's these guys on the right and maybe you can read what this guy's saying, the guy holding the rake there has been raking salt down to the marsh. And he says, "It takes all the pay taxes". They're offering an alternative explanation for that terrible recession of the 1780s. Ordinary farmers are saying, "It's not our fault that there's this terrible recession." It's, this is not a recession caused by irresponsible monetary policy by too loose printing of paper money. You know what happened, what's the big grievance that caused the American Revolution? It's, a, "No blah without blah"?

Audience Member: [1:09:15] No taxation without representation.

Woody Holton: [1:09:17] No taxation without representation. Right! So what's the first thing when they got their own representatives, what's the first thing those representatives did? Levied taxes that were two or three times higher than the Stamp Tax and the Tea Tax and all those other taxes put together. Of course they had enormous taxes to supposedly pay off the war debt, but it was all going to the bond speculators which transferred wealth from the countryside to the city, from farmers to merchants. Look, taxes, a legislature can tax a society into a recession, and that's the alternative explanation for this recession of the 1780s, which I actually think is the correct one, or the more correct one of these explanations for the recession. If these farmers are right, that this was a tax induced recession as opposed to a too much money induced recession, you know what that means? We have a strong federal government because of a monetary mistake. And I'll stop there.

Christine Desan: [1:10:29] Thank you all, this is what's fascinating and, I have tons of questions so I'm going to ask a couple of them and then open it up to the rest of you for the opportunity to talk.

<u>Transcribers</u>

Kyle Kopplin, Clay Kopplin