



11350 Random Hills Road, Suite 800, Fairfax, Virginia 22030 Phone (703) 934-6101 Fax (703) 352-3678

fff@fff.org www.fff.org

Gold and Freedom, Part 3

by Jacob G. Hornberger

Abraham Lincoln and Franklin Roosevelt were the two presidents most responsible for the abandonment of sound money in the United States. These two U.S. presidents opened the floodgates to the monetary debauchery under which today's Americans have suffered for their entire lives.

In waging war to prevent the Southern states from leaving the Union, Lincoln was faced with the age-old problem that rulers have faced throughout history: how to pay for the war's ever-increasing military expenditures. One answer, of course, was taxation, but Lincoln was no fool. He knew that taxes were not popular among the citizenry, especially when they're continually going up.

Thus, he resorted to another revenue-raising device, one that historically did not engender the same amount of animosity among people that taxes did. He simply borrowed the money through the issuance of government notes.

Keep in mind an important point here: The notes promised to pay dollars, which everyone understood were simply units of value reflecting the value in gold coins and silver coins. Ever since the country's founding, the money that people used in their everyday transactions was gold coins and silver coins, along with copper coins for smaller transactions.

Since the Constitution permitted the federal government to borrow money, there was nothing unconstitutional about Lincoln's decision to employ that method to finance the war. The problem arose when the federal government took one additional fateful step: It made the federal notes "legal tender." That action converted the notes from simple evidence of a loan into "paper money."

Why was a legal-tender law important to Lincoln and the Congress? They knew that when profligate governments borrow excessive amounts of money, their notes ultimately begin losing value in the marketplace compared with everything else. As more and more notes promising to pay gold are issued, the chances of default increase. If everyone appears at the government's gold window at the same time and says, "I wish to redeem this promissory note for 10 gold Eagles," there is a chance that the government will be able to pay off, say, only 70 percent of the note-holders before running out of gold.

Inflation and the Constitution

Thus, as more and more notes are issued, their relative value in the marketplace begins to drop. Suppose, for example, a federal agent walks into a dry-goods store and selects merchandise having a price of 10 gold Eagles. He hands the clerk a federal promissory note promising to pay 10 gold Eagles. The storeowner, however, knows that such promissory notes are trading at a discount. So he tells the federal agent, “Sorry, that’s not satisfactory. Either pay me 10 gold Eagles, or give me the note plus an additional 2 gold Eagles in exchange for the merchandise.”

Lincoln’s legal-tender law avoided that problem by simply dictating that every American had to accept federal notes at face value.

Yet that was precisely the reason that the American people had established a sound-money system in the Constitution. They knew that throughout history rulers had plundered and looted their own citizenry through inflation, first through such devices as “clipping the coin” and later through the issuance of paper money. Through the Constitution, the Framers intended to establish a monetary system by which the American people would forever be protected from the ravages of inflation. Lincoln’s legal-tender law effectively removed that protection.

Let’s assume that in 1860 Peter lends Paul the sum of \$1,000 in gold coins. The loan is evidenced by a promissory note in which Paul promises to repay the sum of \$1,000 in gold coins. The loan, principal and interest, is due three years from the date of issuance.

When the loan comes due in 1863, Peter demands his money. Paul tenders to Peter federal promissory notes totaling \$1,000 and cites Lincoln’s legal-tender law, which permits him to use federally issued paper money to pay his debts. Paul refuses the tender of the notes because in the marketplace the notes are trading for only \$700 in gold coins. He demands payment in the money standard that the loan originally called for.

The Legal Tender Cases

That was the issue in the *Legal Tender Cases*, which are among the most significant cases in the history of U.S. Supreme Court. When Lincoln’s legal-tender law came before the Supreme Court in the case of *Hepburn v. Griswold* (1870), the Court held that the law was unconstitutional.

However, because of a change in the makeup of the Court — two new justices were named by President Grant (!) within two years of the *Hepburn* decision — the ruling was overturned and the constitutionality of Lincoln’s legal-tender law was upheld in the cases of *Knox v. Lee* and *Parker v. Davis*.

The thrust of the argument sustaining the constitutionality of Lincoln’s legal-tender law was that since the Constitution granted Congress the power over the nation’s monetary system, it was the prerogative of Congress to use such power to issue paper money and force people to accept it with a legal-tender law.

It was, however, a spurious argument, as the justices who voted against the constitutionality of the legal-tender laws pointed out.

Recall, first of all, that the Constitution expressly prohibited the states from making anything but gold and silver coin legal tender. The Constitution also expressly prohibited the states from issuing “bills of credit,” a term that meant paper money.

Obviously, restrictions on the power of the states do not operate as restrictions on the powers of the federal government. But those specific restrictions on the states do provide a clear expression of the type of monetary system that the Framers intended for the United States — one based on gold coins and silver coins.

Why didn’t the Framers use the Constitution to expressly restrict the federal government in the same way as they did the states?

Recall that the Constitution brought into existence a government of limited powers that were expressly enumerated in the Constitution. Therefore, there was no need for the Framers to impose specific restrictions on federal power. To determine whether the federal government could exercise a particular power, all that people had to do was simply examine the list of enumerated powers. If a power was not listed, then the power could not be legally exercised.

Thus, since the Constitution did not give the federal government the power to issue paper money or bills of credit, such power couldn’t be constitutionally exercised, even though there was no express prohibition against issuing paper money or bills of credit.

By the same token, while the Constitution did give the federal government the power to borrow money, it did not give it the power to make its promissory notes legal tender. Therefore, under the doctrine of limited, enumerated powers there would have been no need to include an express restriction on the power to enact legal-tender laws.

We should also note the importance that the Framers placed on the sanctity of contracts, as reflected by the Constitution’s express restriction on the states from impairing contracts and their decision to not delegate the power to impair contracts to the federal government. That would be especially important to a person who had lent money pursuant to a loan contract that provided for repayment in the same standard of money under which the money had been lent.

Coins versus paper

Was the Constitution silent on federal power with respect to money? Absolutely not. The Constitution expressly gave Congress the power “to coin money, regulate the value thereof, and of foreign coin.” That power made it clear that the intent of the Framers was to bequeath a monetary system to the American people based on gold coins and silver coins.

Obviously “to coin money” means to make coins out of metal, not out of paper. “To regulate the value thereof” obviously means to define how much gold and silver each coin will comprise.

Thus, given the express restrictions on the states prohibiting them from making anything but gold and silver coin legal tender and prohibiting them from issuing paper money, and given no delegation of power to the federal government to do those things, and given the expressly granted power to Congress to coin money and regulate the value therefore, how in the world could anyone rationally arrive at the conclusion that the Framers intended to permit Congress to establish a paper-money system, especially one in which people would be forced to accept devalued or even irredeemable paper notes as money?

Yet that's precisely what the Supreme Court held after the addition of the two new justices appointed by President Grant. The dissenting justices in *Knox* and *Parker* correctly pointed out that the result was that the American people would now be subject to being ravaged by the very inflationary measures that the Framers intended to protect them from. As dissenting Justice Stephen J. Field put it,

Speaking of paper money issued by the states — and the same language is equally true of paper money issued by the United States — Chief Justice Marshall says, in *Craig v. State of Missouri*, “Such a medium has been always liable to considerable fluctuation. Its value is continually changing, and these changes, often great and sudden, expose individuals to immense loss, are the sources of ruinous speculations, and destroy all confidence between man and man. To cut up this mischief by the roots, a mischief which was felt through the United States and which deeply affected the interest and prosperity of all, the people declared in their Constitution that no state should emit bills of credit.”

After the Civil War, the American people continued operating under a monetary system based on gold and silver coins (as well as copper coins and nickel coins), which was the monetary system that the Framers had brought into existence through the Constitution. Since Lincoln's legal-tender law applied only to a select group of federal notes issued during the Civil War, its impact was limited in scope. Nonetheless, it set the stage for what would come 70 years later — the nationalization of gold, the repudiation of gold clauses, irredeemable paper money, ever-increasing federal spending, financial chaos and crises, and never-ending inflationary plunder of the citizenry.

This article was originally published in the June 2009 edition of *Freedom Daily*.