Chapter 11

On the Nature of Paper-Money

Only 22.7% of the total money supply of the United States consisted of paper-money and coinage in 1970. Only 2.2% consisted of coinage. About one-fifth of the whole money supply, 20.5% consisted of paper-money.

The smallness of these percentages, compared with the huge percentage consisting of bank-money, provides no justification for mistaking the importance of both paper-money and coinage. Paper-money is important in part because of the manner in which it comes into existence and in part because it has come to be considered, like coinage, "cash".

The dictionaries define "cash" as, strictly speaking, coin or specie: less strictly as paper-money, and speaking very loosely as money on deposit in a bank. What gives rise to the value traditionally attributed to cash and the peculiar use made of the word today, is that it has from time immemorial meant metallic money—money which has an intrinsic bullion value; money which did not have to be redeemed because the gold, silver and even copper in it had a value as a commodity in its own right.

When paper-money began to be called cash and valued as if it was cash, it was because it was still easy to turn it into gold or silver. What follows from this is that paper-money, if it is properly created and issued, should be as near to cash—as near to being a valuable commodity—as it is possible to make it.

The monetary principle of which this is a reflection is that paper-money should represent and should be redeemable either in gold or silver or in commodities as universally valued as are these two. This principle is violated if the paper issued cannot be redeemed on demand in such commodities. It is violated if the paper represents only an irredeemable fiat backed by a pool of debts—most of them debts of the government. It is now violated by all governments which belong to the IMF. It is flagrantly violated by the paper-money issued by the Federal Reserve System today.

If paper money is to be made constant in value by making it redeemable in a unit of redemption consisting of all the commodities in the International Staple Commodity Standard described, issuance—and circulation—should be provided for as follows:

1) It should be issued to pay the producers or owners for the commodities in which it is to be redeemable. Payment should be made in printed promissory notes redeemable on demand. The notes should state that those who hold them—those to whom they were originally issued and those to whom they were subsequently transferred—can redeem them in all the commodities in the unit of redemption or, at the request of the holder and at the option of the bank-of-issue, in any one of the commodities, in an amount which equals the value for which they were originally issued.

2. It should be issued for the transfer to the bank of title to warehouse receipts evidencing the fact that the amount and grade of the commodity involved is stored in a public warehouse.

3. Finally it should be issued for the transfer to the bank of title to bills-of-lading evidencing the fact that the amount and grade of the commodity involved is in transit to be delivered to the order of the bank.

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For those who accept the paper-money issued in this way, this would mean the monetization of their commodities—they could buy with the notes they received for them whatever they needed or desired. For them and those who subsequently obtained the notes as they circulated throughout the community, this would mean that they held money redeemable on demand in any or all the commodities in the unit of redemption.

For everybody who accepted and used such notes, this would mean that there was a 100% reserve of commodities back of all the parer-money issued and a 20% reserve back of all the bank-money created. In practice the commodity reserve needed would be much less, but what it should be is something which only experience can determine. The greater the confidence in the notes, the less call there would be for redemption.

Finally for the world as a whole it would mean that the chicanery of inflation which has marked the history of paper-money since it was first invented had been, so far as one bank-of-issue's money was concerned, made impossible.

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Certain things about the nature of paper-money must be mentioned, things of peculiar importance to such a bank-of-issue which is here being proposed. To begin with, it is a misnomer to speak of dollar-bills or of any paper-money as a bill. Paper-money consists of notes, not bills. A bill is an instrument stating how much and for what the person to whom it is sent is indebted to the issuer of the bill. A note is the exact antithesis of such an instrument; it states what the signer and issuer of the note owes to the person to whom it has been given. Its very language states that it has been given by the issuer "for value received".

What follows from this is that every issue of notes by a central bank or any other bank-of-issue represents a loan of capital to such a bank by those who accept and use its notes. But unlike all other kinds of loans, the lender receives no interest on his loan. It is like a demand deposit—the depositor lends his money to the bank and asks no interest on it because of the convenience it provides. The bank which receives it, however, when it loans it to borrowers does receive interest on it, and the revenue when it pyramids it in the form of bank-money is not just simple interest but multiple interest which may provide it with ten-fold the revenue obtainable from simple interest.

There is another source of revenue obtained by the issuers of paper-money which must be mentioned—attrition. A part of every note issued is lost. And loss may mean it is never found. Lost notes can only be redeemed if somebody happens to find them. Unlike ordinary promissory notes, which are payable to particular persons, the loser cannot call for their redemption because of the possibility that they may have been found by somebody who may redeem them. Every such permanent loss is a gain to the bank which has issued the notes.

But attrition takes place far more often in fires, in residences, for instance, but probably most often in stores in which paper-money is stored in cash registers and in safes. It even takes place when ships sink. Banks-of-issue are in effect the innocent beneficiaries of what I am calling attrition. Every source of revenue—even unearned revenue of this kind—helps to make a bank-of-issue self-supporting. And this is doubly important for such a bank-of-issue as is here proposed which must maintain its independence and not become dependent upon the government or any other institutions with interests other than service to the community as a whole.