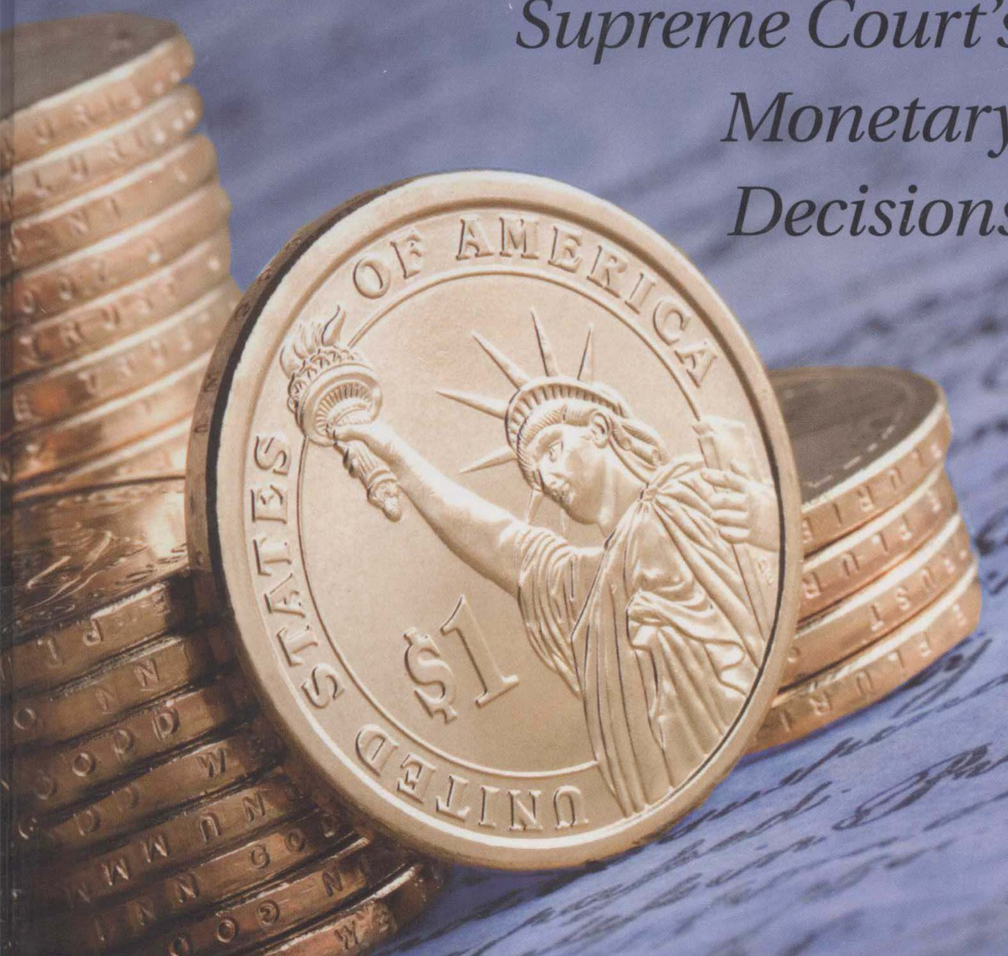
CONSTITUTIONAL MONEY

A Review of the Supreme Court's Monetary Decisions



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To

Those sovereign people of the Constitution who freely and unwittingly contribute to the undesigned order of human affairs

Preface

Constitutional Money examines nine Supreme Court decisions that markedly affected the U.S. monetary system in order to determine how and why money in use today became what it is. The exposition requires attention to three institutions: the Supreme Court because of its interpretations of the Constitution's money clauses, the gold standard and its operations as sanctioned by the Constitution, and the central bank – the Federal Reserve System – and its operations and constitutionality in the presence of a gold standard. The Court decisions begin with *McCulloch v. Maryland* in 1819 and end with The Gold Clause Cases in 1934–1935.

Everyone who thinks critically about the monetary system is aware of the significant difference between the gold-and-silver standard that the Framers originally prescribed and today's central-bank-fiat-money standard. Article 1, Section 8, of the Constitution states: "The Congress shall have power … To coin Money, regulate the value thereof, and of foreign coin, and fix the standard of Weights and Measures." Article 1, Section 10, declares: "No state shall … coin Money; emit Bills of Credit; make any Thing but gold and silver Coin a Tender in payment of Debts." Those passages taken together imply, first, that any legal tender money can only be gold and silver "coin," and, second, that Congress's monetary power is limited to managing the gold and silver contents of those coins. The Constitution does not prohibit banks and other institutions from creating common money managed by "the people," but it clearly denies the states and the federal government, by implication, any authority to change the base of gold and silver.

Barter of goods and services preceded money. Manifestly, any barter-medium that "the people" might use before a general money-medium appears is already "acceptable." Anyone can swap eggs for butter, or labor services for land; no authority in a free society can prohibit barter in any form. Recognizing this principle, the Framers dealt only with the creation of money at the two levels of government – federal and state. The "people," however, could deal with each other on any terms mutually agreeable. That was a significant element of Freedom of Contract.

In spite of these obvious homilies, in 1933 with President Franklin Roosevelt's strong assent and signature, Congress passed a law prohibiting the private ownership of monetary gold. While this law was rescinded in 1974, gold and silver are nowhere to be found in today's monetary system. Their use as money is still illegal. Entrepreneurs who promote them as money are prosecuted, and even persecuted, by U.S. government agencies. The precious metals have become monetary apparitions, futilely reminding Congress of its constitutional limitations and responsibilities.

The Supreme Court's monetary decisions have become a casebook of primary material begging for examination and possible reinterpretation. While the decisions reviewed here are only a small fraction of the total judgments that the Court has rendered over this time span, they have special importance in the economic world of markets because every transaction for goods, services, and capital also includes a sum of money.

The Framers wrote the Constitution for the ages, and they provided for changes by means of simple amendment procedures. Since the Constitution arranges for its own correction, it has no reason to be interpreted differently for different ages, social conditions, or other human circumstances. Judicial decisions that change the original meaning to fit some current social norm are illicit; they violate the substance of the document and destroy its reason for being.

In this book I package an analysis of constitutional cases on money with a summary history of government monetary policies and events through the twentieth century. My account explains how the Federal Reserve System as a central bank has interacted with the later Court decisions to undermine the Framers' monetary constitution, and in so doing has promoted continuous inflation and ongoing public uncertainty regarding the future value of money. I conclude with some suggestions for a constrained monetary system, including the possibility for the reinstitution of an authentic gold standard.

Attempts have been made in the past to treat monetary affairs with some reference to the Constitution. First, Bray Hammond in his book, *Banks and Politics in America* (Princeton University Press, 1957), did a comprehensive study of the operations of the Second Bank of the United States and its struggle to remain in existence after Andrew Jackson became president. Hammond was a historian who spent most of his professional life on the staff of the Federal Reserve Board in Washington. His account is well written and engrossing, but flawed by his misunderstanding of the Framers' monetary constitution and its limits on the monetary powers of Congress. Furthermore, his uncritical acceptance of, and apology for, a central banking institution – The Second Bank of the United States – is highly questionable. The best that can be said for Hammond's work is that it provides a starting point for serious inquiry on the constitutionality of central banking.

Gerald Dunne's short book, *Monetary Decisions of the Supreme Court* (Rutgers University Press, 1960), followed Hammond's work, but did not challenge any of Hammond's analysis or assumptions. Dunne was the legal counsel for the Federal Reserve Bank of St. Louis and a law professor at St. Louis University. His work properly brought the monetary decisions of the Supreme Court into focus for the first time. However, he was not an economist, and he did not question the Court's authority or its clear violations of constitutional monetary precepts in the cases he reviewed.

Much the same is true of James Willard Hurst's work, *A Legal History of Money in the United States, 1774–1970* (University of Nebraska Press, 1973). Hurst, too, was a legal scholar, not an economist. Early in his work, he stated that his research was limited to legal history. He did not try to make "independent judgments that call for expertness [sic] in other than legal matters," and he did "not purport to write an economic history of money in the United States." However, anyone who examines the legal history of monetary decisions must be able to interpret the monetary conditions under scrutiny in order to evaluate the validity of the judicial decisions. Hurst's work therefore lacks economic substance.

A more recent work, *Pieces of Eight*, by Edwin Vieira, Jr. (Devin-Adair, 1983), has much worthwhile legal material in it and addresses critically and validly many of the Court's decisions on monetary affairs. However, Vieira is a legal scholar, so his excellent legal analysis understandably includes only a limited account of the economic events and institutions of the times. Nonetheless, his conclusions correlate highly with my own, even when we emphasize different issues.

A work that focuses primarily on the prohibition of gold ownership in 1934, *The Gold Clause* by Henry Mark Holzer, addresses the constitutionality of gold as the basis of the monetary system, especially with reference to gold clauses in contracts. Holzer's analysis is very useful but limited to the set of circumstances that accompanied the Roosevelt administration's campaign against gold and the resulting Court decision in the Gold Clause cases.

Acknowledgments

I have several institutions, economists, laypersons, and family to thank for assistance with this project. I begin by thanking the George Edward Durell Foundation for a grant that supported the monetary research I was doing in the 1990s. This Foundation also published my monograph, *Gold, Greenbacks, and the Constitution* (1991), which proved to be a springboard for the present work.

I was also very much helped by being appointed a Visiting Scholar at the Social Philosophy and Policy Center of Bowling Green State University, Bowling Green, Ohio, in 2002, where I developed the first section of this book. I received some excellent legal help and encouragement there from Fred Miller and Jeff Paul.

I also thank the Cato Institute for its monetary conferences, which have been complementary to my own research interests, and in which I have had a modest part. I especially thank Cato for promoting and co-publishing the present work. In that vein, I also thank Cambridge University Press for cooperating with Cato. Both institutions have been exemplary in managing the publication of this book.

I have also benefited significantly from my experience with The Independent Institute in Oakland, California, in editing (with Kevin Dowd) the book *Money and the Nation State: The Financial Revolution, Government and the World Monetary System* (New Brunswick, N.J.: Transaction Publishers). Many of the articles therein, especially those by David Glasner, Leland Yeager, and Frank van Dun are especially relevant to material covered in this book. Van Dun's "National Sovereignty and International Monetary Regimes" is especially useful to the Supreme Court's discovery of "sovereignty," and its decisions in the legal tender cases. I also refer to my own article in that volume, "Gold Standard Policy and Limited Government," when discussing the evolution of the gold standard through the nineteenth and into the twentieth centuries. Other articles in that work are germane to an understanding of the state's relationship to the creation and production of money, and can be read with profit.

Several economist friends and legal counsels have done yeoman service in editing earlier versions of this text. George Selgin and Jim Dorn have been unstinting, unselfish, and constructive critics. I owe each of them a great debt. Others who have contributed corrections to my text and offered constructive comments include: David Boaz, William Beranek, Kevin Dowd, Roger Garrison, Tom Humphrey, Roger Pilon, Richard Salsman, Walker Todd, Larry White, and Leland Yeager. I also thank my good friend and financial analyst, Tom Wilkins, for suggesting useful references and for his stimulating discussions while the book was in progress. My thanks as always to my wife Hildegard for her constructive criticisms and constant encouragement. Finally, I want to thank my grown-up children, Tommy, Chris, Megan, Dave, and Dick, for reading various sections; for their skeptical review of some arguments; and for nagging me to finish. I also thank my brother Allen for one especially important observation on past Court decisions.

Contents

ONE

The Current Condition of Monetary Affairs in the United States

It is easy to perceive that individuals by agreeing to erect forms of government... must give up part of their liberty for that purpose; and it is the particular business of a Constitution to mark out **how much** they shall give up.... which says to the legislative powers, "Thus far shalt thou go and no farther." A Constitution, when completed, resolves the two following questions: First, What shall the form of government be? And, secondly, What shall be its power? And the last of these two is far more material than the first.

Anonymous
The Founders' Constitution, "Four Letters
On Interesting Subjects," 1776, Vol. 1, 638

The money clauses in the U.S. Constitution are brief, simple, and explicit; the humblest mind can understand them without elaborate interpretation. Article 1, Section 8 states that "The Congress shall have Power . . . To coin Money, regulate the Value thereof, and of foreign coin, and fix the Standard of Weights and Measures." Section 10 denies the states any monetary powers. It declares that, "No State shall ... coin money; emit Bills of Credit; [or] make any Thing but gold and silver Coin a Tender in Payment of Debts." Yet today the U.S. monetary system seems in conflict with those clauses. In particular, it has no place for gold or silver. All of the hand-to-hand currency in everyday use consists entirely of paper notes – bills of credit – issued by the Federal Reserve System, and none of it is redeemable in anything except other "bills of credit." While the U.S. Treasury also issues coin currency for use in smaller exchanges, none of the currency, paper or coin, is worth anything as a commodity. It is all *fiat.* All checkable bank deposits, the only other money of any consequence, is based either on bank-held Federal Reserve note currency or on reserve balances of commercial banks in Federal Reserve Banks. These reserves are redeemable only for bills of credit – the aforementioned Federal Reserve notes. In sum, all bank reserves and hand-to-hand currency are issues that the Federal Reserve System – the U.S. central bank – has created by what is now regarded as standard monetary policy, primarily, purchases of U.S. government securities that the U.S. Treasury has previously marketed to finance the federal government's long-recurring fiscal deficits. None of it is based on gold or silver; none of it can be redeemed for gold or silver. The entire redeeming medium, fiat Federal Reserve notes, is legal tender for all debts, public and private. Federal Reserve notes and "credit" have completely replaced gold and silver. Yet, the words "Federal Reserve" are nowhere to be found in the Constitution of the United States.

Settled and accepted U.S. policy not only flouts the constitutional prohibition against fiat legal tender money – bills of credit – it also fails to provide any gold or silver money in any form.[1] Courts of law will not even hear cases that would challenge this status quo. They throw out attempts to restore constitutional money as "frivolous." Somehow, between the time that the Constitution and the first ten Amendments were ratified and the present, gold and silver money have disappeared, while the prohibited bills of credit – in this era, Federal Reserve notes – have become conventional standard money. Congress and the Executive branch have often initiated the policies that have reversed what once seemed to be eternal verities, while Supreme Court decisions have sanctioned the changes and given them permanence.

This breach of explicit constitutional provisions, which appears illegal on its face, should have an excuse, or at least an explanation, intelligible to anyone and everyone. The present status of the monetary system seems, however, to have been accepted at all levels – from the unschooled layman to the denizens of the Supreme Court – without serious argument, and without embarrassment at the obvious contradiction between what the Constitution specifies and what has come to exist today.

The Supreme Court is a body of legal experts who, understandably, have interpreted the Constitution from legal and political perspectives. When the Court has handed down decisions that call for an understanding of economics, particularly monetary economics, the justices have had to rely on

[1] "Fiat money" is any money – always a paper currency – that a government issues on its own authority and without any visible redeeming medium, such as gold or silver. "Fiat" is the vocative form of the Latin verb, "fio," and literally means "Let there be," in this case, "Let there be money." "Bills of credit," discussed both here and further on, are the *fiat* currency that governments have issued at various times in the past and present. They are explicitly prohibited to the states by the Constitution, and by implication as well to the federal government.

"expert" testimony from what are often special pleaders, or from their own superficial knowledge of monetary affairs. At times they have also deferred on these matters to Congress or the Executive branch, who are no better equipped than the justices in either economic doctrine or the analysis of monetary complexities.

The Justices are not to be condemned on this account. They can hardly be both learned legal analysts and accomplished professional economists. Consequently, putting an economics perspective into the briefs for the Court's decisions should add credibility to future judgments that cover similar ground, and may correct for posterity mistaken judgments that are now a part of accepted policy. Such a project may seem politically unrealistic. But if no one suggests corrections to what has been handed down as the ultimate word from the Court, manifestly incorrect or improper arguments become part of accepted law and endure forever.

Any work on the history of monetary affairs must treat explicitly the operations of both metallic standards (gold and silver) and central banking institutions. The money clauses of the Constitution provide legal sanction for a bi-metallic monetary standard, that is, one in which both gold and silver coins are legal tender for all debts public and private. To make such a standard operational, Congress had to specify the terms – that is, the mint prices in dollars – on which the two metals would be legal tender. The two metallic moneys would then reflect an explicit legal ratio of monetary value, that is, an *exchange rate*. The history of how this bi-metallic standard worked, therefore, is also a necessary backdrop to a review of Court decisions, particularly those that abused or rescinded the explicit provisions specifying gold and silver as the only legal tender.

Central banks first appeared during the later nineteenth and early twentieth centuries. During the twentieth century, they acquired a monopoly on the provision of base money and have completely supplanted metallic standards, which are now nothing more than artifacts in the dust-bin of history.

TWO

The Emergence of Money in Civilized Societies

Through the ages from ancient times, monetary devices have come into existence spontaneously, in much the same fashion that wheels, levers, writing materials, energy products, languages, and countless other human innovations have appeared. All of these devices make life easier; and by significantly reducing the real costs of man's existence, add to the total product that private institutions can generate and use.

Because money is an economizing agent for any society that exchanges goods and services, it has appeared in many diverse cultures and over many centuries of man's existence. Money, however, has had an evolutionary history somewhat different from that of other commonly used technical devices. Its appearance and use have often given rise to mystical suppositions and superstitions about its nature and those who control it. These traits have accompanied it into the twenty-first century. More importantly, because of its unique properties, money in all ages has been an object of state intervention and control.[1]

Money evolved from commodities that were not money. As primitive peoples began to exploit their productive abilities, they first bartered goods and services directly in order to realize the economic benefits of their specialties. Very soon, they learned to barter indirectly. By exchanging a surplus item for some intermediate good, people could ultimately realize a more desirable end-product or service. These indirect bartering devices were rudimentary media of exchange that had nascent monetary properties.

[1] The following brief history of the evolution of money is well known. For further details, see my account of this evolution in, *Gold, Greenbacks, and the Constitution*. The George Edward Durrell Foundation: Berryville, Va., 1991, pp. 1–12, and my article, "Gold Standard Policy and Limited Government," pp. 167–191, in *Money and the Nation State*.

Carl Menger, a founder of Austrian economics, correctly captured the dynamics of the shift from barter to money in his *Principles of Economics*, published in 1871. "As economizing individuals … became increasingly aware of their economic interest," he wrote, "they everywhere attained the simple knowledge that surrendering less saleable commodities for others of greater saleability brings them substantially closer to the attainment of their specific economic purposes."[2] While "only a small number of economizing individuals … recognize[d] the advantage accruing to them from the acceptance of other, more saleable, commodities" in exchange for their own goods or services, others observing the "economic success" of those employing an intermediate good to achieve their ends, adopted the medium themselves. "In this way, custom and practice contributed in no small degree to converting the commodities that were most saleable" into media of exchange.[3]

Besides describing the path by which some common goods became money because of greater "saleability," Menger made three other important observations:

First, money's appearance was "… not the product of an agreement on the part of economizing men nor the product of legislative acts. No one invented it." Rather, money-commodities appeared *spontaneously* as special devices to meet human needs, much like language, the wheel and common law.[4]

Second, "the specific forms in which [money] has appeared were everywhere and at all times the result of specific and changing situations." The emergence of money was scattered over time and place, and primitive moneys took many forms – cattle, weapons, furs, salt, and, only later, metals. Menger correctly noted that what might have become an optimal metallic money, say, gold in an urban-commercial setting, would not have been so viable a money as, say, cattle in a rural-nomadic society.[5]

Third, Menger noted, governments, whether benign or oppressive, had little to do with the development of money from barter. "The origin of money … is, as we have seen, entirely natural and thus displays legislative influences only in the rarest instances. Money is not the invention of the

2 Menger, Carl. *Principles of Economics*. New York and London: New York University Press, 1981. Translated by James Dingwall and Bert Hoselitz (German edition first published in Vienna in 1871), p. 262.

3 *Ibid.*, p. 261.

4 *Ibid.*, p. 271.

5 *Ibid.*, pp. 263–266.

state. It is not the product of a legislative act. Even the sanction of political authority is not necessary for its existence."[6]

Although he denied any historic role for the state in the origin of money, Menger suggested that the state might contribute significantly to the acceptability of money. "The sanction of the state," he argued, "gives a particular good the attribute of being a universal substitute in exchange, and although the state is not responsible for the existence of the money-character of the good, it is responsible for a significant improvement of its money-character."[7]

The "sanction of the state" and the "significant improvement" Menger thought possible was for the state to impress upon the money already circulating the additional property of *legal tender* so that everyone would be forced to accept it. A debtor then would be able to clear an obligation to a creditor immediately and without controversy.

Governments have always claimed that monetary systems under their direction require the legal tender provision – that legal tender somehow gilds the gold. The argument is, however, specious on two counts. First, any contract may contain in its text, along with other details, the agreeable medium for its payment. Given this condition, no case exists for a state-enforced legal tender provision. Second, since freely circulating money is already acceptable as far as private volition will take it, impressing it with the legal tender feature can only force it into exchanges where people do not need or want it.

In his section on coinage, Menger embellished his argument for state enforcement of legal tender – an argument that has been common through the ages:

> The best guarantee of full weight and assured fineness of [gold and silver] coins ... can be given by the government itself, since [the government] is known to and recognized by everyone and has the power to punish crimes against the coinage. Governments have usually accepted the obligation of stamping the coins necessary for trade. But they have so often and so greatly misused their power that economizing individuals ... almost forgot the fact that a coin is nothing but a piece of precious metal of fixed fineness and weight, for which ... the honesty and rectitude of the mint constitute a guarantee. Doubts even arose as to whether money was a commodity at all. Indeed, it was finally declared to be something imaginary resting solely on human convenience.[8]

6 *Ibid.*, 261–262.

7 *Ibid.*, 262.

8 *Ibid.*, p. 283.

At this point, Menger signed off on the subject.[9] He apparently could not fathom why or how governments that could do so much good in promoting viable moneys ended up doing so much harm. Public choice economics that would explain this seeming contradiction would not appear until 70 years later.

I quote Menger's musings at some length because his analysis of the early progress of money as a medium of exchange from barter is so reliable, and because his presumption of the role of the state in making a good thing better reflects so well common prejudice on this subject, both in Menger's day and in the present. Money, in this naïve Mengerian world of benign governments, is an unusual artifact: When forced upon society by a legal tender law, its quality and utility improve.

Both laymen and trained professional economists unthinkingly presume that governments as functionaries of the state must configure and control any monetary system. Though money in every case came into existence through the private sector, and while experience shows that governments have routinely abused monetary systems, acceptance of state control over money seems assured by default. The momentum of the status quo is overwhelming; the possibility of spontaneous order to regulate monetary affairs appears to have been lost or forgotten.

Primitive moneys initially had no connection to the state. However, once the more rudimentary moneys had evolved into metallic coins, states became interested and, very quickly, a controlling influence. In ancient Greece, for example, the ruling state assumed for itself the prerogative of coinage. The seal stamped on coins became a trademark. Wealthy and powerful merchants whose coins were current, and who themselves could assume political office, used their power to establish coining monopolies. Minting became exclusively a state function.

State authorities realized many benefits from their coinage powers. First, coinage provided a means of exploiting the booty from military conquests and mining enterprises by facilitating expenditures. It also enhanced the state's collection of tribute and taxes, which, noted Arthur R. Burns in his work on ancient money, "the Romans for the first time made efficient." Religious authorities also coined ornaments and temple treasures in order to obtain usable currency.[10]

[9] Menger concluded his discussion of coinage by remarking at length on the difficulty of producing smaller denominations of coinage for common use – the problem that the Framers tried to remedy with "coin money and regulate the value thereof." *Ibid.*, pp. 283–284.

[10] Burns, Arthur Robert, *Money and Monetary Policy in Early Times*. New York: Augustus M. Kelley, 1965 (New York: Alfred A. Knopf, 1927), p. 458.