How Gold Was Money - How Gold Could Be Money Again

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1. Gold and Silver: The Money of the Constitution

Students, scholars, and some curious people who occasionally stray into the text of the U.S. Constitution are properly puzzled by what seems to be that document's " plain language" and some of the things they see around them in the world today. One such thing is the paper money and checks everyone uses to make ordinary transactions. The Constitution stipulates that, "No state shall ... coin money.... or make anything but gold and silver coin' a tender in payment of debts . . . " (Article 1, section 10). Yet on every unit of paper money the U.S. government asserts without apology: "This note is legal tender for all debts public and private." By what political alchemy has gold and silver become paper?

Not only is the paper money legal tender, meaning that it must be accepted as payment for any debt owed by any person to another person or to a government, but the gold and silver specified in the Constitution are nowhere to be seen. Gold and silver coins rarely appear, and then only as collectible artifacts not as money.

This seeming contradiction between the fundamental monetary law of the Constitution and real life conditions might suggest to a thinking person that gold and silver had somehow disappeared from the face of the earth in the 200-plus years since the Framers included that simple clause. However, such is not the case. The world's governments own more than 35,000 tons of gold as bullion and coin, and private persons own another (estimated) 50,000 tons. Silver is even more plentiful. Its current market price, reflecting its abundance, is only about one-eightieth the price of gold.[1]

The absence of gold money correlates with the accumulation of gold hoards in the possession of government central banks and treasuries. If it's there, it obviously cannot be out in markets transacting business dealings, or in banks serving as a base for bank-issued notes and checks.

It was not always this way. Until the time of the Civil War in the United States, banks routinely held gold and silver as redemption reserves for their outstanding notes and deposits while the federal government held just enough to expedite its minting operations. Congress had the constitutional power to "coin money," but that power did not presuppose that it keep any stock of gold and silver beyond the inventory requirements of its mints. Indeed, even though Congress had the power it was not required to coin money at all. Private mints flourished until the Civil War, often minting coins of slightly greater gold content than government mints.

2. Paper Money and Gold after the Civil War

Civil War policies, however, changed fundamentally both the monetary system and the polity norms for governmental management of money. Congress authorized two new paper moneys, U.S. notes, or "greenbacks," which were declared full legal tender, and national bank notes that were legal tender for debts due to and payment due from the federal government. For all practical purposes, both these issues of paper money were obligations that the U.S. Treasury had to redeem in gold on demand after 1879. In addition, silver money at the specified mint price began to decline in real value starting about 1875 due to the burgeoning supplies of silver from the American West, so that it, too, was a viable currency only because it was redeemable in Treasury gold. Gold held for monetary purposes in the 1880s and 1890s therefore became concentrated in the U.S. Treasury and sub--treasuries, whereas 50 years earlier several thousand commercial banks had held the gold to meet the demands of their local depositors and note holders.

The laws that authorized the three major fiat currencies changed the character of the gold standard from a widely dispersed gold standard, kept operational by thousands of local banks, to a "collectivist" gold standard operating from Washington and New York. Almost all the pressure for redemption of paper currency was transmitted to the U.S. Treasury and its sub--treasury offices. During the Panic of 1893, for example, the Treasury allowed its gold reserve to decline from $259 million (average for 1892) to $126 million (average for 1895), or by51 percent. [2]

The Federal Reserve Act that Congress passed in late 1913 continued and aggravated the centralization of gold. The Treasury still held gold as a reserve against its paper currencies outstanding, and the twelve new Federal Reserve Banks received the gold deposits of their "member" banks and gave them in return a bookkeeping reserve asset labeled "Reserve Bank credit." Presumably, the member banks could get these deposits converted into gold whenever they needed it - much as an ordinary householder or businessman could write a check against his deposit at a commercial bank to get cash.

The events of World War I witnessed an extraordinary gold flow into the United States to pay for war materials and services. By 1922 total gold in the U.S. Treasury, including the amount held for the Federal Reserve Banks, was $2,109 million, or 3,188 tons. Treasury gold fluctuated somewhat during the 1920s, but by 1929 was at $3,278 million or 4,956 tons.

3. New Deal Gold Policy: The Government's Great Hoard of Gold

As the Great Contraction began in 1929, the Treasury and Fed increased their hoards of gold -as though the stockpiling of gold in government vaults would serve as some kind of magical panacea that would reverse the disastrous ongoing contraction of money, bank credit, and employment. By 1931, Treasury gold was $3,696 million over 5,500 tons, while commercial banks were failing literally by the thousands for want of reserves.

The compulsion of the U.S. Treasury and Federal Reserve Banks to hoard gold between 1929 and 1933 was in sharp contrast to Treasury policy between 1892 and 1896. In the earlier period the Treasury felt duty-bound to redeem its paper currencies with gold and in so doing lost over 50 percent of its gold reserves. All through the 19291933 period, except for a brief interval in the middle of 1932, the Treasury and Fed added to their gold holdings while the banking system collapsed as its reserves disappeared. The net change in Treasury gold holdings was a minuscule decline of 1.8 percent.[3]

Given the gold flow into the United States at this time, the commercial banks would have had significantly greater reserves for redemption purposes and credit expansion if the Treasury and Federal Reserve had not existed! Rather than an "engine of inflation," the Federal Reserve System at this time was an absorber of gold and an "engine of contraction." Between 1929 and 1933 it allowed the economy's monetary stock of hand-to-hand currency and bank deposits to decline from $26.2 billion to $19.2 billion, or by 27 percent. [4]

Instead of relieving the depressed monetary and credit conditions of 1933 by getting the gold out of the hands of the Treasury and Federal Reserve Banks and into commercial banks and households, New Deal monetary legislation only made matters worse. Congress and the Roosevelt Administration passed several acts in 1933-1934 that added more gold to the government's holdings and at the same time induced the surviving banks to be even more squeamish about extending new credit. On May 12, 1933, Congress passed the Thomas Amendment to the Agricultural Adjustment Act. This provision, among other things, gave the President the power to raise the dollar value of gold by 60 percent. Then on June 5th, three weeks later, Congress passed the Act Abrogating the Gold Clause, which repudiated all gold clauses in all contracts public and private, including the bonds issued by the government itself to help finance World War I.

Next came the expropriation of privately held gold. By the Gold Reserve Act of January 30, 1934, President Roosevelt called into the U.S. Treasury all domestically owned gold and paid for it at the official mint price of $20.67 per ounce. Then, by the fiat power of proclamation given to him in the Gold Reserve Act, he raised the mint price of gold by 59 percent to $35 per ounce. Since the government now owned all of the gold, none of the "profit" from the gold price increase went to private house holds, to banks, or to business firms where it was desperately needed. Rather it enhanced the already bloated hoard of gold in the U.S. Treasury. Treasury gold, which was valued at $4,033 million in January 1934 was accounted at $7,438 million in February 1934! [5]

The political uncertainty in Europe, in addition to the enhanced price of gold in the United States, caused significant exports of gold to the United States in the 1930s. By 1941, Treasury gold had reached $23 billion, which even at the new price amounted to over 20,000 tons! At the same time, private persons and businesses by the Act of 1934 were not allowed to own gold or to use gold for monetary purposes. And certainly the Treasury gold was not their gold.

4. Treasury Gold Policy after World War II

The gold in fact had become nothing more than a balance sheet adornment for the Treasury Department and the Federal Reserve Banks. Government spokesmen dishonestly claimed that the Treasury's hoard of gold "backed" Federal Reserve Banks' notes and reserves. But what does "backed" mean if no one is allowed to own or use the gold? It meant in this case that the U.S. government through its Federal Reserve Banks could issue almost as much paper money as it pleased.

Paradoxical as it might seem, foreigners, unlike U.S. citizens, could legally claim the U.S. Treasury's gold through their central banks and treasuries. Consequently, in accordance with balance of payments adjustments in the 1950s and 1960s, more than half of the Treasury's gold stock was exported to other countries. This continued outflow prompted President Nixon to discontinue even the pretense of a gold standard. On August 15, 1971, he barred any further gold redemptions to foreigners who held dollar claims. The price of gold then became an object of world market forces, but the U.S. Treasury holding since 1971 has remained almost constant at around 260 million ounces, or 8,125 tons. [6]

5. Why the Gold Should Be Separated from Government

What should be done with all this gold the 8,000-plus tons the U.S. Treasury holds as well as the other 27,000 tons that other governments sequester? It seems obvious from the history of the relationship between gold and the state that the more gold there is in the hands of governments the less surely the gold serves as money. Therefore, the only way to restore gold and silver as media of exchange is to get the metals out of the possession and control of governments.

Certainly the gold has no current monetary or fiscal function for its government owners. It generates no revenue of any sort. It has no effect whatsoever on central bank monetary policies nor on the credit volume of the private banking system. In its present status as a government-owned "surplus" commodity, it is the "barbarous relic" that John Maynard Keynes characterized it in 1923. It may serve in the minds of Treasury bureaucrats as psychological starch for something or other that the government does, but the role it could play, and did play in earlier eras, as a viable money is completely absent.[7]

The gold cannot be forced into a monetary role. No government, including especially the U.S. government, is going to re-establish a gold standard by specifying the gold content of gold coins and declaring them legal tender. Treasury spokesmen would claim with some validity that it would be impossible to estimate the gold value of the current Federal Reserve dollar. They would argue that the indeterminacy of gold's monetary value was a good excuse for doing nothing. So the gold would lie there, a useless heap similar in its non-function to other surplus commodities the government has stockpiled.

Even if the Treasury went through the formality of giving dollars a fixed gold value, it would insist on keeping the gold in the Treasury's vaults in order to "back" the existing monetary aggregates that would now be "based" on gold. Central bank policies would continue to operate much as they do today. Rather they would now have an undeserved aura (literally) of respectability behind which Treasury and Federal Reserve managers could conduct business as usual.

Therefore, sound money advocates should not waste their resources lobbying for a gold standard, which by definition would include the state as overseer and manager of a gold currency, specifier of a gold price in terms of dollars, custodian of the gold, and continuing manipulator of a central bank-issued paper money.

No. The only way to ensure that gold becomes a viable money is first to separate the gold from the state and the state from any further role in the operation of a gold money. Indeed, the separation of gold and the state would begin as an economizing measure - a form of privatization. Here are all those thousands of tons of gold lying idle and useless. Give them back to the people from whom the gold was unconstitutionally snatched in 1934.

6. Redistributing the Treasury Gold to the People

The Treasury Department collects and disburses money for the federal government through its Internal Revenue Service (IRS). In some given taxable year, say 19%, the IRS would note the total number of dependents on the various income tax forms1040, 1040A, and 1040 E-Z. It would then issue one one-ounce gold certificate for each listed dependent to the heads of households who had filed the returns.

The stored gold is in the form of ingots each of which weighs 400 troy ounces (27plus pounds), and is worth somewhat more than $15,000 at the current market price of gold. The Treasury would offer to exchange (sell) these bars in the open market for the appropriate number of gold certificates to any private firm or individual tendering them in the proper quantities. It would leave the actual disposition of the gold completely in the hands of private wholesalers and brokers.

In order to get the gold bars from the Treasury, a wholesaler would have to collect enough gold certificates to make his effort worthwhile. Very quickly, the gold market would establish a dollar price for the gold certificates. The price would be slightly less than the spot gold price currently posted in markets because the wholesaler--distributor would have to get some return for his services, which would include shipping, handling, storing, and packaging the gold.

Taxpayers who received the gold certificates would be elated. After all these decades of paying taxes, they were finally getting something in return. True, it would be far less than what they had paid in, but at least the gesture would reflect a disposition on the part of a grateful government to reward its supporters by returning to them some real wealth that the government cannot use and that cost it nothing in the first place.

The new gold owners - virtually all of us - would next ponder what to do with their windfalls. Some would at first want to deposit their gold certificates in banks as gold demand accounts until they were more certain of its value and utility to them. Because many people might want this option, banks would cater to their wishes by offering gold - deposit accounts distinct from conventional checking accounts. The banks would use the gold certificates to claim the gold bars from the U.S. Treasury, and the gold would then become a true reserve backing the gold demand deposits.

Industrial users would also want the gold to make art objects as well as other gold items. And some amount of the gold would probably be used in medical technology and the physical sciences.

Finally, some certificate holders might want to exchange their certificates for gold coins that would be something like the half-eagles, eagles, and double eagles of the pre-1914 era. (The double eagle was a "twenty-dollar gold piece" and contained slightly less than one ounce of gold.) To satisfy the demand for coins, private coin-smiths would buy bunches of one-ounce certificates from the taxpayers who had received them and exchange them at Treasury offices for ingots. The coinage specialists would then produce coins in convenient denominations and sell them to their numismatic clients.

7. How the People's Gold Would Become Money

The gold redistribution would find everyone a winner. True, the U.S. Treasury would lose the gold. But since Treasury executives realized no travail in collecting the gold, and since the gold currently has no fiscal or monetary function to the government or any other use, parting with the gold should cause no more concern than clearing out obsolete records and other trash. Its departure would in fact markedly reduce the administrative costs of Treasury operations.

The now-privatized gold that had become the basis for special bank-administered checking accounts would develop monetary functions. Gold depositors who wished to transact in this medium would have checkbooks appropriately identified with gold logos, and would write checks to anyone who would accept title to the designated quantity of gold as payment for a debt. Gold reserve banks would clear gold balances with each other based on their daily or weekly debits and credits. They would perforce redeem deposits on demand in gold for any gold depositor who so wished. Eventually, borrowers might base their loans on gold, whereupon the gold would complete its restoration as a viable money.

Gold would not become the monetary standard. It would continue to have a dollar-price in the world's gold market but it would not have a mint price specified by Congress. No government department or bureau would own gold. Federal Reserve notes as currency and Federal Reserve Bank reserve-deposit accounts for commercial banks would stiff be the only legal tender (in spite of the Constitution) and available as they are now for those who want conventional fiat paper money. The gold would simply be an alternative money for people who chose to use it for transactions and contracts.

8. The New Gold Money as a Check on Federal Reserve Policies

A final interesting feature of the privatized gold would be the effect of its market price in paper dollars on present-day Federal Reserve policy. Some responsible Federal Reserve officials on the policy-making Federal Open Market Committee (FOMC) are currently trying to implement a policy of long-term price level stability, that is, a policy of zero inflation. However, they are constantly badgered by monetary "activists" in Congress and the Administration who want the FOMC to revert to a short-run inflationary "cure" for unemployment and economic slumps. If the privatized gold became fairly widely used as money side-by-side with Federal Reserve fiat money, the price of gold in Federal Reserve dollars would tend to be an instant check on the state of inflation-much more so than it is today. When the market price of gold rose, everyone would know that the Fed was inflating-that the real value of the paper dollar was falling-and would substitute private gold money for Federal Reserve money. The market price of gold, therefore, would be a constant check on too much monetary activism by the FOMC. It would thereby contribute significantly to the Fed's desired policy of price level stability.

To achieve a gold-based money, the gold must be held ubiquitously so that individual people may endow the gold with monetary properties and monetary functions. But to have this effect, the gold must be in everyone's possession so that everyone "can get the idea." For the last 60 years the Treasury has hoarded thousands of tons of gold, and has only disbursed it to foreign central banks and governments; and for the last 20-plus years the gold has been a largely inert mass of no use to anyone. Even Treasury officials are largely ignorant of its physical details. Suppose, however, that an astute politician promised to return the gold to the people as a means of economizing on the inventory of "surplus" government commodities. Can anyone imagine that such a plank in

a political platform would be unpopular? "No, no," the candidate would declaim, "I am not buying votes with gold. I would not stoop to that. I simply want to economize government operations and, at the same time, return a useful commodity to the public so that people can use it as money if they wish to do so."

Yes, Mr. Candidate, you have my vote.

At the time of the original publication, Dr. Timberlake, this month's guest editor, was Professor of Economics Emeritus at the University of Georgia, Athens.

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1. Lewis Lehman and Ron Paul, The Case For Gold, Washington: The Cato Institute, 1982, pp. 160-161.
2. Richard H. Timberlake, Monetary Policy in the United States, Chicago: University of Chicago Press, pp. 158-159.
3. Ibid., pp. 280-281.
4. Milton Friedman and Anna 1. Schwartz, A Monetary History of the United States, 1867-1960, National Bureau of Economic Research, Princeton: Princeton University Press, 1963, pp. 712-713.
5. Timberlake, ibid. Also, Horace White, Money and Banking, rev. and encl. by Charles Tippets and Lewis Froman, New York: Ginn & Co., 1935, pp. 696-721.
6. Paul & Lehrman, The Case for Gold, pp. 159-161.
7. Treasury officials and other government spokesmen often speak reverently about the "country's gold reserves." This reference is at least 662/3 percent inaccurate. The gold does not belong to the "country"; it belongs to the federal government. And the gold is not a "reserve" for anything. It is an inert stockpile of precious metal. I do not doubt, however, that it is truly gold, and that it exists. Nevertheless, I would like a little more on-the-spot confirmation of this presumption.

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