Money and the Adoption of the U.S. Constitution

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This paper reviews the experience of the early United States with paper money from the end of the Revolutionary War, in 1783, to the ratification of the U.S. Constitution, in 1789. Under the new constitution, the states of the United States subjected themselves to the federal government in certain ways regarding money and debt. The common monetary unit of the country, the Dollar, was thereupon defined by the U.S. Congress as a measure of silver or of gold.[1]

The U.S. Constitution reserved for the Congress the power Ato coin money, regulate the value thereof, and of foreign coin@ (Article I Section 8). And, states were forbidden to Acoin money, emit bills of credit, make anything but gold and silver coin a tender in payment of debts@ (Article I Section 10). These provisions did more than fix the exchange rates among the currencies (Abills of credit@) that might be issued by the states. They prohibited the states from issuing currencies, and so imposed a common monetary unit onto the union (Rolnick, Smith and Weber, 1993). States retained the power to charter banks that could issue bank notes that could circulate as a medium of exchange. But, these bank notes could not be given legal tender status, and were only accepted because of their convenience relative to silver or gold, and the reputations of their issuers. In this system, choice and competition in currency (medium of exchange) was underpinned by a constitutional provision reserving legal tender status to silver and gold.

In addition to this arrangement of monetary powers, the U.S. Constitution granted Congress the power Ato establish Y uniform laws on the subject of bankruptcies throughout the United States@

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[1] Through 1834, the U.S. ratio was 15 to 1, and silver circulated as money and gold as a commodity. After 1834, when the U.S. ratio was set at 16 to 1, both gold and silver circulated as money, although there was something of a problem with silver (see Carothers 1967, pp. 98-101).

(Article I, Section 8), and prohibited states from passing any Abill of attainder, ex post facto law, or law impairing the obligation of contracts@ (Article I, Section 10). These provisions, together with the arrangement of monetary powers, protected creditors from a direct loss through the impairment of contracts or from an indirect loss through the Aimpairment@ of the monetary unit.

To be sure, repayment of debt might be burdensome, and the Constitution allowed for the possibility of relief of debts through bankruptcy. But, such relief was to be obtained through the administration of laws extant at the time of contracting. Bankruptcy laws were not to be changed subsequently, when debtors, by reason of their greater numbers (at least locally), could influence such changes to their benefit. Thus, the Constitution established a rule of law with respect to money and credit, enabling people to enter into financial relationships based on a rational estimation of the risks involved.

The motivation for adopting a common currency

It is beyond the scope of this paper to engage in a complete discussion of the economic provisions of the U.S. Constitution (e.g., Beard, 1913 and McDonald, 1958). McGuire and Ohsfeldt (1986) convincingly argue that economic interests were a significant, although not necessarily an exclusive factor in the ratification of the Constitution. Some things, however, are straightforward with regard to money and credit. While the depreciation of the Continental Dollar during the Revolutionary War was well known at the time of the ratification of the U.S. Constitution, there were more immediate concerns with currency and contracts. Thus, *The Federalist* speaks of Athe loss which America has sustained *since the peace*, from the pestilent effects of paper money@ (Hamilton, Madison and Jay, 1788, p. 298) (emphasis added).

Problems arose from the issue of paper money by several of the states during the Confederation Period, causing conflicts both between and within states. Nevins (1969, p. 570) writes that Athe worst state disputes connected with currency arose from the enactment of measures impairing the obligation of contracts,@ including Athe making of depreciated paper a legal tender for debts.@ Schweitzer (1989, p. 319) quotes Madison as saying that paper money

Ais producing the same kind of warfare and retaliation among the states as were produced by the State regulations of commerce.@

To be sure, some of the states that issued paper money managed their issues well enough; however, others proceeded to ruinous inflation, with a resulting outbreak of conflict among the members of the various economic classes of the state. In these states, APrices rose rapidly, or, in other words, the money depreciated, and, after causing a great variety of mischiefs, disappearedY@ (Bolles, 1969: I, pp. 349-50).

By the time of the Constitutional Convention, even proponents of paper money recognized the mood of the country on the subject. In his *Notes* on the convention, Madison (1987, p. 470) records several arguments, such as AMr. Mercer was a friend to paper money, though in the present state and temper in America he should neither propose nor approve such a measure [explicitly granting the federal government the power to issue bills of credit].@ At the state conventions called to ratify the U.S. Constitution, at least some Anti-Federalists said essentially the same thing. Bailyn (1993, p. 249) quotes one, AThe conduct of several legislatures, touching paper money, and tender laws, has prepared many honest men for changes in governmentY@ These comments indicate that, in addition to the economic interests of some, e.g., creditors, in establishing a rule of law in monetary matters, many people came to see that the general interest would be so advanced.

The state-issued money during the confederation period

Under the Articles of Confederation, each of the states was free, among others things, to issue its own currency, and seven states did so (McDonald, 1958, p. 388). Two states directly-issued bills of credit, and six indirectly-issued bills of credit through land banks[2] (one state doing both). Neither form of paper money was redeemable in specie. General circulation depended on characteristics such as

[2] A land bank was a kind of bank, originated during the colonial period, organized by the government. It extended long-term loans secured by real estate, in the form of bills of credit receivable by the government in payment of taxes and possibly also imbued with legal tender status. These bills of credit were not redeemable on demand for specie.

convenience, acceptability in payment of taxes or in repayment of loans, and/or legal tender status.[3]

During the post-Revolutionary War recession, states, taxpayers and debtors found themselves financially hard-pressed. As Nevins put it (1969, p. 518), AYdepression and pessimism were converted in many communities into desperationY,@ resulting B in some states B in stay laws, paper money, the postponement of taxes, and the acceptance of commodities in payment of taxes.

[3] It might be noted that three states chartered private banks whose paper money could be redeemed on demand.

According to Ferguson (1961), states tended to revert to their colonial patterns in dealing with the financial aftermath of the Revolutionary War. More fundamentally, that some states resorted to paper money and other forms of debtor relief during the economic hard times following the Revolutionary War, and others resisted such expedients, might be related to the economic interests in these states. In addition, voting rules and the actions of key individuals might be mentioned. Thus, Massachusetts, with a relatively advanced, commerce-based economy, which had become known as Athe silver colony@ prior to the Revolution, did not resort to paper money during the Confederation period. Indeed, Massachusetts vigorously pursued collection of taxes and likewise enforced repayment of debts during the post-war recession, with the result of numerous foreclosures and, even, in Shay=s Rebellion in the western counties of the state, itself suppressed through the mobilization of the militia.[4]

Pennsylvania, which had extensively utilized bills of credit for some fifty years prior to the Revolutionary War, did resort to paper money. In this state, the issue of paper money precipitated the organization of the first political parties in the country, as well as the first Abank war@ B involving the Bank of North America. Virginia, which had a long history of using tobacco as money, did not issue paper money, but instead ameliorated the plight of its taxpayers by receiving tobacco and certain other commodities in payment of taxes. James Madison=s skill as a legislator was instrumental in this compromise position.

In Maryland, the upper house of a bicameral legislature deferred approval of the paper money bill approved by the lower house, leading some to think that a Senate could be effective in securing the rule of law during times of duress. In North Carolina, an isolated state whose commerce was mostly conducted through the port cities of its neighboring states, debtor-interests were dominant throughout the Confederation Period. Not surprisingly, this state wound up with a depreciated paper currency.

The good: New York and South Carolina

[4] Even so, following Shay=s Rebellion, Massachusetts allowed taxpayers to pay certain tax arrears in commodities.

The states that issued bills of credit fall roughly into three groups. New York and South Carolina appear to have had fairly successful paper money programs. Their paper moneys never fell much

Table 1
Paper Money Issued Under the Articles of Confederation

	Private Banks	Year	Bills of Credit	Land Banks	Legal Tender	Maximum Depre-ciation
CT						
DE						
GA		1786		, 30,000	Y	4 to 1
MA	Bk of MA					
MD						
NH						
NJ		1786		, 100,000	Y	33%
NY	Bk of NY	1786		, 200,000	N[1]	5 - 8%
NC		1786	, 100,000		Y	50%
PA	Bk of Nor Amer	1785	, 100,000	, 50,000	N	33%
RI		1786		, 100,000	Y	18 to 1
SC		1785		, 100,000	N	10%
VA						

[1] but legal tender for judgments

below par.[5] Not being legal tenders,[6] their paper moneys could not be forced upon creditors, and only enjoyed general circulations because of their convenience and the expectation that they would maintain their value. The paper moneys of these two states continued in circulation for sometime following the ratification of the U.S. Constitution, being effectively Agrandfathered-in.@ They were only gradually removed from circulation, and destroyed, in the collection of taxes following the ratification of the Constitution.

The Bad: Georgia, New Jersey and Pennsylvania

Georgia, New Jersey and Pennsylvania each had some problems with their paper money programs. In Georgia, in 1788, the bills of exchange temporarily fell to a discount of 75 percent when the state suspended its land sales, for which they had been acceptable. In spite of the legal tender status of this paper money, merchants and others began to refuse to accept it. In 1790, the state removed legal tender status from its bills of credit, and it no longer circulated as money (Jensen 1950, p. 323). The state thereafter received its bills of credit in payment of taxes, at a discount of 33 percent (Perkins 1994, p. 164).

[5]In South Carolina, the state=s paper money only briefly traded below par (Hall 1991, p. 131). In New York, where the notes issued by the Bank of New York being convertible into specie on demand proved superior, the state=s paper money fell to a small discount.

[6]The New York issue was a legal tender only in the case of judgments.

In New Jersey, the state attempted to force its paper money upon creditors by giving it legal tender status. Kaminski (1989, p. 116) indicates that creditors who refused to accept the paper money were subject to various fines, including sale into indentured servitude.[7] Motivated by such outrageous legislation, creditors secured a change in government, and removed the legal tender status of the state=s bills of credit. Following this, New Jersey=s paper money did not much circulate, and was only useful in payment of taxes. The market discount on these bills of exchange, therefore, reflected the brokerage cost of transferring it from its holders to taxpayers.

While the paper money issued by Pennsylvania was not declared to be a legal tender, creditors and merchants were unnerved as the state had twice previously issued non-legal tender bills of credit and then later declared the same to be a legal tender. The resulting depreciation led to the formation of the first explicit political parties in the country. The AConstitutionalist Party,@ which advocated Aunbacked@ or fiat money, came to be opposed by the ARepublican Party,@ which opposed fiat money (but nevertheless endorsed banks, including both the state=s land bank as well as its private bank, the Bank of North America). Following the electoral victory of the Republicans, the state=s paper money began to be retired,[8] and its market value stabilized.

The ugly: North Carolina and Rhode Island

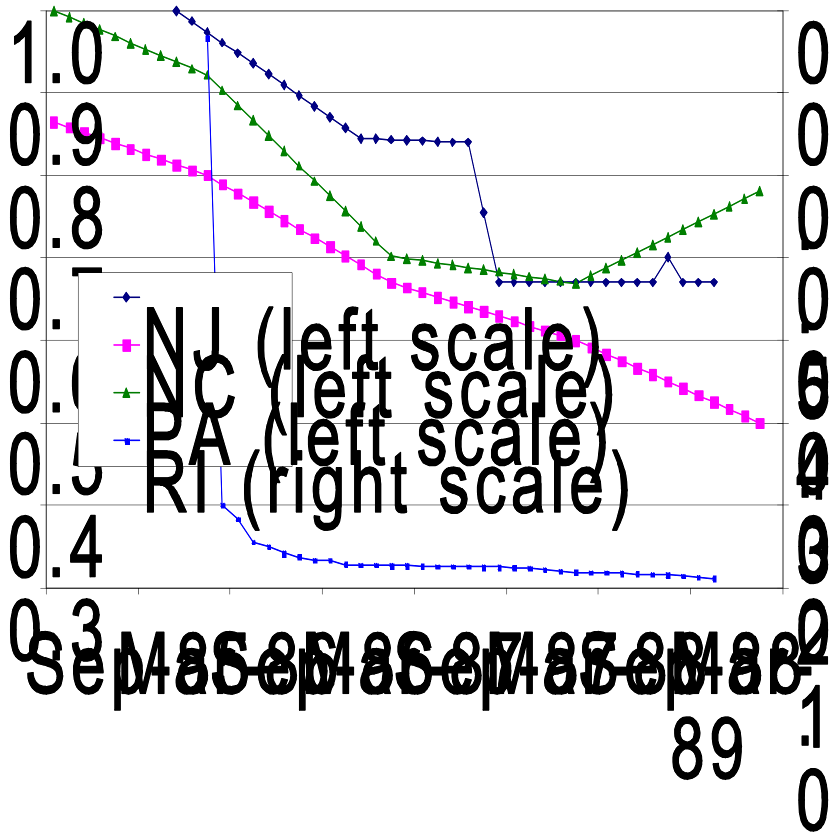
North Carolina and Rhode Island each had substantial problems with their paper money programs. In 1783, North Carolina issued

[7] Thus, while some states were ending debtors= prison, New Jersey was attempting to begin creditors= prison.

[8] By 1789, almost all of the state=s paper money had been destroyed, and what remained outstanding no longer circulated (Jensen 1950, p. 317).

, 100,000 in new paper money.[9] This new paper money was made a

[9]The reader may notice that, during this period, many states denominated their currencies in Apounds.@ This was an attempt to distinguish their currencies from the Continental Dollar, which had depreciated very badly during the Revolutionary War.



Sources: NJ - Kaminski (1989); PA B Bezanson (1951); NC - Morrill (1969); RI - rate of depreciation fixed by the state in 1789 published by *Providence Gazette* of January 16, 1790, from Kaminski (1989).

legal tender. In addition, a state law was passed suspending enforcement of debts for a year. The state enacted initially modest taxes to retire its old paper money and other debts, and commenced selling confiscated land and opened a land office to sell its public lands in the west. By 1789, the state had substantially retired its old paper money (Morrell, 1969, p. 24).

The new North Carolina paper money was initially received relatively well. Most merchants accepted the money, but some only reluctantly after accumulating enough to pay their taxes. A few merchants of border towns preferred to deal in specie, and traveled to towns further within the state to unload their paper money. The paper money stabilized at a discount of 122 to 15 percent relative to specie (p. 70).

In 1785, a second issue of , 100,000 North Carolina currency and a small tax increase were enacted. Following this second issue, the value of the paper money started falling steadily. In 1785, the discount was up to 25 percent (p. 75); in 1786, 33 percent (pp. 89-90); in 1988, 40 percent (p. 90); and, in 1789, 50 percent (p. 92). Increasingly merchants throughout the state refused to accept the paper money on the same basis as specie.

In accordance with Gresham=s Law, the Abad@ paper money was driving-out the Agood@ specie. ASpecie grew scarcer every day in proportion to the amounts of money initially hitting the market@ (pp. 87-88). By 1786, specie Avirtually ceased to circulate@ (p. 88). After all the specie was either driven out of the state or into hordes, the value of the paper money started to fall steadily. It was at this point that political support started to gather to ratify the newly proposed U.S. Constitution as a restraint against continued monetary mischief by the state. Two years later, in 1789, at its second Constitutional Convention (the first having suspended), North Carolina ratified the Constitution, already in effect, and joined the newly-formed union.

In Rhode Island, the issue of paper money sparked the formation of political parties, as had previously occurred in Pennsylvania. The ACountry Party,@ a paper money party, ascended to power in 1786 and proceeded to issue ,100,000 in legal tender bills of credit. Within months, because of opposition by merchants, Athe paper stood six for one gold@ (Sumner 1968, p. 52). Thereupon, politics in the state revolved on the money issue.

Through the next several years, the government battled merchants, creditors and property-owners. To counter the opposition to paper money, those not accepting the paper on a par with specie were made subject to a fine of ,100, with half of the fine going to the informer. Business shut down until the Judge of the Court of Common Pleas said he would not prosecute anyone for the crime of Adepreciation.@ The legislature then allowed a judgment for depreciation to be rendered by any judge in the state, again chilling business.

In 1788, the state of Rhode Island held its first Constitutional Convention. The Country Party dominated this convention, and it decisively rejected the proposed U.S. Constitution. Two years later, in 1790, the state held its second convention. The Country Party secured a narrow majority of the delegates to this convention, but four delegates B all members of the Country Party B choose to boycott the convention. The convention, on a vote of 34 to 32, ratified the Constitution, and the state joined the union already more than one year in operation.

Money and ratification

It is not surprising that the three states that had resolved their problems with paper money through internal political means were among the first states to ratify the Constitution. As Table II shows, Georgia, New Jersey and Pennsylvania were not only the second, third and fourth states to ratify, each did so by an overwhelming majority. As was previously discussed, in each of these states, opponents of paper money had come into control of the legislatures in these states.

Table II

Paper Money and the Ratification of the Constitution

	Date of Ratification	Vote	Experience with Paper Money
DE	12/7/1787	30-0	
PA	12/12/1787	46-23	Bad
NJ	12/18/1787	38-0	Bad
GA	2/1788	26-0	Bad
CT	1/9/1788	128-40	
MA	2/6/1788	187-168	
MD	4/28/1788	63-11	
SC	5/23/1788	149-73	Good
NH	6/21/1788	57-47	
VA	6/25/1788	89-79	
NY	7/26/1788	30-27	Good
New Government Organized			
NC	11/21/1789	194-77	Ugly
RI	5/29/1790	34-32	Ugly

Also not surprising is that the two states that had not resolved their problems with paper money through internal political means were the last two states to ratify the Constitution. Indeed, North Carolina and Rhode Island only ratified the Constitution *after* the new federal government had been formed. Rhode Island, the state with the worst experience with paper money, only ratified the Constitution by a two-vote margin, which vote was facilitated by the boycott of four paper money-favoring delegates of its second Constitutional Convention.

What may be most illuminating is that the two states B New York and South Carolina B that did not experience any real difficulty with paper money were among the last to ratify prior to the new Constitution=s taking effect. Indeed, in most of the late-ratifying states, excepting of course North Carolina and Rhode Island, the money issue was not a compelling issue. In the hard-money state of Massachusetts, the sixth state to ratify the Constitution, ratification was only achieved upon the proposal of a Bill of Rights. In New York, ratification was achieved only after the new Constitution had been approved by the requisite nine states, and then only upon the promise to place the seat of government in New York City for the first ten years of the new Republic (St. John 1992, p. 12).

In Virginia, another late-approving, narrow-margin state, the Federalists were led by James Madison, and the Anti-Federalists by Governor Patrick Henry. Madison and Henry had previously opposed each other on the money issue during the financially-tumultuous years of the mid 1780s. In those years, Madison rallied the forces of hard money and fiscal soundness against populist agitation for relief. According to Madison (1900-1910: II, p. 289), his support of the acceptance of commodities in payment of taxes was a compromise designed to avert worse measures such as paper money or the postponement of taxes, the latter of which was proposed by Henry. While Madison had achieved a strategic victory, Banning (1995, p. 98) says that he sensed that his victory was narrow and doubtful. Banning (p. 99) quotes Madison as saying that he had become convinced that where a majority is united by Aa common interest or passion, the rights of the minority are in danger.@

In 1788, Henry, described by the *Federal Gazette* of Philadelphia (December 20, 1788) as Aan ambitious demagogue Y who has placed himself at the head of the debtors and speculators in [Virginia],@ was unable to prevent ratification by his state when the Constitution was coupled with a Bill of Rights. He was, nevertheless, able to prevent Madison from being elected to the U.S. Senate. Thereupon, Madison sought election to the lower house of the U.S. Congress and, as Speaker of the House of Representatives, was instrumental in the passage of the Bill of Rights.

To be sure, the adoption of the U.S. Constitution involved many things in addition to currency and contract. But, insofar as these matters are concerned, the Constitution can be seen as providing a framework for a common monetary unit, the U.S. Dollar, providing a uniform monetary standard for the new Republic. In addition, states were enjoined from impairing contracts through such measures as ex post facto laws.

While adoption of this monetary arrangement may have been motivated in part by the disastrous experience of the Continental Dollar during the Revolutionary War, it is clear that problems encountered in several states *during* the Confederation Period were determinate. Five of the seven states that issued paper money got involved with depreciation, conflicts between the members of different economic classes within the state and between states, and the break-down, or threatened break-down of the creditor-debtor relationship.

In three of these five states B Georgia, New Jersey and Pennsylvania B those interested in sound money eventually gained control of the state government and addressed the immediate problem by retiring the state-issued currency. In the other two states B North Carolina and Rhode Island B those interested in sound money advocated that their state join the new union with its constitutional protection of currency and contract.

In addition to the problems encountered by these five states, both opponents and proponents of paper money throughout the country came to recognize the potential for abuse of paper money, and the need for the establishment of the rule of law to restrain the impulse of the democratic branches of government in monetary matters. To be sure, in most of the states that did not directly experience problems with paper money, other issues, such as a Bill of Rights, proved to be crucial in the ratification of the Constitution. That other issues were more important in other states, however, does not diminish the crucial role played by money and credit in the ratification. Finally, it must be mentioned that the removal of legal tender and other monetary powers from the states to the federal government would, in the course of time, raise new concerns for the rule of law.

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