

## CHAPTER VIII

### Money and Banking

MONEY NECESSARY AS A MEASURE, A STANDARD, AND A MEDIUM OF EXCHANGE. VARIOUS KINDS OF MONEY AND THE ADVANTAGE OF A GOLD STANDARD.

*The expression, "Production for use and not for profit," was coined by Karl Marx, father of Communism. No sillier slogan was ever thought up by the mind of man. Everything that is made—if you get above the level of children's mud pies—is made for use. Men don't waste their time making things that have no use. If a thing is useful it will be traded. And when it is traded, there's a profit—two profits, in fact, one for each party to the trade. For a profit, mind you, is merely an excess of return over output. When you take in more than you lay out, there's your profit. And that's what happens in every trade. You get more than you give, as you value things at the moment. If you didn't, you wouldn't trade. And that goes for the other guy. He values what he gets more than he values what he gives. If he didn't, he wouldn't trade. He's no sap either. So you can paste this in your hat—and leave it there. There's never a trade without a profit. It is equally true that there is never a profit without a trade. A farmer may have a million bushels of wheat. That million bushels won't do him a bit of good until he trades them. Remember those two great truths—there's never a trade without a profit, and never a profit without a trade. They will help you to realize the importance of trade, and the damage that results when men's freedom to trade is curtailed in any manner—whether by tariffs, cartels, quotas, embargoes, or whatever.*

—C. O. STEELE  
in *The Individualist*

WE HAVE tried to keep the subject of money in the background, for its importance is secondary to questions of the production and distribution of true wealth, and emphasis should be on first essentials. Money is, however, a necessity; and, since we must talk about it, we must understand it.

Money has been defined as the measure and medium of exchange, but to give it first place in our thought is like thinking too much about the score and forgetting the game. We call the counters by which we keep score, money; but just as the counters are incidental to the game, so money is secondary to the necessities of life and the methods by which they are produced and divided.

What is money? We have already defined it, but let's make it a little clearer. All trade is greatly facilitated by the use of

money, because money serves as the measure of relative values. Instead of exchanging one commodity for another, we exchange for money, which gives us a standard by which to measure relative values of commodities and also helps in making change and in keeping books.

Is money wealth? That depends, for money takes many different forms. When, as in Colonial days, an actual commodity, such as tobacco or beaver skins, constituted the only money, it certainly was wealth. Gold is generally the basis for money and, in former days, much of the money was actual gold coin; and that is assuredly wealth, for it is produced by man's labor from the resources of the earth and has exchange value. Gold has a broader exchange value than almost anything else, for it is universally desired and coveted and is always exchangeable for the vital necessities of life. Incidentally, gold has broad utilitarian value for countless purposes and, were it not for its scarcity, it would have many more practical uses. It is used for jewelry and for technical purposes, as in dentistry, because it is non-corrodable and imperishable. We use it in innumerable ways, for pens and gilding signs and the backs of books. Of course, too, it is used for coinage which in itself is a definite practical purpose, although more so formerly than today. Gold is still more or less the standard of most monetary systems, and for this purpose it is ideal; and that is why we hoard billions of dollars' worth of it at Fort Knox, as a background and a supposed guarantee of our money in other forms.

How about other coins, pennies, nickels, dimes, quarters, half-dollars? Are they true wealth? To a certain degree, yes, for all metals are wealth; but almost always the intrinsic value of such coins is far less than the face value, so most of the value is as tokens, exchangeable, in theory at least, for gold coin worth its face value. Paper money is quite another story, and there is much to be said about that; but it is not wealth. Sometimes it is said that paper money is wealth, because paper is a product of human labor and has exchange value. However, as the Germans found only too well when they printed unlimited quantities of paper money, if carried to excess paper money has no value, circulating when it did circulate, at the ratio of a trillion to one—or 1,000,000,000,000 to one—of the old marks. Think of what it meant when insurance, bank accounts, debts and obligations of every kind were paid off in such rubbish!

Buying and selling is, in the last analysis, no more than exchange; but money makes this exchange, or trading as we call it,

far easier and simpler. If you have a hundred barrels of salt pork or a ton of pig iron and wish to exchange these surplus articles of your production for a pair of shoes, a bag of flour, a shirt, or a cart, you will find it pretty hard to drag your commodities around town until you find people who will make the trades. For the farmer to carry his milk, his vegetables, his grain around to trade it for his needs, would be impossible, so money serves a very useful purpose in facilitating this exchange. Instead of trading pig iron for a hundred things, one man sells it in bulk at wholesale, the other man sells the shoes or the shirts, and then with the money we buy what the other fellow has to offer. This gives a method of measuring and of establishing values, makes bookkeeping possible, and gives us definite prices, by which all values may be expressed and compared in terms of money.

In earlier days in this country some important commodity of trade was often accepted as the unit of values and became money. In Colonial Virginia tobacco served, and prices, wages and contracts were in terms of pounds of tobacco. In the old Dutch Colony, now the City of Albany, the beaver skin was the monetary unit and that is why the city still shows a beaver on its coat of arms. A scale of values was drawn up, to translate not only other furs but also the Dutch guilders which found their way into the colony through foreign trade, into the more generally circulating currency of beaver skins. Where life was pastoral, cattle—and the word "cattle" originally included all domesticated quadrupeds—were the basis of wealth and values were computed in flocks and herds; so, even today the word "pecuniary," almost synonymous with monetary and derived from *pecus*, a flock or herd, reminds us of the time when money trotted around on its four feet! The words "cattle" and "capital" are derived from a common source, and the word "salary" brings us memories of the days when the soldiers of the Roman legions received part of their pay in salt.

Almost everything has been used as money—shells, beads, salt, hides, even human beings in the days of slavery—but metal has been found the most convenient. Where coinage is difficult, crude metal serves, and in mining centers, as in early California and Alaska, gold dust was weighed out and passed current. Many names of coins and designations of values were once only weights of some metal, often silver, like the British pound sterling, the mark of Germany, or the talent of Scripture; but to be weighing out metal is a nuisance and wasteful, so very soon it was minted into coins of established weights, often to

be debased, as has been our own dollar. When the government has been slow at minting, someone else has done it; and there are still extant gold coins, dollars, half-dollars and even quarter-dollars struck by metal brokers in California before official coinage reached the state. Any metal has a great advantage for coinage because it is divisible into small units without loss of value, unlike furs, for a beaver skin cut into ten pieces is not worth as much as a whole skin.

Gold answers our requirements better than anything else; its value is high, giving concentration in small bulk. It is imperishable, not evaporating, fermenting or rusting, and production and use are comparatively stable. True, the supply does vary, but generally not widely or suddenly. The use of gold in the arts, a reason for its intrinsic worth, is an advantage, too, for it flows back and forth between practical and monetary uses as conditions dictate, with little impairment of value. When gold is in demand, we melt up jewelry and discarded trinkets, to turn gold back into the treasury; and sometimes this source of gold exceeds the output of the mines. It may be of curious interest to know that it is said that the entire gold stock of the world would make a cube about forty feet in each dimension.

Gold has been generally accepted as a standard of monetary systems; and when we say a country is on the gold standard, we mean that, whatever we use for money—silver, nickel, copper or paper—its value is computed in gold and that the baser money is exchangeable for gold on demand. In the United States we were "on gold" from the redemption of the "greenbacks," the paper money issued during the Civil War, in 1879 until repudiation of our contracts in 1933.

We hear much of nations "going off gold," but to define what is meant is not always easy. Today we may say we are "off gold," for the government has repudiated its promises to redeem its money, or to meet its obligations, in that metal; yet gold is still our standard, although on what basis is uncertain, for there is a possibility of future reduction in the gold content of the dollar and we refuse to pay out the precious metal on demand.

Prices are the expression of values in terms of money, or let us say in dollars and cents, and the prices of commodities vary with the value of our money—gold, if that be our standard. Therefore, prices will go up and down as the supply of gold varies. The more gold we have the less it will buy, and the scarcer it is, the more it will purchase—just another example of

the law of demand and supply. Similarly prices will vary with the supply of commodities, notably with the harvests of the great crops. Conditions abroad play their part, but whatever the causes, there are fluctuations, often very wide, and of course the devaluation of the dollar, of which more will be said, cut its value greatly. One index of prices shows that the purchasing power of the dollar has ranged from 55 on an arbitrary scale to 215 during about sixty years and it has recently touched the all-time low.

Such variations in purchasing power involve hardship to some and advantage to others, affecting particularly relations between debtor and creditor. The farmer, borrowing money to finance his business, may borrow enough to purchase a thousand bushels of wheat, but, when he repays the loan, he finds his debt is equivalent to the value of two thousand bushels. Even if not borrowing, he may find that, after spending money on seed, fertilizer, machinery, and labor, a sharp decline in prices by the time the crop is harvested more than eats up expected profits. Were it possible to stabilize the dollar so that its purchasing power would always be the same, it would be desirable; for then, on whatever standard our money was based, its real value would be constant and unchanging.

To effect this, the "commodity dollar" has been urged, a dollar based on no fixed quantity of metal—although its value might be guaranteed by gold in the treasury—but on what it will buy. To determine its value, prices would be constantly studied and a price index made up by averaging the prices of a large number of the more important articles of trade. To illustrate: the value of the dollar may be established, not as a certain weight of gold, but as equivalent to certain quantities of wheat, cotton, iron, rubber, wool, petroleum, potatoes, and many other things. This, in theory, would give us a dollar of fixed buying power, so that the man who borrows a hundred dollars today and pays it back after many years, would always be dealing with a fixed value having constant buying power, and neither the lender nor the borrower would suffer. This average would be "weighted" to give proper balance to each commodity included, for the price of iron is more important than the price of zinc, and the price of wheat counts far more than the price of peanuts. Parenthetically we may mention a phase more directly concerned with the study of statistics than with economics, for it illustrates a common fallacy—the question of "unweighted" averages.

If you are studying the cost of what goes on your table,

you may average the prices paid for the articles you buy, say flour, sugar, coffee, and tea. If you add these prices and divide by four, you have an entirely erroneous figure, for such an average takes no account of the different quantities of each used. This illustrates the importance of weighting averages properly; and, in working out a price index, this is most important.

This adjustment of averages is one of the difficulties of the commodity dollar, especially as the relative importance of many articles of trade varies widely and sometimes suddenly, as in war times. Since the advent of the automobile, rubber has acquired a far more conspicuous place in the world's markets than it once had; aluminum, not long ago of little more than a curious interest, is today an important metal and destined to become more so. And uranium? Heaven only knows what price it may command, and it looks as if the progress of synthetic fibres would soon make the web of the lowly silkworm an insignificant item.

A more serious difficulty lies in the fact that, unless the commodity dollar were generally accepted the world over, computed on substantially the same basis, and the monetary units of the world kept in prompt and accurate adjustment, it would be next to impossible to compute the value of any coinage in international trade, and export and import business would be upset. It would open the door to all sorts of maneuvering of one country against the other and make uncertain all relations between debtor and creditor. To accomplish true stabilization elements innumerable would have to be considered aside from mere prices of today—rainfall in China, strikes in Michigan, locusts in Africa, frosts and weather conditions the world over, the discovery of new mines, oil fields or processes, and even such intangible things as rumors in Wall Street, elections, political or social unrest, and the probability of wars, for they all have their effect. It would introduce far more problems than it would settle and, worst of all would lend itself to manipulation and fraud. Gold has its drawbacks, but it is far and away the soundest basis for a monetary system.

In one form of speculation, we have a sound plan for meeting the uncertainty of the purchasing power of the dollar. Generally, we think of speculation as a very questionable operation, frequently associated in the newspapers with embezzlement. Even at its best it is often thought of as mere gambling—betting on the ups and downs of the market, buying when we think prices are low in the hope of selling at a profit when they go up, or

possibly the reverse, selling something today for future delivery in the hope that a slump in prices will yield us a profit. Such operations are foolish and generally bring only trouble, but there is a form of such speculation which is legitimate and often almost necessary in business.

It often takes time and the tying up of funds to manufacture and market even a simple commodity like cotton cloth or flour, for there is quite a lapse of time between buying the raw materials—cotton or wheat—and collecting for the sales of cloth or flour. For obvious reasons, the price of the product is closely linked to the price of the raw “makings”—cloth to cotton and flour to wheat—and, if the price of the material drops, the price of the finished goods declines correspondingly. Suppose the miller buys heavily of wheat—let’s say in October—but he won’t sell and collect for his flour until perhaps six months later. Suppose in that interval the price of wheat fluctuates substantially for any of a hundred unforeseen reasons—rain or drought, blights, untimely frosts, or a dozen things affecting the wheat crop anywhere in the world and reacting on the price in our markets. If the price of wheat falls, the price of flour declines proportionately and the miller may face a heavy loss, but there is a way to protect himself. When he buys the wheat in October, he also sells, and collects for, the same quantity of wheat, which he agrees to deliver in April, selling a “future” as it is called in the market. Now, if the price falls, he will gain as much on this speculation in wheat as he will lose by the slump in what he gets for the flour—“hedging” as they say. Of course, conversely, the price of wheat may advance and he may lose on his wheat speculation, but then he will recover this loss by the higher price for flour.

Such “speculation” is common in many trades and serves a very useful purpose in stabilizing the market. It is totally different from the gambler’s speculation, for the gambler hopes to make a profit by fluctuations in price while the legitimate speculator seeks to protect himself from the uncertainty of market changes. Sometimes there is agitation for prohibiting trading in “futures”—and unquestionably such operations are often nothing but bets on whether the market will go up or down—but frequently they serve a good purpose. This may seem to have little bearing on the commodity dollar but it illustrates the difference between a money standard and a commodity standard, for practically the miller does business on a standard based not on gold but on wheat.

In everyday life most of our money transactions are not in coin, beyond minor buying and selling which call for small "change," but in paper money; and now we are getting to a debatable ground of what constitutes money. You think of a dollar bill as money, but is it? Read it and you will find that, in spite of big figures and big letters, it does not even pretend to be a dollar—it is just a bit of paper on which is printed "This certifies that there is on deposit in the treasury of the United States of America One Dollar in silver payable to the bearer on demand." It is no more a dollar than the check which the coat-room girl gives you for your hat is a hat you can wear on your head: either one is worthless in itself, unless the issuing power—the coat-room girl or the government of the United States—will live up to the promise given or implied.

Note too, that the dollar bill is a receipt for a silver dollar, not a gold dollar; and the silver dollar may be worth less than the gold dollar, which is our basic standard. The bill is exchangeable for the silver, and theoretically, the silver is exchangeable for the gold, but the whole chain of values depends entirely on the credit and good faith of the government. This, tragically, is not always above suspicion, and so, until we can get actual gold in our hands, this money, if we so like to call it, is credit money.

Other bills are a bit different. They are not receipts for dollars on deposit but a "federal reserve note." More will be said about the Federal Reserve, but this note is actually a mere promise of the United States to pay to the bearer on demand, the stated number of dollars, but observe: it does not say what kind of dollars. Are they silver dollars or gold dollars; and if so, how much gold will there be in each dollar? This brings us to the subject of banking; but before going into that, a word about different kinds of money based on different standards.

Sometimes countries have tried to maintain simultaneously two monetary systems, always with disaster, for any standard must be a single standard or it is not a standard. Years ago, when Bryan was the perennial candidate for the presidency, we heard much about "free silver," "bi-metalism," or "sixteen-to-one." The substance of Bryan's program was the free minting of both gold and silver into coinage, the dollar representing a fixed weight of gold or sixteen times that amount of silver. With coinage of either metal legal tender, meaning that either metal must be accepted in payment of debts or contracts, this



would have given us bi-metalism, for either metal would be an accepted monetary standard.

The first fallacy in the proposal lay in the fact that the two metals showed a far wider ratio of value than sixteen to one. Gold came closer to being thirty-two times as valuable as silver; and, had the program been adopted of two moneys, both legal tender, one would have had twice the real value of the other whatever the law might say.

Sir Thomas Gresham, an English merchant, financier, and the founder of the Royal Exchange in the time of Elizabeth I, first stated the law which bears his name—that when two forms of money circulate simultaneously, the bad always drives out the good. For this the reasons are obvious. We give the other fellow what we want the least and keep for ourselves the best; so, if Bryan had had his way, we would have spent the silver money, or money based on silver, and would have kept the gold or its equivalent. We might hoard it under the loose brick in the fireplace or in a safe-deposit box, but we would spend the inferior money first. The gold money would also be sent out of the country in payment for imports, for we could pay our bills at home with silver, and gold would buy far more in foreign markets. In international trade, money sells at its true worth; and foreign balances of trade, by which we mean the differences between the values of imports and exports, are settled in actual gold, generally in bars or bricks, on the basis of weight and fineness.

In larger transactions, these same influences apply in domestic commerce, and, regardless of laws or official declarations, the better money will be more acceptable, will buy more goods, and be more readily taken; so, despite laws, the good money will command a premium and the poor money will be taken only at a discount. If gold is actually worth twice as much as silver, gold coins will be melted up and sold to buy twice as much of the cheaper currency, for we thereby double the number of our dollars, and this would have happened had the free silver program prevailed.

History is full of examples of the working of these principles. During the Revolution, the worthlessness of the paper money issued by the Continental Congress gave rise to the expression of "not worth a Continental," and any metal coinage of real value commanded a high premium. In Civil War days, too, paper money was worth far less than coin, although both were legal tender. The paper of the Confederacy became utterly worthless,

but Union money was finally restored to its full value years later, when the "greenbacks" were declared redeemable in gold. This honorable settlement, correcting a situation which arose by sheer necessity during the war, speaks much for the courage and integrity of the political leaders of these days.

The general pattern of experience in attempting to force the circulation of inferior money is, first, acceptance for a time of the two currencies on a parity; and a difficult financial problem looks simple for a while, since mild inflation often brings a short-lived pseudo-prosperity. Then, as things progress, sound money gradually disappears or commands an ever-increasing premium, while the inferior money passes only at a heavy, and generally an increasing, discount. Then, finally, money almost disappears. The good money is hoarded or exported, and poorer money becomes worthless, like German marks during the First World War, which were literally worth less than the paper on which they were printed, for printing had destroyed even the value of the paper. If there is the slightest value to the discredited currency, everyone hastens to spend it anywhere for anything, seeking to turn a valueless voucher into some form of true wealth of any kind, on any terms. Finally, money passes out of use and we resort to barter.

These crises have been experienced many times; and, if our debt continues to soar, and if our money is again devalued, we shall doubtless "go through the wringer" again. Debts, both public and private, are extinguished with a few bales of paper, as long as it remains legal tender, and savings bank balances and life insurance shrink terrifically in value when they can be paid off in almost worthless paper. Then, finally, when our money is worthless and all business becomes crude exchange, a new currency must be established, as was done in much of Europe; and we did much the same thing, devaluing our dollar and creating a new dollar worth only fifty-nine percent of the old.

When, for a time, bi-metalism is accepted, it brings uncertainty and confusion, as years ago when Mexican business was conducted on both the gold and silver standard. The result was a double monetary system, with the value of gold and silver currencies far apart, and with the ratio of value varying from day to day, sometimes from hour to hour. One unfortunate result was speculation and shifting over funds from one currency to the other, by which simple process many made a substantial profit by juggling funds entrusted to their care. Garfield well said,

during the "Black Friday" crises, discussed in a later chapter, "So long as we have two standards of value, recognized by law, which may be made to vary in respect to each other by artificial means, so long will speculation in gold offer temptation too great to be resisted." Sometimes this trading in money for personal profit amounted to embezzlement, for losses on exchange were charged up and the guilty handler of the money made all the profits.

An argument for bi-metalism, which was heard in the Bryan days, was that the two metals tied together would provide a more stable standard than one metal, illustrated by the example of two drunken men, who, arm in arm, are supposedly steadier than either one alone. The argument never was very convincing. The stability of two drunks linked together is not very reassuring; and, if our money can depend upon no better standard than this, we are in for trouble. Actually whatever stability such money has hangs on the inferior coinage, for the better is withdrawn from circulation to be exported or hoarded.

### QUESTIONS

Does money satisfy our needs directly or only when exchanged for wealth?

Is all money wealth? Is a dollar bill wealth?

How does money facilitate the exchange of wealth?

Is money necessary to bookkeeping, pricing, buying and selling?

Why is gold a better standard for money than beaver skins, tobacco, or pig-iron?

Why do we seek a dollar with constant purchasing power?

What is the commodity dollar? What are its purposes? What are its drawbacks?

Why it is better to have a single standard of values than a double standard?

If we have two different standards of values for money, what happens?

What happens to savings accounts, insurance policies, and many contracts when the value of the dollar shrinks?

Is a definite, fixed and stable, monetary standard desirable and almost essential to honest and fair business?

Would it be desirable to fix the value of the dollar at some definite quantity of gold, by Constitutional amendment?