

# THE THIRD PILLAR OF SOUND MONEY AND CREDIT

## THE PRINCIPLE OF REDEEMABILITY

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### **A Chinese Tale**

*Once upon a time a revolution of lasting import took place in China: the invention of paper and the simultaneous invention of paper money. Silk products had long been used as the material on which documents and contracts could be written. The revolutionary character of paper was to be seen in the fact that it was a thousand times cheaper than silk, and it could still carry the same message just as efficiently.*

*The most potent message that paper was capable of carrying was the promise of the Imperial Treasury to pay the bearer a stated sum of silver coins on demand. The Treasurer, Ding, discovered that he could pay the suppliers of goods and services to the Celestial Court with such paper promises. People trusted the Treasury and accepted its promise to pay as equivalent to payment in silver coin.*

*Soon afterwards the Treasury ran out of free silver, as it found that all the silver coins in its coffers had been mortgaged in the form of outstanding promises. Ding refused to issue more paper money except in exchange for silver coins paid into the Treasury. In his view any other course of action would compromise not only the integrity of the promises of the Treasury but also that of all the contracts in the Celestial Empire, affecting a value far greater than the value of paper money in circulation. Contracts made by third parties in*

*good faith would be rendered impossible of fulfillment and the standard, or measuring rod, of honest dealings among the populace would be destroyed. A decline in prosperity would follow in due course, as the cornerstone of economic well-being is the integrity of promises men live by.*

*But the Deputy Treasurer, Dong, was an ambitious man and he saw that Ding had painted himself into a corner. Dong threw himself at the feet of the Emperor, pleading thus: "Sire! Let me issue further promises to pay silver coins against the cutlery, candelabra, and other silverware of the Celestial Court!" The Emperor promptly fired Ding, and rewarded Dong for his resourcefulness by making him Treasurer.*

*Dong could not enjoy his newly found glory and power long. Other ambitious men in the Court took careful note of what happened at the Treasury. They got the ear of the Emperor in suggesting that even more paper money could be issued against silver that had not yet been brought out of the imperial mines, as well as against the silver in the Moon. Because the Moon was considered a province of the Celestial Empire, and it was thought to consist of silver 95% pure, a belief confirmed by a recent scientific study released by the Heavenly Research Council, there was a plausible case for expanding the issue of paper money. The Emperor fired Dong, and thereafter the change of the guard at the Treasury became a frequent ritual, each time a more unscrupulous adventurer succeeding a less unscrupulous one. The promises of the Treasury to pay silver coins on demand had lost all their remaining value.*

*In the aftermath of the depreciation of paper money a Great Cultural Revolution engulfed the Celestial Empire. People took to the streets, purged the Heavenly Research Council, and hanged all the past Treasurers on makeshift gallows erected along the Square of Heavenly Peace, stuffing their mouths with the paper promises that they had signed*

### **Not worth a Continental**

The United States, in its infancy, attempted the same process by the issuance of Continental currency. This currency collapsed in the same way as its ancestor in China. Later, one of the greatest orators of all times, Daniel Webster, denounced irredeemable paper money on the floor of Congress in 1822 in these words: "Of all the contrivances for cheating the laboring classes of mankind none have been more effectual than that which deludes them with paper money. Ordinary tyranny oppression, excessive taxation... these bear lightly on the happiness of the mass of the community compared with fraudulent currencies and the robberies committed by depreciated paper." Today we reject the dictum of Daniel Webster, and indulge in the same national sin which promises to exact, some day, severe penalties for our belief that we can challenge with impunity such fundamental truths as those involved in the maintenance of standards of common honesty in the fulfillment of our promises.

### **The ballot box is not enough**

The principle of redeemability of the currency asserts that, if a citizen believes that there is too much money in circulation, he must have the right to do something about it. He should be allowed to hoard, melt, or export the gold coins in his possession, thereby redeeming the commodity value of the monetary standard. It also asserts that the citizen should be allowed to withdraw the gold reserves which form the basis of the monetary system, to the extent of his holdings of paper money or bank deposits. When a currency is redeemable in standard gold coins, any individual disturbed by the behavior of the government or banks can attempt to protect himself by presenting for redemption such paper currency as he may command. It is this power of individuals that holds, or tends to hold, banks and government in check. Without this power the people, as individuals, are helpless insofar as control over their banks and government is concerned. The power of the ballot box provides no protection, after the government has freed itself from the obligation to redeem its promissory notes, and acquired power to expand the volume of paper money without fear of adverse public reaction. The way to government dictatorship has been opened up. Human freedom has been endangered. The variety of ways in which freedom could be impaired or destroyed is practically countless as the government takes more and more power from the people and to itself. Limited government is not possible unless the principle of redeemability of the currency is respected.

### **A nursery of tyranny, corruption and delusion**

In his classic monograph *Fiat Money Inflation in France*, the distinguished scholar Andrew D. White, joint founder and first president of Cornell University, quoted Mirabeau of France as saying in 1789 that irredeemable currency is "a nursery of tyranny corruption and delusion: a veritable debauch of authority in delirium." His contemporaries ignored the admonition, issued the assignats and the mandats - and history has attested the accuracy of Mirabeau's prophecy.

The act of inflicting an irredeemable currency on a people is an act of dishonesty by the government, and the influence of that dishonesty spreads through an endless number of channels and in an endless number of forms to the mass of people who are then corrupted in countless ways. To use White's words: such corruption grows "as naturally as fungus on a muck heap. It was first felt in business operations, but soon began to be seen in the legislative body and in journalism." As to the corruption among legislators, he stated that "there was enough to cause widespread distrust, cynicism and want of faith in any patriotism or any virtue. Worse still was the breakdown of morals of the country at large, resulting from the sudden building up of ostentatious wealth and from the gambling, speculative spirit, spreading from large towns to small, and to rural districts. The disgraceful result was the decay of national good faith." White stated that "there came cheaterly in the nation at large and corruption among officials and persons holding public trusts... Faith in moral considerations, or even in good impulses. yielded to general distrust. National honor was thought a fiction cherished by hypocrites. Patriotism was eaten out by cynicism."

"It ended in the complete financial, moral and political prostration of France - a prostration from which only a Napoleon could raise it."

White concluded, in his *Fiat Money Inflation in France*, that "every other attempt of the same kind in human history under whatever circumstances, has reached similar results in kind if not in degree."

No doubt the authors of the assignat and mandat thought that they were acting on firmer scientific basis than the Treasurers of the Celestial Empire. Yet, from the perspective of the 20th\* century observer, the only breakthrough was the replacement of the gallows by the more efficient guillotine.

\* (1985)