FORGOTTEN ANNIVERSARY:
ONE HUNDRED YEARS OF LEGAL TENDER

An Address
by

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The year 2009 will most likely expire without commemorating the centenary of a most momentous event in history that figures prominently as the main cause of the Great Financial Crisis of the century. This event was the so-called legal tender legislation in 1909. The bank notes of both the Banque de France and the Reichsbank of Germany were made legal tender by law, first in France and then, a very short time later, also in Imperial Germany. The rest of the world followed suit. In this way all roadblocks were removed in the way of financing the coming world war through credits and monetizing the resulting debt through the issuance of bank notes.

One unintended effect was that all efforts to avert the war and the concomitant great bloodshed and destruction of property through better diplomacy were short-circuited. The war parties in both countries had won a great victory. The cause of peace suffered a decisive defeat.

Please note that I have said “so-called legal tender legislation” because ‘legal tender’ in this context was a vicious distortion of the meaning of the phrase. There was nothing coercive about legal tender before 1909. Bank notes circulated as money, but their acceptance was entirely voluntary. People had an unconditional right to exchange them for the coin of the realm, that is, for gold coins. If the bank did not comply, then it was in technical default and had to face the consequences.

The original meaning of legal tender simply referred to a tolerance standard applicable to the wear and tear of gold coins. Coins meeting the tolerance standard circulated by tale, that is, their value was established by counting them out — a great convenience. Others circulated by weight: each and every coin had to be weighed — a great inconvenience. There was absolutely no coercion involved in this discrimination. The Mint exchanged gold coins within the tolerance standard by freshly struck full-bodied gold coins at no charge to bearer. The government absorbed the loss and covered it out of the general revenue fund. The cost was treated the same way as the cost of maintaining the nation's highway system in good repair. Not only was there no coercion involved in legal tender laws; in effect a public service was provided by the government without charging user-fees. That was the meaning of the phrase "legal tender" prior to 1909.

Notice the underhanded change in the meaning as a result of the legal tender laws of 1909. A public convenience was replaced by public coercion. Two governments with the greatest war-making power in the world introduced coercion forcing their subjects to accept and use debt as money. This was a 'first' in history. In particular, the governments were forcing the military, as well as civil servants, to take paper promises as ultimate payment for services rendered.

Of course, the use of the phrase 'legal tender' in this way is an oxymoron. A promise to pay that is at the same time an ultimate payment is not a promise. It is an ukase. This was a reactionary step, designed to facilitate the unlimited augmentation of monetary circulation regardless of the gold reserve. It allowed the financing of the coming war with government credits, much of it interest free and with no maturity date. The burden was thrown on the shoulders of the people without their concurrence.

The measure was represented as an innocent house-keeping change. There was no public debate on its wisdom. Nobody at the time could see the ominous consequences. Nobody suspected bad faith on the part of the government. As a proof of good faith gold coins were allowed to remain in circulation for another five years. Banks paid them out routinely as before, without fuss. There was no noticeable increase in the hoarding of gold coins by the people, a sign that they implicitly trusted their government. When the war finally broke out in 1914, the "guns of August" heralded the delayed effect of the legal tender laws. All gold coins went into hiding at once. Banks refused to meet any request for payment in gold. Members of the legislation, including all the socialist deputies, voted all the war-credits the government had asked for without demur.

The first author to unmask the connection between the Legal Tender Laws of 1909 and the outbreak of the war five years later, in 1914, was the German economist Heinrich

Rittershausen (1898-1984). He also predicted the Great Depression, and linked the coming unprecedented wave of unemployment to legal tender, as I am going to discuss it in more details in a minute.

We are left to second-guess history. Would the senseless killing and destruction of property have come to an early end in the absence of legal tender laws, just as soon as the belligerent governments had run out of gold to finance it? Most contemporary observers had predicted that it would have. There was no way to finance a conflict of this magnitude out of taxes. People did not understand that legal tender was an invisible form of tax to pay for the greatest war up to that point in history. They did not understand the power of credit that would enable governments to expend blood and treasure freely, without any restraint. People did not see the Moloch behind the façade of legal tender — the god that was preparing to devour his own children.

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But there was also another, most sinister consequence of the legal tender laws that was not recognized at the time. Before 1909 world trade had been financed through real bills drawn on London. A real bill was a short-term commercial paper payable in gold coin upon maturity. It represented self-liquidating credit to finance the emergence of new merchandise in the markets demanded most urgently by the consumers. As its issue was limited by the amount of new merchandise on its way to the market, it was non-inflationary. The credit was liquidated by the gold coin released by the ultimate consumer of the underlying merchandise. You can look at a real bill as credit in the process of presently "maturing into gold coins". As a medium of exchange, a real bill is "the next best thing" to the gold coin. It is virtually risk free to hold, as the underlying merchandise has a ready market waiting for its arrival.

Clearly, real bills are incompatible with legal tender laws. It makes no sense to suggest that you can make real bills "mature in legal tender bank notes". The fact is that the bank note is inferior to a real bill in almost every way. For one thing, real bills are an earning asset. This is due to the existence of discount applied to face value as the real bill is bought and sold before maturity. Real bills are most liquid: only the gold coin has greater liquidity. They are the best earning asset a commercial bank can have.

But what makes real bill paramount in the economy is the fact that, in the aggregate, they constitute the wage fund of society. They alone make it possible to produce and distribute goods *now* that the consumer will only pay for *later*. Up to three months later, to be precise. However, in the meantime workers employed in their production will have to be paid their due wages every week. Indeed, these workers must eat and satisfy other wants to be able to continue their production efforts. The payment of wages is definitely not financed through savings of the capitalists. It is financed through clearing, that is, through the spontaneous granting of temporary monetary privileges to real bills, thus enabling them to circulate before maturity.

An unintended consequence of the legal tender legislation was the destruction of this wage fund out of which workers could be paid before the goods were sold. Legal tender laws bore direct responsibility for the horrible unemployment during the Great Depression — as pointed out by Rittershausen. As long as the wage fund is intact, there can be no unemployment. Everybody who is anxious to earn wages can go into the production or distribution of some goods demanded by the consumers urgently, and get compensation from the wage fund immediately, even before his product is sold. The destruction of the wage fund changed all that. Workers could no longer be compensated for their labor expended in the production of merchandise unless it is ready for sale right away.

The destruction of the wage fund was not immediately obvious in 1909. Military training and production of war materiel absorbed the available manpower. During the war labor was in short supply because of the vast expansion of the production of munitions. Unemployment hit society only after the cessation of hostilities.

Had the victorious powers repealed legal tender laws after the war, thereby rehabilitating the market in real bills and replenishing the wage fund, the great Depression would have never occurred. But the victors were not interested in multilateral world trade. They wanted to punish the vanquished even more by making trade bilateral, to the exclusion of real bill circulation. In this way they wanted to retain control of the trade of their former adversaries. As a result the wage fund was never resurrected and workers could not be paid. The result was the greatest unemployment ever in history. Governments were forced to assume responsibility for the unemployed through the dole system. This system, an affront to people eager to work for wages, is still with us but its root cause, the absence of real bill circulation, remains unrecognized.

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Legal tender laws, representing the unholy alliance (not to say conspiracy) between the government and banks, have never been repealed. Governments have come to love the extra powers they acquired through false pretenses. The banks were happy to take the bribe. They shifted their loyalty from their customers to the government. In exchange for the privilege to create bank deposits without the restraint of a gold reserve, as was the case prior to 1909, the banks were prepared to buy all the government bonds that have found no willing buyers in the bond market. “You scratch my back, I scratch yours.” This conspiracy still goes on under a new ‘social contract’ in which bribe and blackmail has replaced voluntary cooperation.

The connivance of academia and media, in particular, the loyalty of the economists’ profession and that of financial journalists, has been bought by the central banks’ eagerness to sponsor research. “Whoever pays the piper shall call the tunes.” Authors who were prepared to sing the praise of irredeemable currency were handsomely rewarded. Authors critical of fiat money need not apply. Most of the economists and financial journalists today are scribes for hire, selling their pen to the government and the central bank. Propaganda is passed on as research.

Mathematics has been prostituted as never before in the history of the Queen of Sciences. Research papers on economics and monetary theory studded with formidable-looking but otherwise vacuous differential equations are presented as Holy Grail. The studied gestures and hocus-pocus of latter-day economists is similar to those of the priesthood in ancient Egypt. By virtue of their knowledge of astronomy — knowledge denied to the general public — Egyptian priests could predict eclipses of the Sun and other celestial events. They keep their audience in awe and in fear of their supernatural powers. The difference is this: while Egyptian priests were professionals representing state-of-art scientific knowledge, mainstream economists are charlatans and quacks who, while basking in their own glory, are totally incapable of predicting financial collapse even when it is staring at them in the face, as their miserable performance in 2007 showed. Worse still, they are totally incapable to admit their own mistakes. They are a curse on the body politic and a wart on the body academic. They are leading the world into an unprecedented monetary and economic disaster right now as I speak here.

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Our present financial crisis is the epitome of a tragedy brought upon us by coercion in the monetary field. The way out of the crisis, and the way to prevent another great Depression, is through the restoration of freedom in the realm of money: through an adroit repeal of legal tender laws. The gold standard must be rehabilitated together with its clearing system, the bill market. The monopolistic nature of government debt in the bond market must be eliminated through bringing back the competition of the gold coin to the promises of the government. Bondholders dissatisfied with the rate of interest offered by the coupons arbitrarily attached to government bonds must have their rights restored to them: the right to park their savings in gold coins, as they did before 1909. In this way they could force the government to pay competitive rates of interest on private savings, All coercion in the monetary field must be stopped. The dignity of the individual must be respected. The present collectivistic frame of mind of the government must be discarded in favor of one favoring the individual, restoring freedom and the free initiative of man.

A century is just a fleeting moment in history. The past one hundred years must be looked upon as a reactionary episode in our civilization, a mindless experiment with irredeemable currency. The experiment has failed miserably, as have all similar experiments in the past. Unless stopped forthwith, it will plunge the human race in unprecedented economic misery. It literally threatens the survival of our civilization and the entire system of our values.

Freedom in the field of money will bring us peace and prosperity. Continuing coercion is the road to war and misery.