

...and so, what is money?

Money is fascinating because it is so abstract, intangible, mysterious and quite indefinable. Just think, the paper used to print a dollar bill or a franc or a pound note, as paper, is little different from newspaper, yet it represents some value. People accept money because they know others will accept it, too. We no longer accept gold nugget or dust as it was mined and panned during the gold rush of '49 nor do we accept cattle as it was in early primitive times. That heritage, however, is still with us in our money related words. In fact, the word pecuniary comes from the Latin word Pecus, which means cattle. Cowry (brightly marked shells) have been used as money in the South Pacific, India and Africa, and the teeth of whales have been used by the Fijians.

Unlike barter items, money is an abstract unit by which the value of goods, services, and obligations can be measured. Money is ***anything*** that is accepted as a ***representative*** means of payment. Although it has no worth in itself, it does represent something of worth. Historically, money was usually backed by some commodity of intrinsic value, and could be exchanged or converted into that commodity on demand. This is no longer true, and the story of how the transition took place is an intriguing aspect of the history of money.

Why invent money? The inconvenience experienced by ancestral sellers and buyers when they bartered goods or services was no small motivation to invent money. With money, the act of buying is separated from the act of selling. In its infancy, money was a commodity that had intrinsic value. In this sense, the value of the thing purchased or sold was exchanged for an intermediate money commodity of agreed value, such as gold or shells. Whatever the standard chosen, the purpose of money commodities was to eliminate the need for an inconvenient ***double coincidence of barter***.

American Indians used wampum (strings of shell beads) as money. In 1634 the Governor of Massachusetts Bay, Thomas Dudley, had the Pequots pay him for an unlawful act committed by a Pequot tribesman. Dudley demanded furs and "cash payment" – specifically 2400 feet of wampum. Later, other northeast American tribes demanded wampum as payment for their furs and Governor Dudley made wampum legal tender.

Money was mostly gold and silver coins for the colonists when they left the Old World. The British government had banned the export of gold and silver to the New World. As the colonists were successful in acquiring Spanish silver in their trade with the West Indies, they were left with little options but to pay back to England the same silver they had obtained from Spain for their imports.

During the early 1720's the colonists were hard pressed for coin and began to use locally grown commodities as the units for trade, in effect, making their own money. Beef, pork, beans, peas and rice became their monetary commodities. Virginia made tobacco legal tender and inventories of bales of tobacco were used for the payment of outstanding expenses and salaries. Eventually ***Tobacco Notes*** came into existence and were used as a kind of paper money.

The British Parliament did what ever they could to punish the colonists in order to collect revenue – ***money***. They passed the ***Townshend Acts (1767)***, a series of four acts which were

their historic right over colonial authority, which were named by the colonists after Charles Townshend who sponsored them. The *Suspending Act* insisted that the New York Assembly cease all business until it complied with the financial requirements of the *Quartering Act (1765)*, an act that required that the colonists pay for the expenses of the British troops stationed there. The *second act* imposed revenue taxes at colonial ports on lead, glass, paper, paint and tea. The *third act* was the demand that the colonies pay for additional British officers, searchers, spies, coast guard vessels, search warrants, and writs of assistance and British Customs Commissioners at Boston, all to be financed out of customs revenues. The *fourth act* allowed tea to be exported to the Colonies free of British taxes.

Then there was the *Stamp Act (1765)* which was the British parliament's attempt to collect revenue through direct taxation on all colonial commercial and legal papers, newspapers, pamphlets, cards, almanacs and dice. And, still there was the *Sugar Act (1764)* which demanded duties be imposed on refined sugar and molasses imported into the colonies from non-British Caribbean sources.

In 1775, after the Second Continental Congress was established, Congress tried to finance the war by issuing paper called **Continentials**. Within five years they had printed more than \$200,000,000. They flooded the market with this virtually worthless paper and in an act of desperation consulted with Robert Morris, (1734-1806), an American merchant and banker who is recorded in history as the "financier" of the American War of Independence (1775-83).

As an interim reminder, let us not forget that we are discussing money, which is an abstract intangible.

Morris served on various committees of the Continental Congress and it is purported that he practically controlled the financial operations of the war from 1776-1778. At the end of the war, he became Superintendent of Finance. He raised funds for General George Washington in 1777, shortly after he had won the battle at Trenton. Washington needed \$50,000 and it was dispatched to him immediately after the request was made. Morris also raised funds for Washington to move his army from the New York area to Yorktown, the place where Lord Cornwallis eventually surrendered (1781).

After Congress had flooded the market with its nearly worthless \$200 million *Continentials* in 1780, Morris, in his attempt to rebuild the credit of the government, even circulated his own notes which were backed by his own personal wealth. He influenced the Continental Congress to build a financial infrastructure and under his tutelage, in 1781, Congress opened the doors to the Bank of North America, its first federally chartered bank.

Morris eventually disposed of his banking investments and became heavily involved with real estate speculation. His financial luck eventually gave out, fell into bankruptcy and was confined to a debtor's prison for more than three years before he was released in 1801.

Given its experience with **Continentials**, Congress limited its currency involvement to the minting of specie, i.e., gold and silver coins. Banks would accept deposits in specie and issue

paper notes. Customers gladly accepted these notes knowing well, that they could always be turned in for specie, or “cold hard cash” as the term came to be known.

Banks continued to make the egregious error of issuing *paper money* many times over the value of their coin reserves. The perception of (paper) money’s value and the specie on which it was based, toyed furtherly with the elements of abstraction. It raised the awareness of those who were holding these bank notes, to levels, perhaps, unparalleled before.

Another aspect of the same abstraction was that gold and silver coins were the basis of this banking system. They were tangible and of real substance, but how would one establish the value of the specie, with notes(?), or were the notes a derivative of the specie? Did the specie have a specific value and notes would be issued based upon that specific value?(*Or, did the notes have a value which was transferred to the specie?*) And, what would happen if excessive amounts of notes were issued based on the same specie on deposit in the banks? (See how abstract money is? It was suggested that specie (gold) has a value of so many notes (dollars), and yet, the notes are based on the value of the specie. Perhaps, an economic “chicken and egg” issue).

By 1860, there were more than 1500 state-chartered banks and practically every one issued their own notes. Merchants questioned and often challenged the value of these notes and often discounted them when accepting them for payment. President Andrew Jackson, during his second term, became so disenchanted with the surplus of notes being floated by banks, that in 1836, he drew up the **Specie Circular**. This document decreed that federal lands could only be purchased with specie due to the inflationary condition of much of the bank paper in circulation at the time. As hundreds of westward bound individuals went to their banks to exchange notes for specie to purchase land, a great number of banks closed triggering a depression that lasted until 1843.

In 1861, the War Between the States, created another financial crisis. Individuals concerned about the financial stability of the country, felt the urgency to redeem their notes for gold. As increasing numbers of depositors began demanding gold for their notes, many banks stopped redeeming them. With huge gold deposits hoarded, notes banks had issued previously depreciated greatly and in some instances became worthless.

From 1862 to 1865, the U.S. government issued more than \$450 million in paper money referred to as *greenbacks* that were not backed by gold, to help finance the Union cause in the Civil War. Conservative financiers wanted the government to retire these greenbacks but farmers wanted to keep them so as to enable them to maintain high prices for their crops.

In retrospect the significance of the greenbacks is startling. This was the first time that paper notes, greenbacks, did not represent a commodity of value. They could not be turned in for gold, silver, wampum, tobacco or anything else, then or at any time in the future.

From around 1868-1888, farmers and others with agrarian interests insisted that the government issue additional greenbacks or the unlimited coinage of silver. They formed the **Greenback-Labor Party**, influenced Congress in 1875 to pass the **Resumption Act**, which provided that greenbacks could be redeemed in gold in 1879, and championed the **Bland-Allison Act**, that had

a provision for the resumption of the coinage of silver on a limited basis. It also restored the silver dollar as legal tender and made a new requirement of the U.S. Treasury to purchase between \$2 million and \$4 million worth of silver each month and coin it into dollars. The ***Sherman Silver Purchase Act*** (1890) increased the Treasury's monthly silver purchases by 50 percent in response to the farmers' demand for unlimited coinage of silver.

In 1893, a reduction of gold reserves in the U.S. Treasury had the accusatory finger pointing at the Sherman Act, and Congress repealed the act. In 1900, the ***Gold Standard Act*** was enacted which made gold the sole standard for all currency.

In 1869, Jason "Jay" Gould (1836-1892), a clever financier, speculator and important railroad developer, emerged on the gold trading scene. He teamed up with Daniel Drew, Jim Fisk, William Tweed and Peter Sweeney, and attempted to corner the market of gold trading. They established a quasi boiler-room operation with the buying of gold specie with paper money. They created the illusion that there was a great demand for the purchase of gold. By fictitious market bidding, they drove the price of \$100 in gold specie for \$163.50 in paper dollars. When the price fell to \$133 the U.S. Treasury placed \$4 million in specie on the market. The panic that ensued, which ruined the portfolios of many investors, was called the panic of "Black Friday" (September 24, 1869). This was one of the first indications of greenbacks being equal to gold. Although Gould and his team were discounting the greenbacks for the purchase of gold, it was indicative that greenback money could now stand on its own.

The name Black Friday is sometimes also applied to the major financial crash of the New York Stock Exchange of September 19, 1873.

The trauma of Black Friday was significant in a few ways. Not only did it trigger great financial losses to those who fell victim to Gould and his team's fraudulent scheme, but it also removed the veil of comfort that the Democrats and the Greenback movement had created with their paper money.

George Bernard Shaw aptly wrote, "Financiers live in a world of illusion. They count on something which they call the capital of the country, which has no existence."

The war left merchants and farmers without sufficient cash to operate their businesses efficiently. There was not adequate specie to keep up with and to support the country's economic expansion. Those who had emigrated out west were hurting as were the farmers in the mid west.

After the New York Stock Market in 1873, the Greenback Party, whose principle members were southern and western farmers, began to promote currency expansion. Although their movement was one of the most powerful and successful attempts to have the government issue more greenbacks, they eventually yielded to the concept that paper money had to be backed up with precious metals. They promulgated that silver should be added as a companion to gold as the basis of the currency, termed bimetallism. (In 1865, France, Belgium, Italy and Switzerland formed the Latin Monetary Union which established the bimetallic system. The union was disbanded in 1867 and each nation voted for the gold standard.) The "Gresham's Law" named after Sir Thomas Gresham in 1558 elucidated the principal that two coins having the same

nominal value but being made from metals of unequal value, the cheaper or “inferior” money will tend to “drive the other out of circulation”.

Because money functions in ways other than as a domestic medium of exchange, it is also used for *foreign exchange*, as a *commodity* or *stored as a value*. In instances where it was hoarded, from 1792-1834, the U.S. maintained an exchange ratio between silver and gold of 15:1, while European countries had ratios from 15.5:1 to 16.06:1. Owners of gold sold their hoards in the European market and took their silver to the U.S. Mint. In effect Gresham’s law was applied: gold was removed from domestic circulation – the “inferior” money had driven it out.

William Jennings Bryan’s “*Cross of Gold*” speech at the Democratic National Convention in Chicago in 1896, “*You shall not press down on the brow of labor this crown of thorns, you shall not crucify mankind on a cross of gold*” was his attack on the premise that gold was the only sound commodity for currency. Although Bryan was one of the more prominent champions of the *Free Silver Movement*, which advocated the unlimited coinage of silver, in 1900, the Republicans won the election and enacted the *Gold Standard Act*, which made gold the sole standard for all currency.

Interim Summary

After the Civil War gold and silver were the two commodities that were the backbone of the medium of exchange. The Greenback Party eventually yielded to the concept that paper money had to have a precious metal as its essence. They espoused the bimetallism concept which was short lived. And, in 1913, a new monster was created, the Federal Reserve System, by the Federal Reserve Act. The act created 12 regional banks that would be supervised by the Federal Reserve Board. A Federal Open Market Committee is responsible for the purchases and sales of U.S. government securities in the open market. Some of the duties of the Federal Reserve authorities is the maintenance of national monetary and credit conditions to member banks, open market operations, fixing reserve requirements and establishing discount rates. In reality the Federal Reserve bank has become a “banker’s bank”. This allowed member banks to use their reserve accounts just as we, as individuals, use our checking accounts. The economic health of the nation is influenced by the Reserve System’s control of the credit market, that is, the rise and fall of interest rates. It further has an enormous impact on reserve requirements of banks by controlling the buying and selling of U.S. securities, as it increases or decreases the nation’s supply.

The Federal Reserve Bank is a privately owned corporation established pursuant to the Federal Reserve Act to serve the public interest. This corporation has nine directors. Six of them are elected by member banks and three are appointed by the Board of Governors of the Federal Reserve System.

“...and so then, what is a bank?”

Using a broad definitional brush, a bank is a financial intermediary that performs some or many of the following functions:

a) safeguards and transfers funds

- b) lends and assists in loans
- c) establishes and reports on the creditworthiness of individuals and institutions
- d) exchanges money.

A more specific definition is a financial intermediary that it accepts, transfers and creates deposits.

In medieval times the religious and military order, the *Knights Templar*, stored valuables, made loans and arranged to transfer funds from one country to another. During the Renaissance the Medici family in Florence loaned money and financed international trade. Incidentally the three gold balls one sees outside pawnbroker shops are a Medici family symbol

English goldsmiths of the seventeenth century laid the groundwork for present day banking. Gold was deposited with these artisans for them to create artifacts for the owners and the surplus was to be kept in safekeeping until demand was made for its return. It soon became evident to these goldsmiths that they kept in store far more gold than was actually removed by the owners. They began to lend out some of this surplus gold to others obtaining notes promising to pay significant interest plus the return of the gold as well. Eventually, they began to provide paper certificates which were redeemable in gold coin instead of circulating the actual gold itself. Predictably, the value of these certificates in circulation exceeded the actual value of the gold that was on deposit and that which was exchangeable for the certificates. *This condition, the monetary liabilities exceeding the actual reserves of an institution was the precursor of present day banking.*

Economic expansion is predicated in part on this principle. A major part of Western industrialization was based on such a concept. Today's governments, businesses and consumers are able to finance activities based on this principle. Problems arise at times of economic or financial panic when too many depositors request return of their money and the banking system is unable to respond due to its lack of sufficient liquidity. In instances such as these, banks eventually fail if they are unable to honor their promises to pay depositors. In order to alleviate such crises the Federal Deposit Insurance Corporation (FDIC) was created by the U.S. government, which insures individual depositors for up to \$100,000 per bank.

So the government has intervened to protect depositors from losing their deposits with the FDIC in the event a bank falters. However, today money has become even more abstract, mysterious and intangible than ever before.

Here are some points to ponder:

Today we have an electronic network that obscures the dollar and has supplanted it with letters of credit, bank guarantees, SWIFT transfers, Fedwire, CUSIP numbers on securities, Clearing House Automated Payments System (CHAPS), and the Clearing House Interbank Payments System (CHIPS), amongst others.

On a personal level money has become even more **invisible**. Your paycheck is deposited automatically by your employer into your checking account. Already deducted from this is your

IRA contribution, your Social Security and IRS obligations, your health insurance and other retirement deductions.

You have plastic credit cards against which you have made purchases, and, at the end of the month you begin to write checks to these credit card companies, you make your house mortgage, taxes and insurance payments by check, your car payments and auto insurance, and the tuition payments to the university for your eldest child and lunch money to the school cafeteria for your youngest. With all of these payments and you have not touched or even seen one physical dollar bill. And, today, Sunday, you are rushed, you did not have time to stop at the bank yesterday so you stop at the nearest ATM and withdraw some money. Whew! Finally you actually see some physical dollars.

“...and so, what is money?”,... to coin a phrase.