Lesson 29 Article 1, Section 8

The powers given to congress – Part V (Money)

Provision 87: The People of the United States empower the Congress to coin money and regulate the value thereof and also of foreign coins.

With the possible exceptions of "General Welfare," and "regulate commerce," nowhere has our country strayed further from the founders' intent than in the coining of money and regulating its value.

It's not as if they haven't tried, it's just that everything they tried has failed.

During the Revolutionary War, Congress authorized $240 million worth of Continental Dollars be printed. These notes were supposedly redeemable in gold – by the states! This was not authorized by the states. It came as quite a surprise. Since the states did not have $240 million worth of gold laying around with no better purpose, they printed up more Continentals to cover their obligation. To compound the problem, the British started printing their own Continental dollars. They shipped them over here by the bale! They used these dollars to purchase supplies for their army – our enemy, during wartime. It has been said that the British counterfeit money was printed on higher quality paper than the originals.

With our nation flooded in all of this paper money, the value of a Continental dropped until one dollar was worth less than one cent. Washington, in one of his letters to congress during the war, complained that if he sent a wagon filled with Continental dollars into town, it wouldn't return with a wagon full of supplies.

With this history, it's no wonder that when congress did finally get around to affixing a value for American money, they chose the Spanish dollar in 1785. (Question 6) The Spanish dollar, known far and wide as "pieces of eight," because its value was eight *Reals*, and it could be broken into eight pieces for the purpose of making change. (Question 7) Each piece, called a bit, would be worth 12 and a half cents. And two bits would make a quarter.

It is suggested in the book that our dollar sign was inspired by imposing the letters S and P over each other, standing for Spanish Peso. (Question 8) The word dollar is supposedly taken from the Czech word for valley, THALER, since the Bohemian valley was a depository for silver in Europe and most coins came from there. (Question 5)

In 1786 congress set the value of a dollar to 375 and 64/100 grains of fine silver. (Question 9)

The following year saw the Constitutional convention.

One phrase included in the first draft of the Constitution, along with the other enumerated powers in Article 1 Section 8, was "emit bills of credit." This created a firestorm of debate. Some interesting quotes appear in the book on pages 420 and 421. One delegate compared emitting bills of credit with the mark of the beast in Revelations. Another stated that if those words remained in the text, he would vote against the entire Constitution. What do you suppose is meant by "emit bills of credit?" It means issuing paper currency even if backed by a tangible asset. (Question 1) As you've seen, the Continental dollar was issued on the promise and credit of the states. With nothing solid behind it, the more printed the less valuable each one became. So the phrase "emit bills of credit" was stricken. (Question 2) Additionally, in Article 1 Section 10, the states were also forbidden issuing unsupported paper money. The framers had learned the hard way from the experience with the Continentals during the war. (Question 3)

It must be noted here, that this restriction against paper money only applies to the government. It's like the first amendment's restriction against establishing an official religion. The assumption was that people would have a hard time carrying around gold and silver so they would deposit their "hard currency" in a local bank and be issued notes from the bank that would represent that gold and silver. The people could then exchange these paper notes, making commerce safer and easier. But at any time, the bank could be asked to redeem those notes for gold or silver by whoever owned them at the time.

The framers knew the people would have confidence in the money if they knew it was backed by precious metals. The government itself could only issue coins made of gold or silver. (Question 4) This also aligned with both the Old Testament and the ancient Anglo-Saxon laws.

If you could, would you redeem your bank notes for gold or silver?

Once the Constitution was ratified and put into action, the Congress passed the Coinage Act in 1792. (Question 10) This legislation defined the coins the federal government was to make. The dollar was redefined as 416 grains of standard, instead of the fine silver as before. The silver coins were the silver dollar, half dollar, quarter dollar, dime and half-dime. The amount of silver in each coin was in direct ratio to the 416 grain standard. (a dime would have 41.6 grains of silver)

Copper coins were the penny and half-penny.

The gold coins were the Eagle worth $10, and the half-Eagle. (Question 11) The double-eagle came later.

The Coinage Act defined the death penalty for anyone willfully debasing the currency. Yet it also provided "Free Minting Privileges." This means anyone could take raw gold or silver (or, presumably foreign coins) to a US mint and have the metal made into coins. (Question 12) This practice continued until 1873.

The legislators screwed up a bit on the ratio to the value of silver to gold, setting it as 15 to one. It wasn't until 1834 that the ratio was changed to 16 to one – a more fair assessment. But trying to control the price and value of precious metals by way of legislation probably wasn't a good idea either.

Alexander Hamilton, our first Secretary of the Treasury under President Washington, persuaded congress to approve a Bank of the U.S. (BUS for short) based on the Bank of England. The BUS was a privately owned bank that became the repository for tax collections. It also issued currency. Its main functions, as Hamilton saw them, was to issue bonds to clear the national debt (remember, he had the federal government assume all the debts incurred by the states during the war). He foresaw that wealthy investors would buy the bonds, and not only reduce the debt, making these wealthy and powerful men beholden to the new federal government.

The bank had been given a charter of just 20 years. When that time expired in 1811, so did the bank because congress refused to renew it. Just in time for the War of 1812.

During this war, most state chartered banks quit paying each other in precious metals because their supply ran perilously low. This did not, however, keep these same banks from issuing more paper money.

To make matters worse, a volcano on the island of Java erupted spewing so much fine ash into the air causing global cooling, causing snowfalls throughout the summer of 1816. Crops were ruined. The economy was in a shambles.

So, in order to take credit for "doing something" Congress authorized a second Bank of the US. A bank so big and so well funded, state chartered banks had a hard time competing. The first action taken by the new, improved BUS was to harness inflation. So it contracted the money supply. Prices went down – making consumers happy, but making farmers miserable. Remember that 60 to 80 percent of Americans at this time were farmers.

With their customer base decimated, a lot of smaller banks in rural states failed.

A side-note: Do you know why the southern part of the US is called "Dixie?" What does that word even mean? Dixie? I'll tell you. Amid all the fallacious paper money floating around between the War of 1812 and Civil War, one bank operated on very conservative principles: The Citizen's Bank and Trust Company of New Orleans. Their bills were trusted and honored across the country. Their currency was written in a mixture of English and French. So their ten dollar bill had both words "ten" and "dix." (rhymes with geese) Gradually the South became the land of Dixes – or honest money.

Speaking of the Civil War... Congress was having a difficult borrowing and borrowing more and more money to keep the Union afloat. So what does a country do when it is unable to borrow the funds it wants? It prints money. Called greenback dollars, currency that, unlike the Continental dollar, had not even the slightest pretense of being backed by anything. Greenbacks couldn't be redeemed for gold or silver. As it turns out, they couldn't be redeemed for much of anything. America's first attempt at a true "fiat" money system. Thankfully, it didn't last long; by 1878 the greenback was down to about 35 cents in value. So Congress decided to change the greenbacks from fiat money to debt money by offering to redeem greenbacks in gold at face value.

Congress also quietly began discouraging state banks from issuing currency by taxing their notes. The government also chartered a series of "National" banks. This pretty much left the field open for the greenback.

This attempt at centralizing banking actually worked pretty well. It powered the industrial revolution. And with the industrial revolution, came all the abuses capitalism is famous for: trusts and monopolies, worker abuse, and price gouging to name but a few. But we covered this two lessons ago when we discussed the Commerce Clause.

In 1913, the Federal Reserve System was created to replace the National Bank system. (Question 13) Their currency, called Federal Reserve Notes, was also redeemable in gold upon demand. True to progressive policy: leave banking to the experts in Washington. They will know better how to manage the economy – just think of it, no more boom to bust cycles, no more depressions, no more inflation. A controlled utopia for all.

Along comes the great depression. How did THAT happen in our utopia? A man is elected president promising great hope and change.

One month after Franklin Delano Roosevelt's inauguration, he sprang into action: through executive order he commands all privately held gold be turned in to the nearest Federal Reserve System bank. Coins, bullion, even gold certificates were handed over. Those turning in their gold were given Federal Reserve Notes redeemable in silver. Dollars could no longer be redeemed (by Americans) for gold. (Question 15)

Six months later, the Gold Reserve Act was passed changing the value of gold from $20.67 an ounce to $35 per ounce. Seemingly overnight, all of those silver certificate holders lost 40% of what their gold HAD BEEN worth. The Federal Reserve was also given free and clear title to all the gold they had collected.

America now had a dual monetary system: gold for foreign transactions and silver for domestic.

In 1965 President Johnson authorized the issuance of "sandwich" coins devoid of most of the silver content. In 1968 Johnson canceled the redeemability of silver certificates, they would now be fiat money only. (Question 16) (Think for a moment about the Coinage act of 1792)

By 1971 President Nixon was in a bind: the Viet Nam war dragged on, he wanted to fund his brand new Environmental Protection Agency (EPA) but most importantly, he wanted to complete President Eisenhower's legacy – the interstate highway system. But he was out of cash. Worse, ever since the Bretton Woods agreement at the end of WWII, the US had been throwing cash money at Europe to help them rebuild after the war, Europeans had tons of Federal Reserve Notes that were still redeemable in gold. President DeGaulle of France, having his own money troubles, made it known that he intended sending a shipload of Federal Reserve Notes to the US for redemption.

Richard Nixon had to act quickly to avoid a run on the treasury: He put a stop to this by unilaterally terminated the US dollar's convertibility to gold. Nixon effectively defaulted on US obligations to the rest of the world-- a complete betrayal of trust. Yet despite this massive shock that reset the global financial system, the dollar somehow managed to remain the world's reserve currency.

You'd think they would have been grateful the rest of the world gave them a second chance. But no. Over the past 43 years, the US has continued to print, and devalue the dollar. *

This ended the dual monetary system: now there was nothing but worthless, fiat money for all transactions, both foreign and domestic.

A couple of years later, the dollar was officially devalued by changing the price of gold from $35 to $42.23 per ounce. After that the value of a dollar was completely disconnected from gold, allowing the dollar to "float" on the open market. This also allowed gold's price to float. (I assume Americans were at this point allowed to own gold again.)

Thanks to this, inflation ran rampant in the 1970's. Are you old enough to remember grocery prices rising three to four times a week? Remember certificates of deposit paying 11 percent? How about when credit card rates shot up from seven to 25 percent? Wait they're still around 25 percent.

I dare to say inflation is the real reason presidents Ford and Carter were both one term presidents. There were other factors, of course, but when inflation is spiraling out of control, the general mood of the electorate is not good. It would be hard for anyone to be reelected in such an atmosphere.

The constitution gives the federal government the exclusive right to coin money and regulate the value. Once a right is conferred by the people can that right be handed off to a third party? Especially a privately owned company? Especially without consulting and getting the approval of those who conferred that right in the first place? (Question 14)

* Adapted from SovereignMan.com