Vol. XXIII No. 3

ECONOMIC EDUCATION BULLETIN

March 1983

Published by

AMERICAN INSTITUTE *for* ECONOMIC RESEARCH

Great Barrington, Massachusetts 01230

50 YEARS OF MONETARY MISCHIEF

> There is no need in human life so great as that men should trust their government, should believe in promises, and should keep promises in order that future promises may be believed in and in order that confident cooperation may be possible. Good faith – personal, national, and international – is the first prerequisite of decent living, of the steady going on of industry, of governmental financial strength, and of international peace. – Benjamin M. Anderson

Fifty years ago, respect for monetary promises was dealt a severe blow. A new era of monetary tampering, tinkering, and chiselling started. In many ways, today's economic troubles can be traced to that change in attitude. The smooth operation of the wheels of industry and commerce demands the widespread fulfillment of a vast web of promises, and virtually all economic promises involve the currency unit. When the currency unit is unrealistic, promises made in terms of the unit also are broken, even if the parties involved would perform as agreed. When past promises are broken, fewer promises are accepted, in the future, fewer transactions occur, and economic activity is impeded.

Today's economic problems perplex many professional economists. New theories are offered, inasmuch as the former dominant theory – Keynesianism – now is widely recognized to be fundamentally flawed. Old theories, with modifications are being resurrected. When explanations are sought for what went "wrong," inquirers would do well to consider the views of keen economic observers who did not succumb to the allure of Keynesian spend-for-prosperity notions. One was our founder, E. C. Harwood, who developed a framework for studying money and banking that serves us to this day. But here our focus is on the views of some others who, as did E. C. Harwood, foresaw monetary turmoil and economic adversity as the outcome of a lax attitude toward the fulfillment of promises – especially the monetary promise.

The economic hardship thus far experienced almost surely will be mild compared with later suffering unless the lessons of the past are used for corrective steps. Consider these comments of Walter E. Spahr:

> Our government leaders who are conducting our irredeemable currency and credit program, apparently cannot be convinced that our people can be faced with the common end of tragedy and disaster as a consequence of our use of irredeemable currency. Until that devastating catastrophe occurs, they proceed as though they assume that some special Providence will protect us from the common ultimate end of monetary and social chaos in which the helpless and hopeless mass of people cry out in despair. It is the latter that can do little or nothing but suffer because inept men, in the area of monetary economics, took possession of the monetary program of our nation.
>
> When monetary statesmanship is replaced by foolishness, recklessness, irresponsibility, and related examples of human misbehavior in the area of monetary economics, catastrophe and chaos await the unfortunate nation caught in that frequent tragedy of mankind. The United States is illustrating once more how a nation, when sufficiently inept and presumptuous in the area of monetary economics, pursues the course that commonly ends in distress, tragedy, and despair.[1]

A TURNING POINT

On March 6, 1933, 50 years ago, President Franklin D. Roosevelt as part of his "proclamation" of a bank holiday, ordered banks, not to pay out any gold or silver. As the first step toward an irredeemable, fiat dollar, this was one of the most disastrous acts in recent times, disastrous both for the United States and for the rest of the world. The world increasingly is struggling with the consequences of that act, when the redemption of promises to pay dollars (dollar-claims) in actual dollars (gold) was suspended – for 50 years so far, as it has turned out – and the gold standard thus was discarded.

FDR's repudiation of the solemn promise of the U.S. Government to pay gold, only 2 days after he took the oath of office by which he swore to uphold the Constitution of the Republic, cannot be defended as fulfilling a campaign promise to the people. Indeed, it was contrary to his promises. And when a nation's leaders disregard these promises when that is convenient, that the public later should adopt those practices should not be surprising. James P. Warburg, in his book, *Hell Bent for Election*, allows Roosevelt's own words from a speech given in Butte, Montana, September 19, 1932, to indict him: "Remember well that attitude and method – the way we do things, not just the way we say things – is nearly always the measure of one's sincerity." (p. x) This speech was omitted from *The Public Papers and Addresses of Franklin D. Roosevelt*, compiled by Samuel I. Rosenman.

Also omitted was the speech given by Roosevelt in Brooklyn, November 4, 1932, in which he chastised those who alleged he was plotting to tamper with the dollar:

> One of the most commonly repeated misrepresentations by Republican speakers, including President [Hoover] has been the claim that the Demo-

[1] *Monetary Notes*, February, 1970 (The Economists' National Committee on Monetary Policy, New York) p. 1.

cratic position with regard to money has not been made sufficiently clear. The President is seeing visions of rubber dollars. This is only a part of his campaign of fear. I am not going to characterize these statements. I merely present the facts.

The Democratic platform specifically declares: "We advocate a sound currency to be preserved at all hazards." That, I take it, is plain English.

Far up in the Northwest at Butte I repeated the pledge of the platform, saying "Sound money must be maintained at all regards."

In Seattle I reaffirmed my attitude on this question. The thing has been said . . . in plain English three times in my speeches. It is stated without qualification in the platform and I have announced my unqualified acceptance of that platform in every plank.[2]

The Democratic Platform of 1932 was sound on the issue of monetary economics. The author of the monetary plank was the widely respected Senator Carter Glass. Senator Glass declined the offer to serve as Mr. Roosevelt's first Secretary of the Treasury, apparently after he failed to receive satisfactory assurances from the President-elect that the new administration under no circumstances would adopt inflating as a policy and that the monetary plank of the Democratic Platform would be respected. After the new President suspended redemption on March 6, 1933, the Democratic Platform was largely abandoned.

Although the new President's monetary plans were not clear at the time, in retrospect they reflected a one-way thrust toward the centralization of power over monetary matters. Here is a critique of Mr. Roosevelt's monetary policies by a man who served him as an Under Secretary of the Treasury from May 2, 1934 to February 15, 1936:

Free enterprise has made us great and prosperous and free enterprise is an essential of democracy. Consider certain principles deemed through the centuries vital for free enterprise under liberal governments:

The gold standard, so that money is free and stable and cannot be ruined by an unwise Government. . . . We have . . . no assurance of future convertibility into gold or anything else. The Administration is all-powerful as regards monetary values. . . .

No sound principles have been established. Rather past principles considered sound for centuries have been laid aside and in their place the Administration is the dictator of what is to be done from day-to-day. . . .

Unfortunately the record shows that governments cannot be trusted to use wisdom in monetary affairs or to keep their promises.

My plea is for the return to a definite gold standard, a uniform currency, the placing, under carefully drawn laws, of full power and responsibility on the Federal Reserve System as the proper instrument of Congress to assume control of rates and sound credit policies.[3] This would involve the cancellation of all unnecessary monetary powers now delegated to others by Congress. . . .

For centuries fixed values of gold and silver were the means of monetary stability and, all told, these values served well; financial troubles have been created by overborrowing, bad banking practices, dislocations by wars, and speculations followed by bankruptcies and depressions, coupled with lack of providence and disregard of solemn promises by governments. Unwise use of credit, not the fixed gold value, has been the seat of monetary troubles. Let us remember that the cause of instability during the past twenty years has not been the failure of the gold standard; it has been the partial destruction of this standard by the world-wide war inflation and tremendous borrowing for war purposes accompanied by dislocation of all trade for purposes of war – accompanied and followed by creation of international debts with no means of repayment in full and intensified by the reckless speculation on borrowed money in the late twenties. No management of currency could have withstood these forces.

Let Congress fix the value of gold definitely; let us buy and sell at this price with all the nations and thus return to the gold standard as the tried and tested base for our money. Then the countries of the world can tie in their currencies to ours and to gold, aided perhaps in some cases with credits, and a great step will have been taken in restoring stable money. . . .

Let us recognize that gold should not be a Government monopoly to be played with at the dictates of party politics. . . . It should be our money and be stored in great reserves in our banking system payable to all, whether for domestic or foreign use, and removed from political control. Management by a political chief at his discretion is never the road toward sound money.

Furthermore, let us recognize that in a free economy there is no substitute for gold. Either gold is shipped when demanded by the economy of free peoples or money is no longer free, nor are the people. . . .

Only through gold can the countries of the world maintian stable currencies in a free economy. . . . We have long recognized the desirability of not having monetary powers in the hands of political representatives under constant pressure of minority groups, who are often not well-versed in monetary matters. Thus our Federal Reserve System was formed by Congress as its agent to strengthen the banking system and supply currency, when needed, while the officers were to be chosen for wisdom and knowledge and removed from politics. . . .

To leave the value of our money subject to the whim of political leaders indefinitely is to court disaster, as the long experience of mankind well indicates. We need to recognize sound principles and implant these into our monetary laws if we are to have assurance of sound money for the future generations. One principle above all others should be definite. Trust not the ideas of political leaders, but let our dollars be assured of convertibility on demand into a definite amount of gold – remembering that after centuries of experience gold has been chosen by mankind as his money.[4]

---

[2] Rixey Smith and Norman Beasley, *Carter Glass* (Longmans, Green & Co., New York 1939) pp. 321-322; James P. Warburg, *Hell Bent for Election* (Doubleday, Doran & Co., Garden City, N.Y., 1935) pp. 22-24.

[3] We, too, once thought that the Federal Reserve System could serve to preserve a sound money-credit system. But the Fed Reserve's active participation in the removal of market constraints on the banking system, in the monetization of Government deficits, and in the general promotion of inflating constitutes condemning evidence to the contrary.

[4] J. Jefferson Cooledge, *Why Centralized Government* (The Riverside Press, Cambridge, Mass., 1941) pp. 11, 45-49, 51, 55.

But the President, who did not have a popular mandate to tamper with the monetary system of the country, sought monetary changes that would give Government unrestrained power to manipulate money. In the words of his Secretary of the Treasury Henry Morgenthau, Jr., "As the President put it, they [the Roosevelt Administration] unshackled themselves and the federal government. . . . They made the manipulation of the value of the currency an open and admitted instrument of public policy."[5]

IT IS DISHONOR

Lest we think that all the critics of Roosevelt's move to destroy the gold standard came from outside the Government, the reactions of Senators Glass and Gore should be recalled, as reported by Benjamin M. Anderson:

> Senator Carter Glass said, as he talked in the President's office on the day the [Thomas] Amendment was first announced: "It's dishonor, Sir. This great Government, strong in gold, is breaking its promises to pay gold to widows and orphans to whom it has sold Government bonds with a pledge to pay gold coin of the present standard of value. It is breaking its promise to redeem its paper money in gold coin of the present standard of value. It's dishonor, Sir." To the grand old Senator, morality was something written in the Heavens, eternal and unchangeable. But the pragmatic philosopher, to whom morality is human-social discipline, growing out of the needs and experiences of human social life, was no less shocked than the Senator. There is no need in human life so great as that men should trust their government, should believe in promises, and should keep promises in order that future promises may be believed in and in order that confident cooperation may be possible. Good faith – personal, national, and international – is the first prerequisite of decent living, of the steady going on of industry, of governmental financial strength, and of international peace.
>
> The President's course in connection with the gold standard represented an act of absolute bad faith. He had not dared to make any suggestion of anything but adherence to the gold standard in the campaign. Both political parties had stood for the gold standard in the campaign. The President had given 100% endorsement to Senator Glass's magnificent speech in the campaign replying to President Hoover's gold standard statement – and Glass, in that speech, had pledged the Democratic Party to protect the gold standard. The Government, after the defeat of the Free Silver movement in 1896, had twice pledged the faith of the Government to the maintenance of the gold standard, once in legislation in 1900 adopted by a Republican majority, and once in 1913 in the Federal Reserve Act adopted by a Democratic majority. The Government had not only written the word "gold" on the Federal Reserve notes, but also on all its bonds and on every interest coupon attached to them. The Government was bound by its solemn promises, and the President was personally bound by his campaign utterances and by the platform of his party. It was dishonor.
>
> We knew nothing of "hot money" on a large scale in the decades that preceded the first World War, when great governments protected the gold standing of their currency as a matter of course because it was the honorable and expected thing to do. But since the bad faith of the two greatest governments in the world, Great Britain in 1931 and the United States in 1933, we have had a world full of "hot money" jumping about nervously from place to place, seeing no safety anywhere, but going from places that seemed unsafe to places that seemed less unsafe. We have had a world in which conscientious and scrupulous trustees have been turning from "gilt-edged bonds" toward common stocks, not because common stocks were safe, but because they were less unsafe than Government obligations, and we have had them doing this with the approval of scrupulous and upright judges who have taken cognizance of the bad faith of the Government.
>
> President Roosevelt did not escape sharp rebuke from distinguished men in his own party who opposed this bad faith. As part and parcel of his policy of debasing the gold dollar, he had introduced into Congress a joint resolution (signed by the President on June 5, 1933) abrogating the gold clause in existing governmental and private obligations. The resolution not only forbade private debtors to keep their gold obligations, but also freed the Government itself from its solemn promise. Before the introduction of this resolution, the President conferred with a group of Senators regarding it. Among them was Senator Thomas P. Gore, the great blind Senator from Oklahoma. When the President asked Senator Gore for his opinion regarding the matter, the Senator replied, "Why, that's just plain stealing, isn't it, Mr. President?" Senator Gore, moreover, in debate on the Senate floor, said, in substance, this: "Henry VIII approached total depravity, as nearly as the imperfections of human nature would allow. But the vilest thing that Henry ever did was to debase the coin of the realm!"
>
> Senator Gore, who, though blind since the age of twelve, made himself a great scholar, and who mastered the literature of money as few professional economists have, exhibited throughout his career courage and independence and tenacious adherence to principle almost unmatched in our history. He defied two Presidents of his own party when he believed that they were wrong. He lost his seat in the Senate as a result of defying Woodrow Wilson, but he came back. After his defiance of President Roosevelt in the conference above referred to, he was a marked man. Roosevelt succeeded in beating him for renomination to the Senate in 1936. He could have made his peace and would have been reelected, had he yielded on any one of several issues in the period between 1933 and 1936, but he would not yield. The country's greatest need today is more men like Senator Gore in high places.
>
> There was bad faith on the part of the British Government and bad faith on the part of the United States Government in abandoning the gold standard. The British at least had the excuse of being under heavy pressure and of being short of gold. It has been shown that the excuse was not a valid one. But we had no pretext of an excuse. We went off the gold standard with $3,000,000,000 of gold in the Federal Reserve banks.[6]

---

[5] John Morton Blum, *From the Morgenthau Diaries: Years of Crisis 1928-1938* (Houghton Mifflin Co., Boston, 1959) p. 75.

[6] Benjamin M. Anderson, *Economics and the Public Welfare, Financial and Economic History of the United States, 1914-1946* (D. Van Nostrand, Princeton, 1949) pp. 317-320.

Herbert Hoover, the man FDR defeated in 1932, gave his own appraisal of the monetary mischief initiated by his successor:

> Although Roosevelt had denied any such intent during the campaign of 1932, he stepped as soon as possible into managed currency, the power to create fiat money, and the abandonment of the convertible gold standard just as I had forecast. In every case, that was the first step toward fascism, socialism, planned economy, or whatever other name collectivism happens to be using at the moment. Currency convertible into gold of the legal specification is a vital protection against economic manipulation by the government. As long as currencies are convertible, governments cannot easily tamper with the price of goods, and therefore the wage standards of the country. They cannot easily confiscate the savings of the people by manipulation of inflation and deflation. They cannot easily enter into currency expansion for government expenditures. Once free of convertible standards, the executives of every "managed-currency" country had gone on a spree of government spending, and the people thereby lost control of the public purse – their first defense against tyranny.[7]

Another eye-witness of the adoption of managed money in the United States, Garet Garrett, observed:

> ... Certainly almost no one who voted in November, 1932 for a sound gold standard money according to the Glass money plank in the platform could have believed that less than a year later, in a radio address reviewing the extraordinary monetary acts of the New Deal, the President would be saying: "We are thus continuing to move toward a managed currency."
>
> . . . . .
>
> And so the first problem was solved. The seat of government was captured by ballot, according to law.
>
> . . . . .
>
> So it was that a revolution took place within the form. Like the hagfish, the New Deal entered the old form and devoured its meaning from within. The revolutionaries were inside; the defenders were outside. A government that had been supported by the people and so controlled by the people became one that supported the people and so controlled them.
>
> . . . . .
>
> By this chain of events a revolution was brought to pass, almost unawares. Many people are still dim about it. The revolution was that for the first time in our history the government was *free*. Formerly free government was understood to mean the government of a free people. But now that meaning changed. The government itself was free. Free from what? Free from the ancient limitations of money. It no longer had any money worries; it had no longer to fear a deficit because it could turn a deficit into money; the bigger the deficit the richer the government was. It had only to think billions and behold, the billions were in the Treasury.
>
> After that it was merely nostalgic to talk any more of controlling government or limiting its powers of self aggrandizement. What had limited it before was the public purse, which the people filled. Now, by this new magic, it could fill its own purse and scatter beneficence not only at home but throughout the world....
>
> . . . . .
>
> ... Actually in a few years, a momentous change has taken place in the relationship between government and people. It is commonplace to say that people have lost control of government. It is a thing too vast, too complex, too pervasive in all the transactions of life to be comprehended by the individual citizen. Indeed, as the Hoover Commission was able to show, the government no longer comprehends itself.
>
> ... No government can acquire power and put it forth by law and edict. It must have the means....
>
> That is why every government in the secret recesses of its nature favors inflation. Inflation provides the means. Under pretense of making money cheap for the people, the government creates money for itself. When it goes into debt for what it calls the public welfare it first fills its own purse and then, as it spends the money, it extends its authority over the lives and liberties of the people. It suborns them. Their consent is bought. It is bought with the proceeds of inflation.[8]

THE CONSTITUTION IS GONE

In the United States, the Constitution is the supreme law of the land, but the Supreme Court is the ultimate interpreter of the Constitution. After the Congress rubber-stamped FDR's anti-gold, pro-managed-money actions with the passage of various bills and the adoption of resolutions, the Supreme Court was called upon to judge the constitutionality of the actions.[9] In a series of four cases, called the "Gold Clause Cases," argued January 8, 9 and 10, 1935 and decided February 18, 1935, the Supreme Court (by a five to four majority) sustained the actions of the Congress except in one instance. In that instance, eight of the nine Justices agreed that Congress was prohibited from repudiating the promise of the Government in its debt contracts to pay gold money of a specific weight or its equivalent value in paper money or gold money of a different weight.[10] Even in this instance, however, the plaintiffs were not awarded damages, because the five to four majority concluded that the gold-clause Government bondholder did not suffer any damages in terms of general purchasing power by having been paid in devalued irredeemable dollars rather than the promised gold dollars or their equivalent in new dollars.

The dissenting view in the gold-clause cases was delivered by Justice McReynolds in vivid language:

> Mr. Justice Van Devanter, Mr. Justice Sutherland, Mr. Justice Butler, and I do not accept the conclusions announced by the Court. The record reveals a clear purpose to bring about confiscation of private

---

[7] *The Memoirs of Herbert Hoover: The Great Depression, 1929-1941* (Macmillan, New York, 1952) Vol. III, pp. 390-391.

[8] Garet Garret, *The People's Pottage* (Western Islands, Belmont, Mass., 1965) pp. 20-21, 56, 68, 74, 77.

[9] The key pertinent actions of Congress were: (1) The Emergency Banking Act of March 1933, which validated the provisions of FDR's "bank holiday proclamation," including granting power to the Treasury Secretary to suspend gold payments; (2) The Thomas Amendment to the Agricultural Adjustment Act, May 12, 1933, which, among other things, authorized the President to devalue the dollar but by no more than 50 percent; and (3) the Joint Resolution of Congress to suspend the gold standard and abrogate gold clauses, June 5, 1933.

[10] Support for this conclusion was found in Section Four of the Fourteenth Amendment, providing that "The validity of the public debt of the United States, authorized by law shall not be questioned." If the Congress subsequently could alter the substance of an obligation to pay, the pledge to pay would be illusory and its validity effectively overruled.

rights and repudiation of national obligations. To us these things are abhorrent. We cannot believe the wise men who framed the Constitution intended to authorize them. On the contrary, adequate words of inhibition are there. . . .

It is impossible fully to estimate the result of what has been done. The Consitution as many of us have understood it, the instrument that has meant so much to us, is gone. The guarantees heretofore supposed to protect against arbitrary action have been swept away. The powers of Congress have been so enlarged that now no man can tell their limitations. Guarantees heretofore supposed to prevent arbitrary action are in the discard.

That statement is not overdrawn; you may expect an unfolding unhappy panorama.

The particular situation: There are three classes of cases; one involves private obligations, another solemn promises by the Government to pay, the third perhaps are still more solemn undertakings.

In harmony with policy sanctioned for many years, individuals entered into contracts which they expected would protect them against a fluctuating currency – a depressed currency, if you will. Such currency is not new; it has been known for centuries. Nero used it. Long ago it was familiar in France.

Many men entered into contracts, perfectly legitimate, and undertook to protect themselves. The lender against depreciated currency, the borrower possibly against an appreciated one. Under these obligations millions were loaned. Railroads, canals, many great enterprises were begun and their bonds sold throughout the world. With them went solemn promises that takers would receive in payment money like that furnished by them. Now we are told Congress can sweep all this away; declare such payments against public policy!

Government bonds: Congress in 1900 enacted a statute declaring that money value should depend upon the Gold Dollar – 25.8 grains of gold. Later, that all Government bonds should contain a contract to pay in gold. Billions went out with that solemn obligation in every one of them.

During the World War men stood on the street corners and proclaimed the advantage of such bonds. "We are offering you the finest investment known, the solemn promise of the United States to pay you in Gold Dollars. Our country is in danger, freedom is at stake, your assistance is needed; buy that we may survive." Billions were bought on such assurances. On May 2, 1933, after the Government had commandeered all gold, it nevertheless sold five hundred millions of bonds, containing this same solemn promise!

In 1900 the Government began to receive on deposit Gold Dollars and issue certificates therefor. The Treasury accepted the gold coin. Certificates acknowledged the receipt of gold and promised to return like coin upon demand. Millions of such certificates went out; every one bore that assurance.

In April 1933, under threat of heavy penalties, Congress declared all gold within the United States must be brought to the Treasury and directed the Treasurer to issue for this some form of currency. Millions came in. We left the Gold Standard and refused to recognize obligations. Our currency was depreciated, for all gold bullion received, only paper was offered.

That was not enough. Notwithstanding the five hundred million gold bonds sold on May 2, Congress on the 12th declared its duty to raise the price of commodities and lower the value of securities. Also, that every dollar obligation, whatever the form, should be equal to every other one. And it gave the President power to depreciate the gold content of the dollar to fifty cents.

If in that state of affairs the President had reduced the dollar to fifty cents, the holders of gold securities might have been entitled, under their contracts, to the value of the thing contracted for. But that would not have produced the end desired; so another act undertook to destroy all contracts for payment in gold.

Later the dollar was depreciated to less than 60 cents, and we were told that for all obligations, only 60 percent of the thing contracted for must be accepted.

To that condition our Government came. These suits followed. Not an agreeable situation; certainly not a thing of which I like to speak. But there are responsibilities which attach to a position here – to reveal in all its nakedness what has been decreed is obligatory.

The owner of private bonds demands payment. His debtor replies, "I have no gold with which to pay. I am prohibited by Congress from carrying out my contract; here is a paper dollar, you must take it." And this Court holds Congress may sanction that very thing.

The holder of a Government bond, which promises payment in gold, presents it. The Treasurer replies, "Here is a paper dollar which you must accept; we are prohibited from paying gold and you are prohibited from accepting it." The holder insists, "But my contract provides for payment in gold, or its equivalent." The Treasurer replies, "Take this paper dollar."

This Court, in one breath, declares Congress has no power to repudiate Government obligations; that the Constitution grants the right to bind the Government to pay bonds in coin. In the next it is said, a creditor can get only sixty cents for a promise to pay one hundred, but Congress, although without authority to repudiate debts, has declared unlawful the acceptance of what it agreed to pay. It being unlawful now for him to accept the thing contracted for, he is not damaged! This gives with one hand, takes with the other.

Such argumentation, I submit, is at war with logic and suggests unconscious, though dominant, wishing.

The gold certificates: All gold certificaters recite upon the face that gold has been deposited and promise to pay this metal upon presentation of the certificate. What is he told? "For each dollar, we offer sixty cents; you must take it." "But," he says, "in the Treasury are gold dollars which I placed there upon the solemn promise of return upon demand." The Treasurer declares, "Congress has made payment of gold unlawful; has made it unlawful to receive or keep gold, therefore you are not hurt. True, I do not return what you left here, but I give you a promise to pay something else in the indefinite future; that is now full value." Such reasoning seems to us mere verbiage – a conclusion without regard to fact.

We are told that all this is possible because under the provisions of the Constitution granting power to

coin money and regulate its value, Congress may adopt any monetary system and effectuate this by destroying whatever interferes.

It is well to observe the point at issue. Mere generalities with many words avail nothing. None deny the power of Congress to adopt a monetary system. But because Congress may adopt a system, it does not follow that this may be enforced in violation of existing contracts. Congress may not arbitrarily undo what it has sanctioned.

What was the purpose of the grant? Obviously to fix standards and establish a circulating medium; not to cover up repudiation under the guise of law. Congress has full power to provide for honest obligations. Such was the holding in the Legal Tender cases. Here we have a supposed monetary system intended to effectuate plain repudiation.

First, the President is granted power to depreciate the dollar. He fixed sixty cents. Next, attempt is made to destroy private obligations by "A Statute to Regulate the Currency of the United States." Also to destroy Government obligations. The same language – the same section – covers both. Having put out five hundred million Gold Clause bonds in May, Congress declares in June that these promises so to pay in gold are illegal and contrary to existing public policy, although this had been consistently observed for many years and had been approved by the courts.

After this effort to destroy the gold clause, the dollar is depreciated to sixty cents. Prices are to be estimated in deflated dollars. Mortgages, bank deposits, insurance funds, everything that thrifty men have accumulated, is subjected to this depreciation! And we are told there is no remedy!

We venture to say that the Constitution gives no such arbitrary power. It was not there originally; it was not there yesterday; it is not properly there today.

We are confronted by a dollar reduced to sixty cents, with the possibility of twenty tomorrow, ten the next day, and then one.

This thing we utterly abhor. We have earnestly tried to prevent its incorporation into our system without success.

. . . . .

Shame and humiliation are upon us now. Moral and financial chaos may confidently be expected.[11]

Were Justice McReynolds' words, "Moral and financial chaos may confidently be expected," excessive? Many were sure they were, including Angus D. MacLean, who was the Assistant Solicitor General of the United States when the gold clause cases were held and who was primarily responsible for the Government's briefs in those cases. In a 1937 outline of the Government's position, Mr. MacLean finished with:

Mr. Justice McReynolds concluded his lugubrious dissent in all these cases with the prediction that "Loss of reputation for honorable dealing will bring us unending humiliation; the impending legal and moral chaos is appalling." It is too close to the event to appraise future consequences, but so far it can fairly be replied that no such chaos has occurred and that even now the three great democracies of the world have turned toward monetary stabilization. What has been decided is that in a conflict between the obligation of private contracts and the power of Congress over the monetary system of the country, the private right must give way to public policy.[12]

TWENTY-FIVE YEARS AFTER

In 1937 it was indeed too close to the event to appraise the consequences of the Government's repudiating its promise to pay gold for dollar claims held, embracing the notion of managed money, arrogating power over much of economic life in general, and of disdaining the inviolability of contract. But it is not too close to the event any longer. As we commented at the outset of this bulletin, economic conditions – especially those directly involving money – have become increasingly troublesome and crisis-prone during recent years. The signs of developing chaos are more obvious now, but keen observers reported many such signs long ago. Some 25 years after the event, one keen observer of the monetary scene, Dr. Melchior Palyi, reviewed the consequences of the monetary mischief initiated on March 6, 1933:

"Inflation" means the sustained expectation, if not the actual realization, of a continuous upward pressure on prices in general, or at least in major sectors of the economy. This condition obtains when the money supply and its velocity of circulation outgrow the anticipated flow of goods and services.[13] Which is what has taken place on an unprecedented scale in the last 25 years.

. . . . .

The *modus operandi* of the money supply's inflation is well-known. It rests on the debt monetization practiced by the Federal Reserve System that provides the banks with the reserves to sustain the expansion of deposits. . . .

The prolificness of the Federal Reserve is highlighted by the growth of its credit volume that has risen from a bare $2.6 billion in 1939 to $36.6 billion at the end of 1963. And that is not the whole story. In the 1950's the legal reserve requirements of the member banks were reduced from a range between 28% and 7½% to between 16½% and 4%. The faucets of money inflation are wide open. Easy money – ample liquidity at low cost – is a basic aspect of every inflation; it can be maintained as long as the rise of prices does not catch up with the growth of the money volume, provided that the balance of payments does not deteriorate in the meantime in a catastrophic fashion.

True, the Federal Reserve managed to extricate itself in 1951 from the obligation to maintain a frozen rate structure – ½% on 30-day Treasury bills and 2½% on long maturities. The changeover to variable interest rates had the salutary effect in the disinflationary direction; federal obligations of more than one year's lifetime have lost the character of prime liquid assets which they had acquired under the rule of rigid interest rates. But the policy changeover stopped short of restoring an unfettered money

---

[11] "Justice McReynolds' Corrected Dissent in the Gold Clause Cases," reprinted in Henry Mark Holzer, *The Gold Clause* (Books in Focus, New York, 1980) pp. 91-96, from the *Tennessee Law Review*, 1945, pp. 768-771, where it contained as part of an introduction this comment of Justice McReynolds, "A while ago I corrected a badly reported account of my oral dissent in the Gold Clause Cases. I send herewith a copy which you may feel free to publish if you so wish."

[12] "Outline of the Gold Clause Cases," reprinted in Holzer pp. 60-66 from the *North Carolina Law Review*, 1937, pp. 249-254.

[13] On this matter, we have a somewhat different view, but its implications are similar to those expressed by the author.

market. Bond prices were kept high by open market operations; especially so since 1960. Abandoning (in 1963) the "bills only" policy by turning some 20% of the portfolio into intermediary maturities, has been very "helpful" in "nudging" downward the long-term rates despite a ½ percent boost in July, 1963, in the short-term sector. The federal government contributes its own share to lowering the charge on long-term loans (for housing, exports, rural electrification, etc.) by credit subsidies and guarantees.

Excessive liquidity has sparked a fantastic expansion of public and, especially, private indebtedness – the liability side, as it were, of the prosperity equation. . . .

Every liability has of course its counterpart in an asset. But *the liabilities consist of dollars in fixed numbers; the estimated value of a non-liquid asset is a volatile quantity.* It may turn out to be purely fictitious. The fact is that all households and a majority of non-financial business firms have maneuvered themselves into an extremely vulnerable position. In both groups, the ratio of debt to net worth has fallen to a level akin to the one that obtained on the eve of the 1929 crisis. And the process is still gaining momentum, as to be expected. Catastrophic repercussions can be avoided only by ever-growing money-outpour in order to reduce the burden of the debt by depreciating the currency's purchasing power. Continued inflation of prices, meaning the progressive expropriation of capital for the benefit of the debtors, is the alternative to debt-liquidation, i.e., depression.

The Debt Deluge stimulates further currency-creation – as long as the authorities cooperate in stretching the monetary base. The "credit-card prosperity" thus engendered may go a long way. But it tends to revolutionize the nation's financial set-up, with incalculable consequences. For one thing, while the volume of liquid assets has been blown up, ever-more symptoms of spreading illiquidity disturb and distort the body economic. This is no paradox. Reckless credit expansion is possible only when creditors and debtors rely on perpetual inflation for being bailed out – and they lose sight of the safety and quality of credit.

. . . . .

Statistical aggregates and over-all averages are poor substitutes for economic judgment, useful as they may be for some purposes. Averages do not disclose the deterioration of the quality of credit; healthy condition in one bank is no offset for the illiquidity of another. In any case, the available data speak an impressive language. Credit terms have been extended beyond reason, up to 10 years or longer mortgages and term loans, often less than "bankable" quality – by any standards derived from past experience. Lax loaning policies reflect the sense of false security, a characteristic feature of the inflationary boom. . . .

. . . . .

Scant attention is being paid to the liquidity status of the institution at the nerve-center of the monetary organism. From the custodian of the currency's stability and safety, the Federal Reserve System has been demoted to a handmaiden of the Treasury; from the leadership position in commerical banking to a depositary of federal securities. *The credit it provides bears no relationship whatsoever to the production or turnover of saleable goods*; it is "financial credit" pure and simple, to serve the government's debt-making and debt-converting operations, and to manipulate interest rates in accordance with "ideological" requirements.

More than one of the original and essential functions of the Federal Reserve have been totally perverted. It has lost whatever control over the *quality* of bank credit it was supposed to exercise at the "discount window": over 96% of its earning assets consists of government paper (the rest being collateralized by government paper). The maturity dates on that sort of paper are irrelevant. Short or long, it is irredeemable in all but name. *The principle of self-liquidating loans is not only forgotten; it has been ridiculed as an antiquated relic. . . .*

The Federal Reserve commands an "instrumentarium" that should permit unquestionable control over the reserves of the member banks. But ever since 1933 the money managers' power has been used to start the inflation and to keep it progressing, with deviations from this canon few and far between. Indeed, it was imposed on the Reserve authorities by the political powers that be. As a matter of fact, no central bank can maintain its independence from a government that suffers from chronic budget deficits. Since 1961 deficit finance has been promoted to the rank of a permanent rule of "sound" economics. Financial vice has become a fiscal virtue.

. . . . .

The illiquidity of the Federal Reserve is potentially the most serious problem created by our inflationary policies. Its ultimate domestic aspect – flight into gold – can be ignored because the police state, inflation's adjunct, prohibits the private ownership of the yellow metal.[14]

. . . . .

In order to force the pace of domestic "growth" – and to win elections – one Administration after the other keeps inflating the money supply. The progressive deterioration of the payments balance and the accumulation of short-term debts to foreigners is camouflaged by tricky financial expediences. Allies and friends are being cajoled and bullied. Some deal: the future security of our monetary *and* economic system bargained away for the sake of inducing a temporary acceleration of the G.N.P.'s growth. A birthright for a pottage of lentils.

. . . All actual and potential worries fade out in the glamorous light of a flourishing prosperity. The longer it lasts, the more people become convinced that we have found the key to the millennium: the government's power to spend and to inflate provides the "built-in stabilizers." For guaranteeing stability and progress, the price mechanism and private initiative are being replaced by the central authority; the autonomous function of the free market by the scheming of politicians in charge of the money printing press.[15]

[14] As we report below, the dollar was made a totally fiat currency on August 15, 1971 when President Nixon unilaterally declared the Government no longer would pay gold for dollar-claims presented by even foreign governments. On December 31, 1974, U.S. citizens again were permitted to hold gold in any form, but since the dollar had become a totally fiat currency, the legalization of gold ownership did not restore the public's direct power over monetary creation.

[15] From Melchior Palyi, "The Great American Inflation: Twenty-Five Years' Records and Results" (unpublished manuscript, Chicago, 1964).

MORE OF THE SAME: EASY MONEY AND PROBLEMS

As followers of our publications well know, the troubling trends that Dr. Palyi spotted 20 years ago, larger Government deficits, "easy" money, excessive use of debt, unsound banking – in sum, toward more and more inflating – have continued, albeit with interruptions from time to time. During the process, remaining gold constraints on the power of authorities over monetary matters were removed.

On March 3, 1965, President Johnson signed a law abolishing the remaining 25 percent gold reserve requirement against Federal Reserve bank deposit liabilities; only the 25 percent gold reserve requirement against Federal Reserve notes (most paper currency in use in the United States) remained effective. But that was not for long. That gold requirement was abolished on March 18, 1968. A day earlier, governments that had jointly operated to keep the value of the dollar in gold markets at one-thirty-fifth of an ounce of gold (a "price" of gold of $35 per ounce), abandoned the effort because they no longer were willing to sell their gold at that price to meet rising public gold demand. The major governments – including, of course, the United States – agreed to continue to exchange gold at the official rate of $35 per ounce, but the private market rate would be whatever private participants determined by exchanging in the markets. Thus, the final link that gold provided to the public to restrain official power over monetary creation was broken; only the U.S. promise to convert officially held dollar claims into gold at the rate of 35 per ounce remained.

We recall at this point, Dr. Palyi's assertion that "[easy money] can be maintained as long as the rise of prices does not catch up with the growth of the money volume, provided that the balance of payments does not deteriorate in the meantime in a catastrophic fashion." During the 1960's, persistent U.S. international payments deficits had placed in foreigners' hands the dollar claims that led to the March 17, 1968 "two-tier" gold market. Furthermore, broad price indexes in the United States rose to then-worrisome rates of increase in the later 1960's, roughly 5 percent annually. In spite of a "tight" money policy during 1970 and an associated recession in the United States, doubt about the future value of the dollar continued to mount – both in private and official circles. On August 15, 1971, after England requested some gold for dollar claims, President Nixon repudiated the U.S. promise to redeem even officially held dollar claims. He had closed the "gold window," and it remains closed to this day. With that act, the dollar became a totally fiat currency in law as well as in practice. In practice, the dollar had become a fiat unit 38 years earlier.

Subsequent to President Nixon's further arrogation of economic power, cycles of crises have become more frequent. In the early 1970's, general price increases rose to double-digit rates and began to overtake the rate of monetary growth; "easy" money had to give way to "tight" money in order to prevent more serious loss of confidence in the dollar – domestically and internationally.[16] But then the most severe recession since the 1930's, that of 1973-75, took hold. Many banks failed and many more were on the brink. "Easy" money – only this time more of it – again was called for, and private and public debt was monetized in record amounts by the banking system. The economy recovered, but price rises also shot up – this time to mid-teen and upper-teen rates. Confidence in the dollar fell sharply, necessitating another application of "tight" money policy. Then followed: the recessions of 1980 and 1981-82, record bank and nonbank failures, forced mergers of thrift institutions; evolution of new types of accounts serving as money, so that authorities do not know what money is; larger-than-ever Budget deficits; international debt moratoria; highly volatile interest rate swings; and many other signs of deeply distorted economic conditions.

When will these grave problems end? We have no idea of the date, but almost certainly it will not be until the public again can believe that most economic promises made – private and public, short-term and long-term, domestic and international – will be fulfilled. We believe that will not happen as long as governments insist on retaining the kind of power that fiat money gives them. When monetary power is more directly vested in the people, as it is with a gold-redeemable currency, fiscal and monetary mischief will be more successfully controlled and a sound foundation will be in place to support sustainable growth by the efforts of a free people.

---

[16] See our *Economic Education Bulletin*, "Signs of More Inflating," December 1982, for evidence and implications of prices catching up with the growth of money.

ECONOMIC EDUCATION BULLETIN

AMERICAN INSTITUTE FOR ECONOMIC RESEARCH
Great Barrington, Massachusetts 01230

Second class postage paid at
Great Barrington, Massachusetts

50 Years of Monetary Mischief

Economic Education Bulletin (ISSN 0424-2769) (USPS 167-360) is published once a month at Great Barrington, Massachusetts, by American Institute for Economic Research, a scientific and educational organization with no stockholders, chartered under Chapter 180 of the General Laws of Massachusetts. Second class postage paid at Great Barrington, Massachusetts. Printed in the United States of America. Subscription: $17 per year.