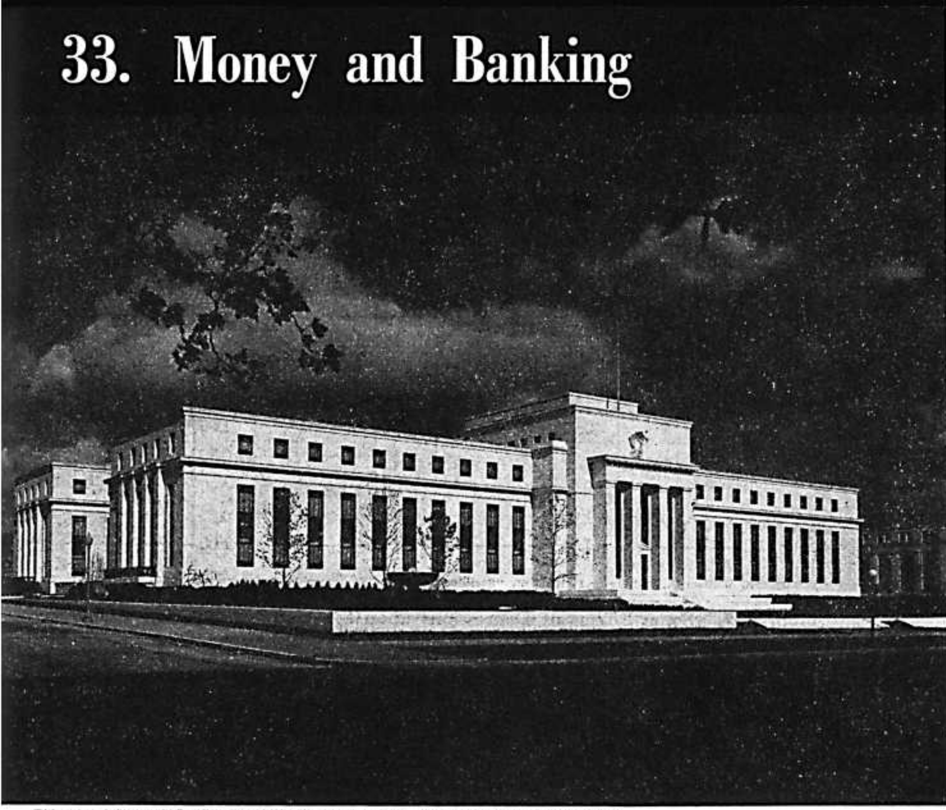
PART IX

National Finances

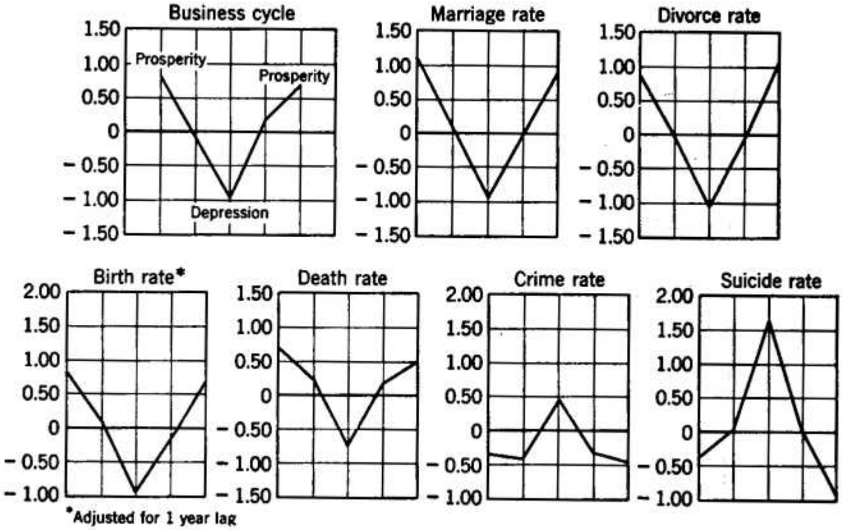
33. Money and Banking



Rideout and Stapp, 607, 15th St., N.W., Washington, D.C., per Federal Reserve Commission

In a survey made during the 1952 political campaign, 21% of a sample of all American adults declared that the Republican Party is the party of depression; by contrast 26% said that they liked the Democratic Party because it is the party of prosperity and good times. In fact, of all reasons for disliking the Republican Party and liking the Democratic Party, this was the most common. This great wave of opinion was still moving from the earthshaking depression of 1929. Most severe depressions have had great impacts upon politics, so much so that when there is a tremor of unemployment, as in the campaign of 1954, politicians of both parties become visibly agitated. Figure 67 shows how a few forms of behavior are drastically affected by economic depression. Hundreds more of such charts might be drawn; one survey listed 100 effects that a depression has on a local school system alone. Hence it is no wonder that people and politicians alike tremble at the thought of a decline in business activity.

In good times and bad, most people hold the government accountable for prosperity. The government is expected to so rule the economy that people will have jobs and will be able to provide for their families. Though



Ogburn, William F., and Meyer F. Nimkoff, "Sociology" (Boston, Houghton Mifflin Company, 1950), figure 151

Figure 67. Some Effects of Depressions upon a Society. Hardly any institution or form of behavior escapes the effects of a serious depression. Every agency of government finds its functions altered. A few general effects are shown here as they were computed from facts relating to American depressions between 1870 and 1920; averages were figured at five points, from one prosperity peak to the next peak.

perhaps not so unsophisticated in their expectations, the authors of the Constitution were intent not only upon preventing commercial stagnation, but also upon promoting business. Therefore they gave the government of the new nation ample controls over the monetary system, and enough implied powers so that subsequent financial schemes going far beyond the coinage of money might be authorized. Today the financial powers of the federal government are exercised in many places and ways. In fact, no part of the process of earning and spending money, which is pictured in Figure 68, is free from the effects of government policies. Part of the dollars earned by Americans come from government spending; the value of the dollar depends upon government practices; where and when some of the dollars go into the Treasury are questions for the government to determine. A close study of Figure 68 can be rewarding; it suggests the relations that exist among many elements of the American government to be treated in this chapter, dealing with money and banking, and in several of those that follow, discussing expenditures, taxation, income, and credit.

SOURCES OF GOVERNMENT MONETARY POWERS

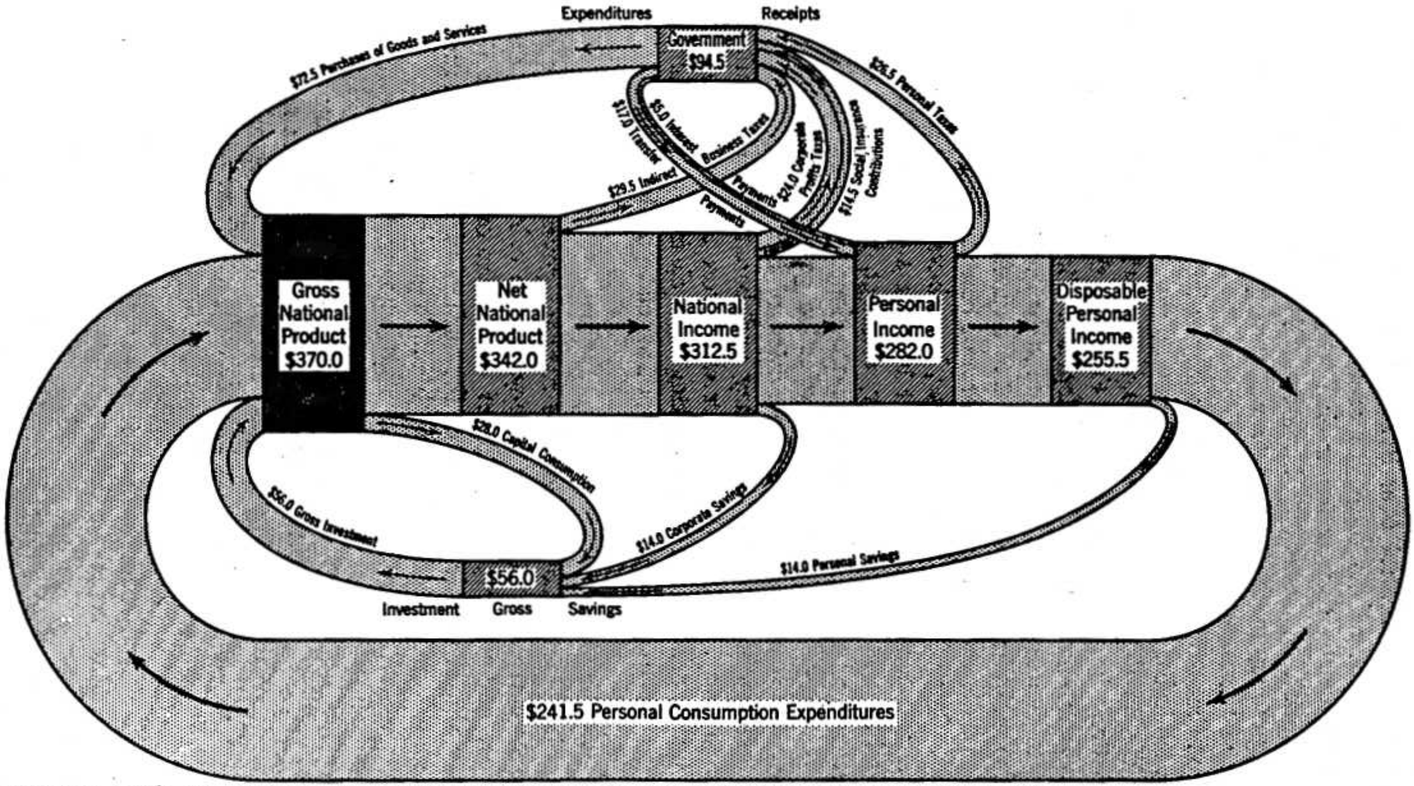
The creation and management of money is one of the primary functions of the federal government. Indeed, this is a leading power of every sovereign state; it has been such for centuries. At one time the wealth of a nation was measured by its stocks of metallic money; obviously the government must provide that its currency be sound. Since the High Middle Ages, governments have collected their revenues chiefly in money, again necessitating control over their monetary structures. The national economic systems of the twentieth century are based to a considerable extent upon money; their course is charted largely by the nature and the value of money. Governments have devised a host of new methods for controlling money in the interest of whatever group or groups may hold the tiller of the state.

Granted that national control over money is inescapable, national supervision of banks has become equally essential during the past century. Banks now create, in the form of credit, the money with which the vast bulk of the nation's business is carried on. Probably the most evident purpose of banks is to serve as custodians of deposits. Banks then combine these deposits to purchase public and private debentures. On these deposits banks also make loans to individuals and to business organizations. At one time this credit was extended in the form of bank notes printed for or by the banks. Since the Civil War, however, loans have usually been extended in the form of accounts upon which the borrowers could write checks. In this way banks actually create money, although not as coins or paper. However, several times as much business is done with this "bank money" as with currency. Consequently any effective governmental control over money must be accompanied by supervision of banking.

Many phases of the study of money and banking are difficult for a beginner to grasp. Hence this chapter will resort to rather extended historical illustrations as a means for making most clear the several important principles that are involved in national financial policies.

Control of money

Under the present Constitution the national government has exclusive power over currency. American moneys in the colonial era, during the Revolution, and under the Articles of Confederation, were chaotic and frequently almost valueless. Most of the authors of the Constitution had vested interests in a stable currency with a high purchasing power. Doubtless, too, some of them felt that an unsound money reflected poorly upon the dignity and the solvency of the new American republic. Hence the Constitution empowers Congress to "coin money" and "regulate the value thereof" (Art. I, sec. 8, cl. 5); too, it forbids the States to "coin money; emit bills of credit; make anything but gold and silver a tender in payment of debts" (Art. I, sec. 10, cl. 1). A bill of credit is a form of money issued by a State; its value in exchange is based upon the receiver's faith in the credit of the State. No State has issued a bill of credit under the present Constitution. Legal tender money is money that a creditor must accept from a debtor in payment of a debt. State banks have issued paper money whose value in exchange has depended upon popular faith in the bank's ability to redeem its notes in gold or silver coin; however, State bank notes have never been legal tender. Finally, to protect the currency, Congress is authorized "To provide for the punishment of counterfeiting the securities



Dewhurst, J. Frederic, and Associates, "America's Needs and Resources: A New Survey" (New York; Twentieth Century Fund, 1955)

Figure 68. The Cycle of Income and Spending in the American Economy (as Predicted fcr 1960).

and current coin of the United States" (Art. I, sec. 8, cl. 6). Acting under these sanctions Congress in 1792 created the decimal system of dollars and cents that prevails to this day.

Control of banking

On the other hand, the federal power to charter and regulate banks is drawn solely from authority implied in the Constitution; no such power is explicitly conferred by the Constitution. Shortly after the adoption of the Constitution, Secretary of the Treasury Hamilton sought to have the government establish a Bank of the United States. After a long dispute, the first of many involving a "broad" as opposed to a "narrow" interpretation of the Constitution, Hamilton persuaded Congress and President Washington that this power was implicit in the authorization to coin money and to regulate its value. This principle was endorsed by the federal Supreme Court in the case of *McCulloch* versus *Maryland* in 1819. Thenceforth the national power to create and supervise banks was unchallenged. However, it has been exercised according to the wishes and needs of the interest group currently in command of the fiscal machinery of the national government.

DEFINITIONS OF TERMS USED IN FIGURE 68

GROSS NATIONAL PRODUCT	Gross value of all goods and services produced by business enterprises and by government agencies
CAPITAL CONSUMPTION	Value of physical capital consumed in the process of turning out goods and services
INDIRECT BUSINESS TAXES	Sales and excise taxes collected from buyers by business firms and turned over to government
CORPORATE PROFITS TAXES	Chiefly, the federal corporation income tax
SOCIAL INSURANCE CONTRIBUTIONS	Chiefly, payroll deductions for old age and survivors insurance and for unemployment compensation
PERSONAL TAXES	Personal income taxes at various levels of government
CORPORATE SAVINGS	Liquid assets of corporations, such as profits retained instead of being paid out as dividends
PERSONAL SAVINGS	Liquid assets of individuals, such as bank accounts
GROSS INVESTMENT	Primarily new construction and capital equipment; but also additions to, or subtractions from, business inventories, and foreign investment
INTEREST PAYMENTS	Payments of interest on government debts at various levels
TRANSFER PAYMENTS	Transfer of income from a government to a person without a reverse transfer of goods or services, such as old-age pensions

BIMETALLISM AND THE GOLD STANDARD

The bimetallic standard

The first money issued by the federal government was based on a bimetallic standard of gold and silver. In this respect the United States was simply following the practice then common in Europe. The value of the two metals, for the purposes of the coinage, was set in the ratio of 15:1; that is to say, gold was to be worth fifteen times as much as silver, or, in other terms, one ounce of gold was to be worth as much as fifteen ounces of silver at the Treasury. However, this government ratio did not correspond to the market value of the two metals, since gold as bullion was worth more than fifteen times as much as silver. Hence, since gold was worth more as bullion than as coin, it virtually disappeared from circulation.[1] Under President Jackson an effort was made to restore gold to circulation by changing the ration to 16:1. Now silver was undervalued at the Treasury, for gold bullion was not worth sixteen times as much as silver bullion. Hence silver dollars disappeared; lesser silver coins continued to circulate largely because their metal was deliberately debased to keep them current. At the time the Civil War broke out, therefore, gold dollars and larger coins predominated in the coinage. Actually the bulk of the currency consisted of State bank notes; however, these were not legal tender, and fluctuated in value.

The Greenbacks

With the outbreak of the Civil War, gold coins disappeared too; they were hoarded, since their value was certain. In order to finance the war the federal government itself began to issue paper money, the so-called Greenbacks, which could not be redeemed in gold or silver but were nonetheless declared legal tender. An important outcome of the Greenback issue was monetary inflation, raising farm prices and making it easier for debtors—mainly farmers saddled with mortgages—to pay their debts. Greenbacks themselves circulated at considerably below face value with respect to gold; their value tended to rise with Union victory and fall with Union defeat. Sometimes a gold dollar would buy twice as much as a Greenback dollar. Hence after the war the debtor group insisted that the Greenbacks be kept in circulation without gold support, and organized the Greenback Party to realize their aims. However, the postwar Republican administrations were favorable to the creditors' interests, which sought deflation—that is, money with greater purchasing power.

The position of the clashing interests can be readily demonstrated. Assume that a farmer had borrowed one thousand dollars at a time when

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[1] This process is known in economics as Gresham's Law. Another way of stating the process is to say that bad money drives good money out of circulation. Silver money at this time would be termed "bad" money because the silver in the coins was overvalued; silver coins were worth more than the silver in them would have brought as bullion.

wheat was worth one dollar a bushel. So long as the value of money remained constant, it would cost him one thousand bushels of wheat to pay the principal of his debt. To make it easier for him to pay his debt, he would campaign for inflated money, or money with a lesser purchasing power. If he were successful in his campaign, and money were so cheapened that a dollar would buy only half a bushel of wheat, he could repay his one-thousand-dollar principal with five hundred bushels of wheat.

The creditor, on the other hand, in order to make more from his loan than his simple interest, would demand deflated money, or money with a greater purchasing power. If his demands were heeded by the government, and the purchasing power of money enhanced, a dollar might buy two bushels of wheat. In this way the creditor would receive a thousand dollars that would buy two thousand bushels of wheat. Since the creditor groups after the war had the greater influence in the government, Congress in 1875 voted to establish a reserve of gold with which, starting in 1879, Greenback currency would be redeemed. Soon a Greenback dollar with this support would buy as much as a dollar in gold. The deflation of the Greenback dollars represented a major triumph for the creditor interests.

"Free silver" and the gold standard

The establishment of the gold standard in 1900 was immediately preceded by a far more strenuous and more highly emotionalized campaign than that of the Greenbackers: the campaign for "free silver." In 1873 Congress enacted a coinage law that entirely omitted the silver dollar. Actually, since this coin had for years been undervalued, it had disappeared from circulation. However, certain groups stigmatized this omission as the "Crime of '73" and began to demand, first the restoration of the silver dollar, and second the unlimited coinage of silver. Inasmuch as the silver production of the new western mines during the 1870's altered the comparative prices of gold and silver so that silver was now overvalued at the mint, unlimited coinage of silver would produce the inflation that the Greenbackers had aimed for.

The free silver movement, however, received more support, and appeared more respectable, than the Greenback Party. It was favored not only by the debtor interests but also by the silver mine owners. It appeared more respectable because silver, unlike paper, is a precious metal; moreover, inflation through silver coinage would be absolutely limited by the amount of silver that could be mined. As the dollar grew increasingly valuable, resulting in ever falling farm prices, the Greenbackers rallied to the cause of free silver. Two measures, the Bland-Allison Act of 1878 and the Sherman Silver Purchase Act of 1890, although they authorized the government to purchase more silver, actually did little to increase the amount of silver money because the Treasury bought the minimum amount allowed by law. Eventually the free silverites captured the Democratic Party through the nomination of William Jennings Bryan for the presidency in 1896; however, his defeat by McKinley sealed the fate of the free silver movement. In 1900 Congress placed the United States on the single gold standard.

The contest between the gold and the silver adherents mirrored more than a simple dispute over money. It was a contest between the debtor farming group on the one hand, and the creditor industrial and financial interests on the other, for control of the federal government. The creditor interests won the struggle; yet the inflation that the silverites had pursued was commenced before 1900 by the discovery of gold in Alaska and South Africa, inaugurating an epoch of a declining dollar and higher farm prices.

BANKS BEFORE THE FEDERAL RESERVE SYSTEM

The banks of the United States and State banks

American banking systems, like the American currency, have constantly reflected the struggles among the various financial groups in the country. In 1791 Congress created the Bank of the United States. Chartered for twenty years, this institution was designed to stabilize the currency. It was also intended to tie the financial and mercantile interests closely to the new government; the bulk of its stock was sold to the public, but only those groups could afford to purchase shares. In order to win public confidence, the Bank was empowered to issue notes based upon its holdings of gold and silver, which, although not legal tender, might circulate as money; the Bank was custodian for the funds of the federal government; and the government owned one-fifth of the stock. The Bank was so well managed that its private shareholders earned handsome dividends. Hence in 1811, when its charter expired, the Bank was not at once revived, for the government was then controlled by spokesmen for debtor interests and by advocates of State banks.

The difficulties of financing the War of 1812, and the sense of nationalism that followed the war, induced Congress to charter a second Bank of the United States. But even before its charter ran out President Jackson had begun to deposit federal revenues in State banks; in addition, the Congresses of the 1830's, like Jackson fearful of centralized banking control, refused to renew the charter (note the cartoon in Figure 69). Until the Civil War, then, the States monopolized the creation and control of American banks. This meant that many banks were weak, and that the notes they issued were sometimes unredeemable in coin. It also meant that Westerners secured credit more readily, and that the West expanded perhaps more rapidly, than might have been the case under the Bank of the United States.

Creation of the national banks

During the Civil War the supporters of a national banking system rewon control of the federal government through the Republican Party. In 1863 they pushed through Congress legislation authorizing the government to charter banks whose financial practices it could regulate. These banks were allowed to issue notes of a value up to ninety per cent of their holdings of federal bonds, which were deposited with the United States Treasury. By this device the Treasury secured additional funds to finance the war. Also, in order to give the national banks a monopoly on the issuance of bank notes, Congress levied a ten per cent tax on State bank notes, effectively driving them out of circulation.

Operation of the national banks

National banks still carry on the largest share of the nation's banking business, but they no longer issue currency. While the banks were supervised by the Treasury Department, they had no strong ties among themselves. Consequently, in the event of a sudden need for money in one section of the country, the banks in other sections were under no obligation to extend credit outside their locality. Moreover, it was often charged, and with some truth, that the banks of New York City had an unbreakable grasp upon most of the national credit facilities. Most important, experience showed that in case of a depression, when added credit might be wanted, money tended to contract rather than expand. This circumstance resulted partly from the banks' practice of selling government bonds during a depression so as to acquire ready cash. Of course, a bank that did this reduced its holding of bonds; then, since the value of the bank notes it might issue was limited to ninety per cent of its holding of bonds, the bank

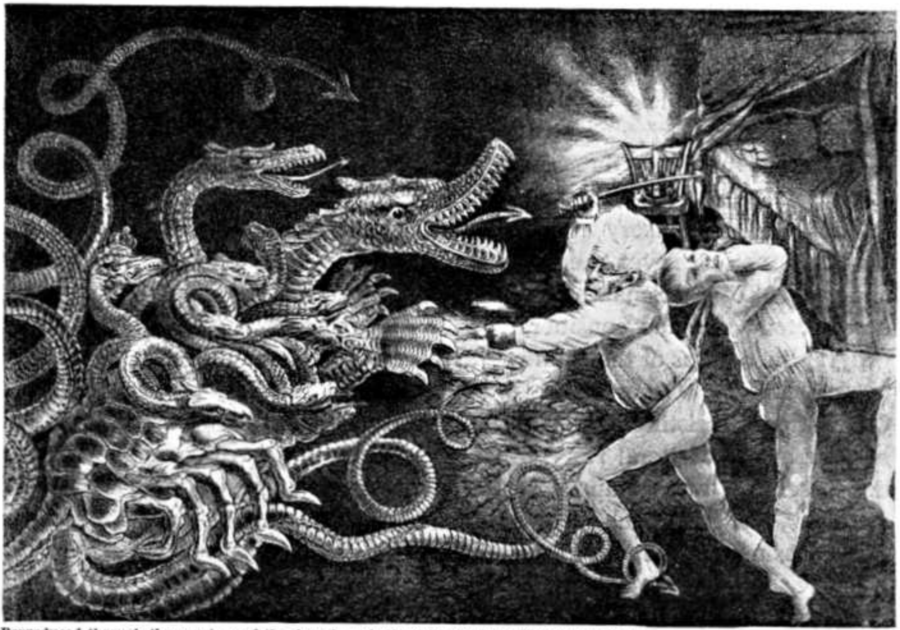

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Figure 69. Andrew Jackson *versus* the Bank of the United States. Jackson's raging quarrels with the Bank led some to believe he was the victim of nightmarish delusions. Here a friend is pictured as pulling him back to bed. Indeed, beneath many a so-called economic issue of history there lie various psychological and political roots that a student may well inquire into.

was compelled to withdraw some of its notes from circulation whenever it sold some of its bonds. This difficulty was especially marked in the depression of 1907, which appears to have been little more than a bankers' panic. Subsequently a congressional investigation by the Pujo Committee in 1912 showed the weaknesses of the American banking system. In keeping with the recommendations of the Committee, Congress in 1913 passed the Glass-Owen Act, which established the Federal Reserve System.

THE FEDERAL RESERVE SYSTEM

General structure

The Federal Reserve System provides the national government a strong institution for the control of American banking. All national banks must belong to the System, and State banks that satisfy certain minimal conditions may join. Unlike the two Banks of the United States, the Federal Reserve System is regionalized. The United States is divided into twelve federal reserve districts; a Federal Reserve Bank is located in a leading city of each district, as follows: Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco. The federal reserve banks are owned by the member banks of their districts, each of which must subscribe six per cent of its capital and surplus for stock in the Federal Reserve Bank. The reserve banks are each managed by a board of nine directors: three of the directors are chosen by the chief central agency of the System, the Board of Governors, which names one of its appointees chairman of the board; three directors are chosen by the member banks to represent the various economic interests of the district; and three more, also selected by the member banks, to represent the banks themselves. The terms of the directors are arranged so that one expires every year.

The chief supervisory agency of the System is the Board of Governors, which consists of seven members chosen by the President, with the advice and consent of the Senate, for overlapping fourteen-year terms. They must be selected with due consideration for the different economic groups and geographic regions of the country; no more than one may come from a single reserve district. Other central bodies are: (1) the Federal Open Market Committee, consisting of the Board of Governors and five additional members named by federal reserve banks, to manage the open market activities described below; and (2) the Federal Advisory Council, of twelve members, one from each reserve district, to furnish the System with counsel about business conditions.

Operations

Rediscounting Commercial Paper: The federal reserve banks do not carry on business with private individuals and corporations; they are "bankers' banks," for their relations are almost exclusively with member banks and with the government. Among their principal functions is the rediscounting of commercial paper held by member banks. An individual or a corporation borrowing money from a bank offers some form of security termed "commercial paper," such as a note or a mortgage, which the bank then "discounts." Before the establishment of the Federal Reserve System, a bank could lend money only to the extent of its own resources. Now, however, a bank that needs additional credit facilities may turn over to the Federal Reserve Bank of its district some of this commercial paper, along with a prescribed percentage of gold certificates (a type of paper money no longer publicly circulated, which represents gold), which the Federal Reserve Bank "rediscounts"; that is, it lends money to the member bank. This loan is given in federal reserve notes, which make up the largest part of American paper money today. In the event a federal reserve bank needs added credit facilities of its own, it may borrow from one or more of the other federal reserve banks. The consequence of this functioning is that when there is a greater demand for money, as evidenced by a larger volume of borrowing from banks, there is more money in circulation. In other words, the elasticity of credit is such that the amount of money available corresponds to the need for it.

Stabilization of Credit: Another major purpose of the Federal Reserve System is the stabilization of credit, and through it of the whole American economy. It has divers means for effecting this purpose. One is by manipulation of the rediscount rate, or rate of interest it charges on its loans to member banks. By raising the rediscount rate it can oblige member banks to raise their discount rate, thus discouraging would-be borrowers since money has become more expensive, lessening the amount of money in circulation, and bringing about a deflationary effect. By lowering the rediscount rate the System can bring about the reverse effect.

Federal reserve banks may also engage in "open-market operations" at the direction of the Open Market Committee. Such operations involve the purchase and sale of government bonds and commercial paper. For example, in the event it is desired to stimulate business activity, federal reserve banks may begin to purchase government bonds. This action, in the first place, will put more money in the hands of the public. In the second place, it will tend to lower interest rates. The demand for the bonds presumably will raise their market prices; then, since their interest rates are based on the bonds' par value, their rise in price in the face of their fixed return will constitute a lowering of the interest rate they yield. This in turn will tend to depress all other interest rates, which is considered an inflationary movement. Finally, the decline in government interest rates will encourage investment in more remunerative private undertakings. On the other hand, should it be decided that business investment ought to be curtailed, the System may begin to sell government bonds.

One other noteworthy control is the power of adjusting the percentage of reserves that banks must hold against their loans. By lowering the percentage from twenty to ten, for instance, the System can theoretically double the lending power of banks, since on reserves of $100.00 banks may now lend $1,000.00 where previously they could lend but $500.00.

Additional Services: Federal reserve banks perform numerous additional services for member banks and for the government. They hold member banks' reserves of gold and silver, and they are clearing houses for checks. The Federal Reserve System accepts deposits of government revenues; it sells government bonds, and cashes government checks and coupons. During and after World War II, through its open market operations the Federal Reserve System endeavored to keep government interest rates low by purchasing bonds whenever they threatened to drop below a specified market value, usually just above par. In this way the federal government was able to sell its short-term debentures at a lower interest rate, reducing the cost of financing the war.

Success of the Federal Reserve System

The Federal Reserve System has not succeeded in controlling the money market to the degree its creators claimed it would. Admittedly it functioned ably in the financing of World War I. However, it failed signally to cope with the depression of 1929. Raising the rediscount rate in 1929 did not stem the speculation in the stock market. In fact, since certain major parts of the economy were already depressed in 1929, this action may have been positively harmful. Furthermore, lowering the rediscount rate in the early 1930's did not noticeably stimulate recovery. After World War II the System and the Treasury Department entered a spirited dispute over the management of credit; the former wished to raise interest rates so as to curb inflation, but the latter wished to keep them low in order to make servicing of the federal debt less expensive.

This contest illustrated one important aspect of the federal government: monetary control is not concentrated, but is entrusted to these two agencies. Because the Secretary of the Treasury is directly responsible to the President, Treasury policy is apt to mirror that of the White House. Federal Reserve policies, on the other hand, are directed by a long-term Board of Governors that may have been appointed by earlier administrations with contrary fiscal policies. The clash between the two institutions may sometimes weaken the federal government; nonetheless, it does afford representation for differing monetary philosophies.

The Federal Deposit Insurance Corporation

The failure of many banks during the 1930's inspired the creation of a new federal agency to protect bank depositors, the Federal Deposit Insurance Corporation (FDIC). The FDIC is a government corporation that insures all deposits in Federal Reserve member banks, and other banks that can fill certain requirements, to the sum of $10,000 per depositor. The insurance is financed by premiums paid by the affiliated banks at the rate of one-twelfth of one per cent of their deposits. So far every depositor in a failed bank has been recompensed in full. Some bankers, however, argue that in case of a major depression the resources of the FDIC would be insufficient to deal with the needs. In some circles it is also averred that the FDIC has encouraged speculation and unsound financial practices on the part of some banks. However, since certain States already had deposit insurance corporations before 1929, it appears that public demand is apt to forbid any drastic change in the FDIC.

THE POLICY OF FLEXIBLE CURRENCY

After more than thirty years of the gold standard, the United States through a series of measures in 1933–1934 abandoned the standard and adopted a considerably revised monetary system. This change was prompted by a number of factors. In the first place, many European countries, notably Great Britain in 1931, had already discarded the gold standard. In the second place, the United States was in a serious depression, with low prices and high interest rates. Thirdly, through the election of 1932 the debtor, "easy money" interests had won domination of the federal government. Finally, there was a widespread conviction that the value of the dollar should rest, not on its gold content, but upon a price index of commodities, so that its purchasing power could be stabilized.

Steps toward a flexible currency

Among the steps bringing about this transformation in American money were the following: (1) In order to curtail the private hoarding of gold, the government required that all gold currency and bullion be surrendered to the Treasury, in exchange for paper money not based on gold. (2) An executive order authorized by the Emergency Banking Act of 1933 provided that the various kinds of currency could no longer be redeemed in gold, thus formally taking the United States off the gold standard. (3) Congress repealed the clause in public and private debentures requiring that their principal and interest be paid in gold, substituting only the obligation to pay in legal tender. (4) Empowered to do so by the Agricultural Adjustment Act of 1933, the President in 1934 reduced the value of the dollar to 59.06 cents in gold. (5) Under the Gold Reserve Act of 1934 the government began to buy domestic and foreign gold at the fixed price of $35.00 per ounce, so that by 1956 the Treasury owned almost $22 billions' worth. (6) As a gesture to the silver-mining interests and the residual "free-silver" sentiment, Congress directed the government to buy enough silver to equal one-third of the national gold stock.

The chief goal of these measures was to raise prices, especially those of farm products. Actually the resultant change in prices seems to have been far less than either the supporters or the detractors of these innovations predicted. The reason probably lies in a fact noted above, that the currency provides only a minor fraction of the money with which the nation's business is conducted. It is also evident that the supply of money is only one of several factors influencing the level of prices. But certainly these steps did give Congress and the President several new means for dealing with money.

American money today

The monetary system of the United States today is often described as "managed." This is true, at least in the sense that the value of the dollar is no longer subject only to fluctuations in the national and world price of gold. However, American money has always been "managed"; Congress ever since 1789 has been passing laws directly affecting the purchasing power of the dollar, such as the establishment of the 15:1 ratio in 1792. What is important is to determine for what group or groups American money is being "managed," and toward what ends. Management in the early years of the United States revolved primarily about the question of the ratio between gold and silver. Later it concerned the struggle between the debtor and the creditor interests. Today money management impinges upon the whole of the American economy. Furthermore, it should be remembered that until 1933, apart from the era falling roughly between Presidents Jackson and Lincoln, the national government tended to favor the creditor group. Much of the monetary control exercised under Presidents F. D. Roosevelt and Truman was at the behest of the debtor grouping. It must also be remembered that those who owe now have been joined by a mighty new force, the greatest debtor of all—the United States government.

Function of the American gold stock

Whether the gold bullion stocked by the federal government has any function is often asked. It should be recalled that American currency is still measured in terms of gold, even though it is not convertible into gold. Moreover, all federal reserve notes are based not only on commercial paper but also on at least twenty-five per cent gold certificates held by the Federal Reserve System. Too, gold is still used for payments in international trade. The bullion stock certainly has psychological power; witness the opposition to proposals occasionally emanating from the gold-mining States that the price of gold be raised, and the uneasiness resulting from sporadic reports that the USSR is exporting gold in quantity. From time to time, in fact, one still hears recommendations that the United States return to the traditional gold standard. At a minimum, gold still plays a major role in the American monetary system, but it can be safely said that a return to the traditional standard is extremely unlikely if not impossible.

QUESTIONS AND PROBLEMS

1. You are a farmer today with a $10,000 mortgage on your property. Paying that mortgage is the most important thing in your life. What action would you like to see the Federal Reserve System take? Why?
2. Under the system of national banks established in 1863, what might have been the consequences if the national debt had been entirely paid?
3. Ralph Johnson, an Ohio farmer in 1877, had a $5,000 mortgage on his property. He wanted nothing so much as to pay his mortgage. What government policies would it be logical for him to support? What policies in 1894?

4. What might be the monetary consequences if the Soviet Union should suddenly dump $20 billions' worth of gold on the market?

5. Which can be more easily inflated, paper money or coinage? Why?

6. If all the gold owned by the Treasury should suddenly vanish, what might be the results?

7. If today you held a $10,000 mortgage on a farm, and you wanted as large a profit as possible without foreclosing, what policies would you want the Federal Reserve System to follow? Why?

8. Give arguments for and against the statement that "American money has been 'managed' only since 1933."

9. What is "bank money," what is its function, and how important is it?

10. What might be the monetary consequences today if the national debt were paid in full?