The Hard Truth of Hard Money

In our Republic's youth, presidential candidates openly debated central banking, and Andrew Jackson even won election as a "hard-money" advocate. Today's economic crisis requires a similar return to sound monetary policy.

by Patrick Krey

An economic crisis struck America seemingly out of nowhere. The nation was firmly in the grasp of a sharp financial downturn. The citizenry was unsure of its cause, how seriously it would endanger the nation's future, and how long it would last. Fear and confusion spread while a select few with a deep understanding of the monetary system attempted to educate the people about the real cause of the financial crisis. These individuals argued that the inflationary policies of the national bank were the root cause of the crisis and that the only solution was a sound monetary policy based on hard currency.

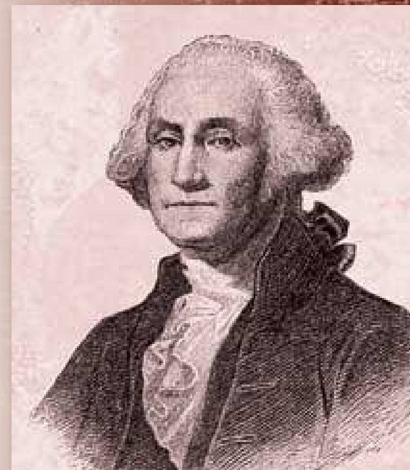
Thus began a vigorous public debate over the American monetary system and its role as the culprit of the current economic downturn. This "hard money" populism began to gain momentum with the masses. Numerous politicians were educated about the need for sound currency and were motivated to speak out against the central bank and its detrimental policies. The movement eventually rose to national prominence, and the American people elected a proponent of a hard-money system to the presidency. That president succeeded in putting an end to the national bank.

The aforementioned scenario might sound like a potential solution to the current economic crisis facing America, but it has actually already occurred in American history. These events took place following the financial panic of 1819. The followers of the populist hard-money movement have become what we now refer to as Jacksonian Democrats because they succeeded in electing a hard-money advocate, Andrew Jackson, to the presidency.

The Bank of the United States

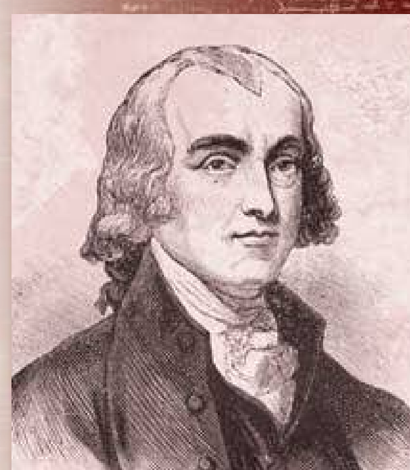
Today's substance- and issue-free presidential debates bear little resemblance to those of the first one hundred or so years of our Republic's history, which saw candidates discussing the intricacies of monetary policy. At that time, the issue of central banking and monetary policy typically played a vital role in the national debate between the presidential candidates. The presidential debate over central banking dates all the way back to the days of our first president, George Washington. It was during Washington's administration that then-Secretary of the Treasury Alexander Hamilton proposed the creation of America's first central bank, the Bank of the United States (BUS). Washington asked his Cabinet members to submit letters to him with their own personal assessment of Hamilton's proposal. Then-Secretary of State and future President Thomas Jefferson claimed that the BUS was unconstitutional on two grounds: there was no clear authorization to be found within the document itself, and the states would have been hesitant to ratify a Constitution that allowed the federal government the power to create a national bank.

> The incorporation of a bank and the powers assumed have not, in my opin-



George Washington

Thomas Jefferson



James Madison

Andrew Jackson pulled no punches when speaking about the central bank: "[The national bank was] dangerous to the liberty of the American people because it represented a fantastic centralization of economic and political power under private control."

Andrew Jackson

Martin Van Buren

ion, been delegated to the United States by the Constitution. They are not among the powers specially enumerated.... It is known that the very power now proposed as a means was rejected as an end by the Convention which formed the Constitution: a proposition was made to authorize Congress to open canals, and an emendatory one to empower them to incorporate but the whole was rejected, and one of the reasons urged in the debate was, that then they would have power to create a Bank, which would render the great cities, where there were prejudicies [sic] or jealousies on the subject, adverse to the reception of the Constitution.

Hamilton opened the door for liberal interpretation of the Constitution with his opinion that the Constitution's "Necessary and Proper Clause" implied authorization for the federal government to create the BUS. This implied authorization argument was cemented as early constitutional law by Supreme Court Chief Justice John Marshall, a Hamiltonian, with the decision of *McCulloch v. Maryland*.* Washington was swayed by Hamilton's argument and the BUS was established in 1791 with a 20-year charter. This ideological split within the Washington administration would lay the framework for future debate over monetary policy.

The free-banking argument, as opposed to an argument backing a central bank, was heavily influenced by the failure of fiat (unbacked) paper "continental" currency during the Revolutionary War. In an effort to fund the war effort, the Continental Congress printed vast amounts of currency not backed by gold or any other commodity, thereby depreciating its value over time. This episode of currency depreciation by government action gave us the phrase "not worth a continental." The supporters of a free-banking system did not want to return to this type of hyperinflation and therefore wanted a currency backed up with specie (gold or silver) that would be 100 percent redeemable on demand.

The central-banking argument was motivated by the desire for increased liquidity, as its advocates wanted banks to be able to loan out more money than they had on hand in order to spur investment, which would require a central bank to act as "a lender of last resort." The central-bank supporters also wanted a fiat currency, one that derives its value from government mandate, and fractional reserves (not requiring 100-percent redeemable reserves).

As libertarian pioneer Murray Rothbard explains, the Hamiltonians were in favor of "paper money, fractional reserve banking, and central banking … as part of a comprehensive policy of inflation and cheap credit in order to benefit favored businesses." The Jeffersonian opponents of the central banking system, on the other hand, preferred "a hard money system based squarely on gold and silver, with banks shorn of all special privileges and hopefully confined to 100 percent specie banking." Jefferson would later go on to win the presidency and continue to speak out against the dangers of the BUS.

> [The] Bank of the United States … is one of the most deadly hostility existing, against the principles and form of our Constitution.... An institution like this, penetrating by its branches every part of the Union, acting by command and in phalanx, may, in a critical moment, upset the government. I deem no government safe which is under the vassalage of any self-constituted authorities, or any other authority than that of the nation, or its regular functionaries. What an obstruction could not this bank of the United States, with all its branch banks, be in time of war! It might dictate to us the peace we should accept, or withdraw its aids. Ought we then to give further growth to an institution so powerful, so hostile?"

* The "Necessary and Proper Clause," which is also referred to as the "Elastic Clause," authorizes Congress to "make all Laws which shall be necessary and proper for carrying into Execution the Foregoing powers (listed directly above this clause), and all other powers vested by the Constitution in the government of the United States, or in any Department or Officer thereof." The Marshall Court ruling was the first step in interpreting this clause to apply not only to the Constitution's enumerated powers but to just about anything Congress deems "necessary and proper."

Although Jefferson's resistance to the BUS never succeeded in rising to a level of abolishing the bank and he was not able to undermine the BUS during his presidency, his criticisms did help to turn public opinion against the bank when its charter came up for renewal in 1811.

The administration of James Madison, the successor to Thomas Jefferson, was not as opposed to the BUS and actually fought for its recharter! This might seem contradictory because 20 years prior, Madison argued in the House of Representatives against the BUS on constitutional grounds. Years later, Madison would write a long and meandering defense of his nuanced position proclaiming that it was not a flip-flop.

After assuming the presidency, Madison found his Jeffersonian limited-government ideology challenged as his administration became embroiled in a war. The War of 1812 cemented Madison's attitude change toward central banking. The excessive borrowing to fund the war led to a renewed drive to establish a second BUS, and Madison led this concerted effort to reestablish a national bank. The Second Bank of the United States (BUS) was established in 1816 during Madison's second term. The BUS immediately began acting as an expansionary force. This easy credit led to a "boom" with overinvestment in real estate, sharply raising property values. The expansionary policies of enormous inflation of money and credit, combined with massive fraud at the BUS, put the bank at risk of being unable to make payments in specie. Therefore, the BUS began massively redeeming its heavy balances and notes to fully restore its ability to make payments. This contraction of money and credit led to the inevitable bust which came to be known as the Panic of 1819.

This panic further encouraged growth of the more stridently "hard money" Jacksonian movement. (This Jacksonian movement would also include other national figures such as Senator Thomas Hart Benton and future President James Polk as well as prominent economists of the day.) The Jacksonian movement was focused on eliminating fractional reserve banking. As Rothbard explains, "The Jacksonians … pinned the blame for boom-bust cycles on inflationary expansions followed by contractions of bank credit.... They believed that government should be confined to upholding rights of private property. In the realm of monetary sphere, this meant the separation of government from the banking system and a shift from inflationary paper money and fractional reserve banking to pure specie and banks confined to 100 percent reserves."

Jackson himself pulled no punches when speaking about the central bank: "[The national bank was] dangerous to the liberty of the American people because it represented a fantastic centralization of economic and political power under private control."

One of the crowning achievements of Andrew Jackson's presidency was the elimination of the Second BUS, which he accomplished with a veto of its charter renewal. Jackson gave a stirring speech after the controversial veto explaining why there was a need to eliminate the BUS. In his lengthy and groundbreaking veto message, Jackson touched on the dangers of central banking as well as the separation of powers and the importance of a strict constructionist interpretation of the U.S. Constitution.

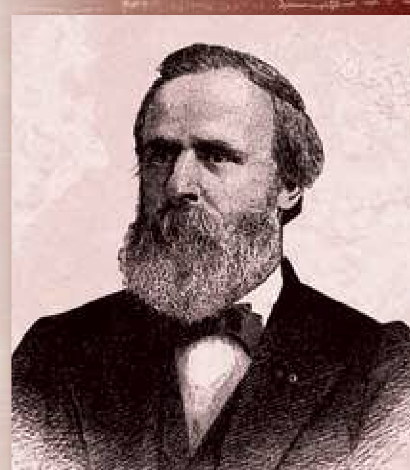
> It is to be regretted that the rich and powerful too often bend the acts of government to their selfish purposes.... Most of the difficulties our Government now encounters and most of the dangers which impend over our Union have sprung from an abandonment of the legitimate objects of Government by our national legislation, and the adoption of such principles as are embodied in this act. Many of our rich men have not been content with equal protection and equal benefits, but have besought us to make them richer by act of Congress. By attempting to gratify their desires we have in the results of our legislation arrayed section against section, interest against interest, and man against man, in a fearful commotion which threatens to shake the foundations of our Union.

The Jacksonians were not able to enact their entire hard-money agenda, but they did succeed in eliminating all traces of centralized banking. Even after the abolition of the Second BUS, monetary issues were routinely debated and discussed at the national level.

Martin Van Buren, who assumed the


Abraham Lincoln


Ulysses S. Grant


Rutherford B. Hayes

President Grover Cleveland fought to preserve the gold standard even when his own party was split bitterly over the money issue. Sadly, Cleveland was one of the last presidents to strongly support the gold standard as both parties began moving away from hard-money stances.

Grover Cleveland

Theodore Roosevelt

presidency after Jackson, called for "a total separation of bank and State through an Independent Treasury." The Independent Treasury required the government to hold all monetary balances in the form of specie, rather than bank notes or deposits. Van Buren accomplished this after a long and bitter political battle with opponents. Economic historian Jeffrey Rogers Hummel wrote that the Independent Treasury introduced a period of "massive financial deregulation at the national level and one of the most stable monetary systems in American history.... Laissez-faire was the Independent Treasury's primary consequence. There was no nationally chartered bank, the Treasury for the most part avoided dealing with the many state-chartered banks, and the only legally recognized money was gold and silver coins. Because the economy's currency consisted solely of bank notes redeemable in specie on demand, private competition regulated the circulation of paper money." This system ensured stability in the money supply and also kept the nation safe from inflation. Ultimately, the Jacksonians succeeded in removing the federal government from the banking system and returning its finances to a specie foundation.

The Advent of Greenbacks

Over the following decades, there were always politicians clamoring for a return of some type of central banking, while others constantly reminded the voters of previous harms caused by it and of the need for sound monetary systems based on hard currency. It was not until the Lincoln administration and the need to fund the Civil War that a version of central banking returned in the form of a series of National Currency Acts that took America off the gold standard.

The National Currency Acts of 1863 and 1864 established a network of nationally chartered banks that would issue bank notes supplied to them by the federal government. These notes, referred to as greenbacks, immediately returned inflationary power to the federal government. In this new system, the U.S. Treasury had control, with some legislative oversight, over all U.S. paper currency, as well as regulatory power over large sectors of the banking industry. The National Currency Acts granted the monopoly of all bank notes to federally chartered national banks. Of course, with this new legislation, inflation of the money supply soon followed. Greenbacks began to depreciate in value almost as soon as they were issued. The money supply ballooned and, over the course of the war, rose 137.9 percent! With the drastic increase in the money supply, there was also a sharp increase in the price of goods, and prices rose 110.9 percent from 1860 to the end of the Civil War.

It was not until several years later and the administration of Ulysses S. Grant that substantial steps were taken to halt the expansion of the money supply and return the national currency to a hard standard. The national debate over the monetary system raged throughout the 1870s until the Grant administration signed a bill in 1875 which would resume specie repayment of paper dollars in gold at prewar levels by 1879. Specie payment finally did resume in 1879 under President Rutherford Hayes. Unfortunately, the centralized banking semi-cartel established by the National Currency Acts was not undone. The gold standard would still be a highly controversial subject in the national debate, and there were attempts to bring back or add silver to the monetary standard. The goal of bimetallism, where the monetary standard is a ratio of gold to silver as fixed by government mandate, was a return to increasing the money supply due to the abundance of silver while hiding under the banner of hard currency by using a commodity.

President Grover Cleveland fought vigorously to preserve the gold standard even at a time when his own party was split bitterly over the money issue. Sadly, Cleveland was one of the last presidents to strongly support the gold standard. Political divisions and realignment among the Democratic and Republican parties changed the foundations of the parties and moved both away from hard-money stances. Rothbard explained that the political changes at the end of the 19th century

meant the end of America's great laissez-faire, hard money libertarian party. The Democratic Party was no longer the party of Jefferson, Jackson, and Cleveland. With no further political embodiment for laissez-faire in existence and with both parties offering 'an echo not a choice,' public interest in politics steadily declined. A power vacuum was left in American politics for the new corporate state ideology of progressivism, which swept both parties … in America after 1900.

The Federal Reserve Is Born

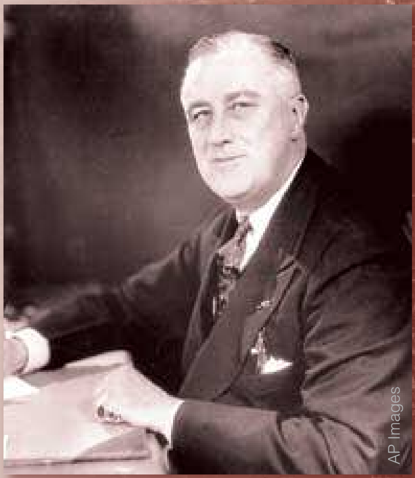
At the beginning of the 20th century, progressivism was a bipartisan effort that succeeded, over the course of the first three decades of the new century, to transform the American economy from laissez-faire to one of "centralized statism." From this point forward, there was a concerted effort to centralize the banking system even further. Inflationist policies were promoted by both major parties. President Theodore Roosevelt called for new legislation to increase elasticity in the monetary system — that is, to increase the money supply. By 1906, he was calling for "a considerable increase in bills of small denominations."

His successor, William Howard Taft, was even more progressive in his inflationist intentions. "One of the reforms to be carried out . . . is a change of our monetary and banking laws, so as to secure greater elasticity . . . and to prevent the limitations of law from operating to increase the embarrassment of a financial panic."

The election of Woodrow Wilson in 1912 was the culmination of the progressive movement's efforts to have one of their own as the president, and the beginning of America's current central banking system. In 1913, Wilson signed the Federal Reserve Act into law, establishing the Federal Reserve System. In 1933, under the administration of Franklin D. Roosevelt, Fed notes and deposits were no longer redeemable in gold to Americans. In 1935, the Fed was reorganized to centralize control in Washington. In 1971, under the administration of Richard Nixon, the dollar was no longer redeemable in gold to foreign governments and central banks. In the years since the Federal Reserve was created, almost all restraints on the Fed have been lifted, and it now has the unlimited power to inflate the money supply.

William Howard Taft

Woodrow Wilson



Franklin D. Roosevelt

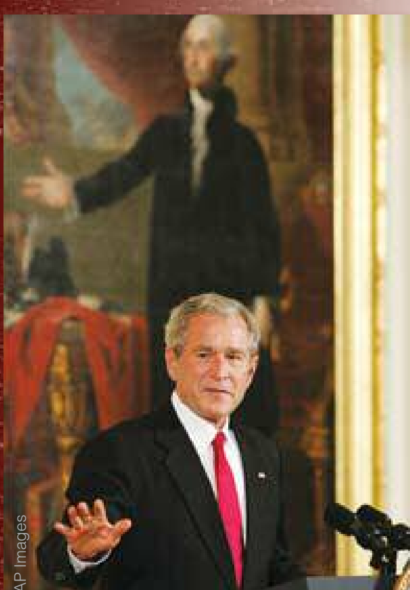
John F. Kennedy

Richard M. Nixon

Ronald Reagan

Past hard-money movements were not accomplished by the work of one man but, rather, by a group of patriotic, liberty-loving individuals making a concerted and continuous effort to educate the public, politicians, and the media about sound monetary policy.

Bill Clinton



George W. Bush

Monetary Debate in Modern Times

Sadly, in modern times, the presidents have failed to even address the issue of monetary policy of the central bank other than to praise the Fed as a savior in times of financial crisis. In addition, any efforts by Congress to make the Fed more transparent or accountable have actually been resisted by presidential administrations. Shortly after President Clinton was inaugurated, the Democratic Chairman of the House Banking Committee introduced some proposals which would open up the Fed to public scrutiny. He was rebuffed in his efforts by the new president, who felt that such measures might "undermine market confidence in the Fed." The Clinton administration also expressed concerns about what such reforms would do to the independence of the Fed. Economist Thomas DiLorenzo questioned that independence with his research, showing that Fed chairmen typically adjust their growth policies based on the wishes of the current administration.

> President Eisenhower wanted slower money growth. The money supply grew by 1.73 percent during his administration — the slowest rate in a decade. President Kennedy desired somewhat faster money creation. From January 1961 to November 1963, the basic money supply grew by 2.31 percent. Lyndon Johnson required rapid money creation to finance his expansion of the welfare/warfare state. Money-supply growth more than doubled to 5 percent. These varying rates of monetary growth all occurred under the same Fed chairman, William McChesney Martin, who obviously was more interested in pleasing his political master than in implementing an independent monetary policy.

DiLorenzo further explains that Martin's successor, Arthur Burns, was such a strong supporter of Nixon's that he engineered a huge expansion of the money supply to help Nixon's reelection. Then, when President Ford advocated slower monetary growth, Burns did as he was asked and provided a 4.7 percent growth rate. Finally, Burns deferred to Jimmy Carter and increased the growth rate to 8.5 percent. Fed Chairman Paul Volcker also complied with President Reagan's wishes by supplying rapid growth initially and then slower growth. Fed Chairman Alan Greenspan also was accommodating to both Presidents Clinton and Bush. These figures would seem to explain the close relationship between the president and the Fed chairman. In 2003, President George W. Bush heaped praise on Alan Greenspan and told the press his wish that Greenspan could serve another term, despite the fact that under Greenspan's tenure, prices increased 71 percent (compare this to the fact that the price level was relatively the same in 1900 as it was in 1800). And over the course of Greenspan's tenure, the money supply rose from $3.62 trillion to over $10 trillion, a 179-percent increase!

The Struggle Continues

For nearly the first 100 years of our nation's history, presidents debated central banking and monetary policy. A titanic struggle was waged between free bankers and central bankers, with the pendulum swinging back and forth in their struggle. This public debate came to an end in the 20th century when both major parties adopted the inflationist line. Today, the Fed is an unquestioned money machine that supplies the president with enough cash to fund his extravagant government programs, be they vast expansions abroad or at home or both. The presidential candidates rarely question what effects these large increases in the money supply might have on future generations as the dollar is devalued and Fed-manufactured booms and busts rock our economy.

It does seem like wishful thinking to believe that a modern-day Jefferson or Jackson or even a Van Buren or Cleveland would rise to national prominence and return anti-inflationist positions to the debate about monetary policy. But we should not forget that past hard-money movements were not accomplished by the work of one man but, rather, by a concerted and continuous effort of education and campaigning to educate the public, politicians, and the media about sound monetary policy by a group of patriotic, liberty-loving individuals. There is a similar effort of education and activism afoot today as well. ■