Gold – A Brief History of Gold Backed United States Currency

Gold has no intrinsic value. It only has value because we all agree it has value. As humans became "civilized," the need for an intermediary device for transferring value became apparent. The intermediate device can be anything that the community agrees represents a certain value—a currency. The ideal currency will meet certain requirements, including at least being durable and transferable. Anything that a community agrees on for holding value will work.

On Yap Island in the western Pacific Ocean, value is stored in certain (usually) calcite donut-shaped stones. They range in size from about 12 feet in diameter and weighing 8,800 pounds to about 1-1/2" in diameter. The larger stones do not move as ownership changes—everyone in the community knows who owns the value through a shared oral history.

As no more stones are being introduced, the money supply based on this currency is fixed. The stones have no fundamental value beyond what the community agrees. Transportability from the island was not an issue on Yap.

Anything can be currency if the community using it agrees it has a certain value.

Out of all the 118 elements, only silver and gold have the necessary qualities to be of use as or to back currency. None of the gasses or liquid elements is suitable, nor are elements that are poisonous, radioactive, or reactive. We can rule out rare earths, as they are too hard to distinguish from each other. What remains is the middle area of the periodic table, the "transition" and "post-transition" metals. Of these, all except silver and gold have some serious flaws as use for a currency. They are either hard to smelt, weak, or easily corrode. That leaves us with eight possibilities: platinum, palladium, rhodium, iridium, osmium, ruthenium, silver, and gold. All except silver and gold are TOO rare. Only silver and gold offer just the right amount of rarity, stability, non-toxicity, color differentiation, malleability, and distribution. Note that except for their properties of conductivity, gold and silver have little inherent value. They only have value because we, as a society, have decided that they do.

Humans introduced paper currency backed by deposits of silver and gold because it is more convenient to conduct large value transactions in symbolic paper than metal. The metal that was to lose the least value over time would become the standard for the world.

1785 - 1873

The Continental Currency collapsed after the Revolutionary War. As a result, the United States adopted a silver standard based on the Spanish milled dollar in 1785. However, runaway inflation and the collapse of the Continental currency prompted the Constitutional Convention delegates in 1787 to include in the constitution a gold and silver clause. Only the Federal Government was to have the power to "emit bills." Article 1 prohibits States to "make any Thing but gold and silver Coin a Tender in Payment of Debts."

In the early 19th Century, gold rose relative to silver, resulting in the removal from the commerce of nearly all gold coins, and their subsequent melting. Therefore, in the Coinage Act of 1834, the 15:1 ratio of silver to gold changed to 16:1, reducing the weight of the nation's gold coinage. This Act created a new US dollar backed by 1.50 g (23.22 grains) of gold. However, the previous dollar represented 1.60 g (24.75 grains) of gold. The result of this revaluation, which was the first devaluation of the US dollar, reduced its value in gold by 6%. For a time, both gold and silver coins were useful in commerce.

In 1853 the Government reduced the weights of US silver coins, except the rarely used dollar. This action had the effect of placing the nation effectively (although not officially) on the gold standard. The retained weight in the dollar coin was a nod to bimetallism, although it had the effect of further driving the silver dollar coin from commerce. Foreign coins, including the Spanish dollar, were also widely used as legal tender until 1857.

With the enactment of the National Banking Act of 1863, during the American Civil War and its later versions that taxed states' bonds and currency out of existence, the dollar became the sole currency of the United States.

The American Civil War was followed by a boom in railroad construction.

Various companies laid thirty-three thousand miles (53,000 km) of new track across the country between 1868 and 1873. Government land grants and railroad subsidies drove much or this investment. At that time, the railroad industry was the nation's largest employer outside of agriculture, and it involved copious amounts of money and risk. A massive infusion of cash from speculators caused abnormal growth in the industry as well as overbuilding of docks, factories, and ancillary facilities. Construction projects offering no immediate or quick return consumed too much capital.

The Panic of 1873

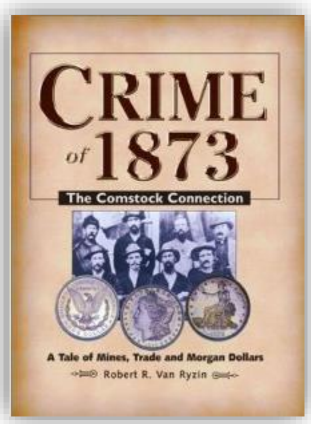
The Panic of 1873 was a financial crisis that triggered a depression in Europe and the United States. It lasted from 1873 until 1879, and even longer in some countries. The Panic of 1873 and the subsequent depression had several underlying causes. Post-war inflation, rampant speculative investments (overwhelmingly in railroads), a large trade deficit, ripples from economic dislocation in Europe resulting from the Franco-Prussian War (1870-1871), property losses in the Chicago (1871) and Boston (1872) fires, and other factors put a massive strain on bank reserves. These reserves plummeted in New York City during September and October 1873 from $50 million to $17 million. Germany abandoned the silver standard in the wake of the Franco-Prussian war. The first symptoms of the crisis were financial failures in the Austro-Hungarian capital, Vienna, which spread to most of Europe and North America by 1873.

On 9 May 1873, the Vienna Stock Exchange crashed, unable to sustain the bubble of false expansion, insolvencies, and dishonest manipulations. A series of Viennese bank failures ensued, causing a contraction of the money available for business lending.

Black Friday at The Vienna Stock Exchange, May 9, 1873.

Coinage Act of 1873

The German Empire's decision to cease minting silver coins in 1871 caused a drop in demand. Much of the supply originated in United States mines, and the downward pressure on value was acute. As a result, the United States changed silver policy with the Coinage Act of 1873. Before the Act, the United States had backed its currency with both gold and silver, minting both types of coins. The Act moved the United States to a 'de facto' gold standard, which meant it would no longer buy silver at a statutory price or convert silver from the public into silver coins (though it would still mint silver dollars for export in the form of trade dollars).



The Act had the immediate effect of depressing silver prices. This hurt Western mining interests, who labeled the Act "The Crime of '73." Its effect was offset somewhat by the introduction of a silver trade dollar for use in the Orient, and by the discovery of new silver deposits at Virginia City, Nevada, resulting in new investment in mining activity. But the coinage law also reduced the domestic money supply, which raised interest rates, thereby hurting farmers and anyone else who normally carried heavy debt loads. The resulting outcry raised serious questions about how long the new policy would last. This perception of instability in United States monetary policy caused investors to shy away from long-term obligations, particularly long-term bonds. The problem was compounded by the railroad bubble, which was getting ready to burst.

In September 1873, the American economy entered a crisis. It came at the end of a series of economic setbacks: the Black Friday panic of 1869, the Chicago fire of 1871, the outbreak of equine influenza in 1872, and the Coinage Act of 1873.

In September 1873, Jay Cooke & Company, a significant component of the United States banking establishment, found itself unable to market several million dollars in Northern Pacific Railway bonds. Cooke's firm, like many others, had invested heavily in the railroads. At a time when investment banks were anxious for more capital for their enterprises, President Ulysses S. Grant's monetary policy of contracting the money supply (again, also thereby raising interest rates) made matters worse for those in debt. While businesses were expanding, the money they needed to finance that growth was becoming scarcer. Note that the money supply was tied directly to the quantity of gold in our reserves.

Cooke and other entrepreneurs had planned to build the second transcontinental railroad, called the Northern Pacific Railway. Cooke's firm provided the financing, and broke ground near Duluth, Minnesota, for the line on February 15, 1870. However, just as Cooke was about to swing a $300 million government loan in September 1873, reports circulated that his firm's credit had become nearly worthless. On September 18, the firm declared bankruptcy.

The failure of the Jay Cooke bank, followed quickly by that of Henry Clews, set off a chain reaction of bank failures and temporarily closed the New York stock market. Factories laid off workers as the United States slipped into depression. The New York Stock Exchange closed for ten days starting 20 September. By November 1873 some 55 of the nation's railroads had failed, and another 60 went bankrupt by the first anniversary of the crisis. Construction of new rail lines, formerly one of the backbones of the economy, plummeted from 7500 miles of track in 1872 to just 1600 miles in 1875. 18,000 businesses failed between 1873 and 1875. Building construction was halted, wages were cut, real estate values fell, and corporate profits vanished.

A bank run on the Fourth National Bank, No. 20 Nassau Street,
New York City. From *Frank Leslie's Illustrated Newspaper*, October 4, 1873.

1878
In 1878, the Bland-Allison Act provided for the freer coinage of silver. This Act required the Government to purchase between $2 million and $4 million worth of silver bullion each month at market prices and to coin it into silver dollars—in effect, a subsidy for politically influential silver producers. The discovery of large silver deposits in the Western United States in the late 19th Century created a political controversy. Due to the massive influx of silver, its value in the nation's coinage dropped precipitously. On one side were agrarian interests such as the United States Greenback Party that wanted to retain the bimetallic standard to inflate the dollar, which would allow farmers to more easily repay their debts. On the other side were Eastern banking and commercial interests, who advocated sound money and a switch to the gold standard. This issue split the Democratic Party in 1896. It led to the famous "cross of gold" speech given by William Jennings Bryan and may have inspired many of the themes in *The Wizard of Oz*.

The Panic of 1890 was an acute recession, although less serious than other panics of the era. Still, it is the nineteenth Century's most famous sovereign debt crisis. The near insolvency of Barings Bank in London precipitated the downturn.

Barings faced bankruptcy in November 1890 due mainly to excessive risk-taking on poor investments in Argentina. Argentina itself suffered severely in the recession of 1890 with its real GDP falling by 11 percent between 1890 and 1891. The international financial distrust generated with this crisis helped to blow a bubble in the Brazilian and Uruguayn economies as well. The poor investment climate caused European immigrants from these countries to stop sending money home. The region suffered significantly.

"Barings" Lord Revelstoke as caricatured by Liborio Prosperi in Vanity Fair, September 1888

The Baring crisis affected the United States. John T. Flynn wrote in his 1932 book: "The preceding year [in 1890] the great Baring failure had shaken London and the rest of the financial world. America was shielded from its most virulent effects because of a bountiful wheat crop. But, the following year, all the forces of business disturbance were assembling, though the country as a whole hardly realized it. Gold was leaving the country at an alarming rate."

The **Sherman Silver Purchase Act** was a United States federal law enacted on July 14, 1890. The measure did not authorize the free coinage of silver that the Free Silver supporters wanted; however, it increased the amount of silver the United States was required to purchase on a recurrent monthly basis to 4.5 million ounces. The Sherman Silver Purchase Act passed in response to the growing complaints of farmers' and miners' interests. Farmers had immense debts they could not pay caused be overproduction deflation. They urged the Government to pass the Sherman Silver Purchase Act to boost the economy and cause inflation, allowing them to pay their debts with cheaper dollars. Mining companies, meanwhile, had extracted vast quantities of silver from western mines resulting in oversupply. This oversupply drove down the price, often to less than the cost of extraction. They hoped to enlist the Government to increase the demand for silver.

Silver investor

Under the Act, the federal government purchased millions of ounces of silver, with issues of paper currency. It became the second-largest buyer in the world, after the British Crown in India, where the Indian Rupee was backed by silver rather than gold. In addition to the $2 million to $4 million that had been required by the Bland-Allison Act of 1878, the US government must now purchase an additional 4.5 million ounces of silver bullion every month.

The law required the Treasury to buy the silver with a special issue of Treasury (Coin) Notes redeemable for either silver or gold. That plan backfired, as people (mostly investors) redeemed the new coin notes for gold dollars, thus further depleting the Government's gold reserves.

In 1890, the price of silver dipped to $1.16 per ounce. By the end of the year, it had fallen to $0.69. By December 1894, the price had dropped to $0.60. On November 1, 1895, US mints halted production of silver coins, and the Government closed the mint in New Orleans. Banks discouraged the use of silver dollars.

The "Billion Dollar Congress of 1890" received its label for its limitless spending. Republicans, having earned control of both houses in Congress, went on a spending spree. Relying on the $1 billion surpluses in the National Treasury, it established the Dependent and Disability Pensions Act (1890), the McKinley Tariff (1890), and the Sherman Silver Purchase Act (1890), which ultimately led to the creation of other governmental-based financial assistance programs in America.

The Panic of 1893 was a severe economic depression in the United States. Similar to the Panic of 1873, it was marked by the collapse of railroad overbuilding and railroad financing, resulting in a series of bank failures. Compounding market overbuilding and the railroad bubble was a run on the gold supply. The Panic of ’93 was the worst economic depression the United States had ever experienced at the time.

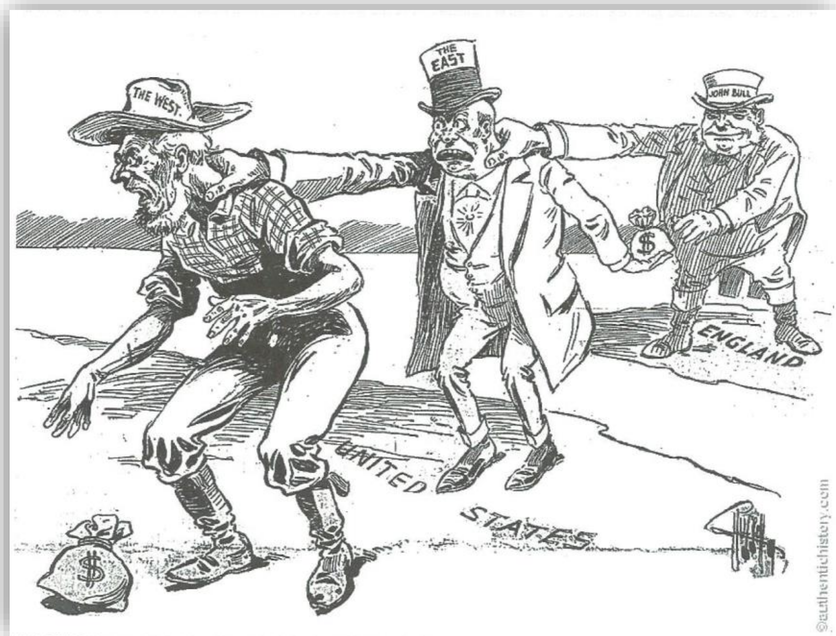
A growing credit shortage created panic, resulting in a depression. Over the course of this depression 15,000 businesses, 600 banks, and 74 railroads failed. There was unemployment and wide-scale protesting, which in some cases became very violent. The economic collapse of the Philadelphia and Reading Railroads was the first step toward the Panic of 1893. A growing depression in Europe resulted in British investors selling their American investments and redeeming them for gold. This fostered a growing American loss, creating panic. By May 15, stock prices reached an all-time low. Many major firms, such as the Union-Pacific, Northern-Pacific and Santa Fe railroads, were forced to declare bankruptcy. Unemployment steadily grew, rising from 1 million in August of 1893 to 2 million by January 1894. By the middle of the year the figure had reached 3 million.

Panic of 1893 - Wikipedia

The failure of the wheat crop in Argentina ended further investments there. The shock started a run on gold in the US. Treasury, as investors cashed in their investments. This Panic occurred during “The Gilded Age,” where the United States was experiencing economic growth and expansion. This expansion eventually became to be driven by railroad speculation. Railroads were over-built, incurring expenses that outstripped revenues. Also, new mines flooded the market with silver, causing its price to fall. Also, farmers—particularly in wheat and cotton regions--struggled under a decline in prices for agricultural commodities.

One of the first clear signs of trouble came on February 23, 1893, with the bankruptcy of the Philadelphia and Reading Railroad, which had overextended itself ten days before Grover Cleveland’s second inauguration. Upon becoming President, Cleveland dealt directly with the Treasury crisis by convincing Congress to repeal the Sherman Silver Purchase Act.

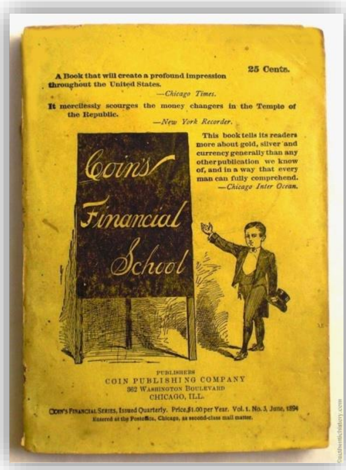
As concern for the state of the economy worsened, people rushed to withdraw their money from banks and caused bank runs. The credit crunch rippled through the economy. A financial panic in the United Kingdom and a drop in European trade caused foreign investors to sell American stocks to obtain American funds backed by gold.



"John Bull's Little Game," St. Louis Post-Dispatch, September 20, 1896. England's promotion of the gold standard is blamed for the indebtedness of the American farmer.

The huge spike in unemployment, combined with the loss of life savings kept in failed banks, meant that a once-secure middle-class could not meet their mortgage obligations. Many walked away from recently built homes as a result. From this, the sight of the vacant Victorian "haunted house" entered the American mindset. After the Panic of 1893 broke, President Grover Cleveland borrowed $65 million in gold from Wall Street banker J.P. Morgan and the Rothschild banking family of England.

Bimetallism and *Coin's Financial School* (1894)



Coin's Financial School

The "free silver" campaign was aided in large part by the publication in 1894 and 1895 of a booklet called, *Coin's Financial School.* Through the educational teachings of fictional Professor Coin, the booklet extolled the sound financial decisions made by the founders, when in 1792 Congress fixed the monetary unit of one dollar at 371.25 grains of silver. Gold was also made money, but its value was pegged to the silver dollar at a ratio of 15 to 1, and then 16 to 1. Although this was called bimetallism, it was actually a silver standard. Silver fixed the unit and the value of the gold. This was wise, according to Professor Coin, because silver was scattered among the people, and one person could not so easily injure the economy by monopolizing the metal as he could with gold.

Professor Coin further explained such concepts as credit money (paper, coins, etc.), was redeemable in “primary” money (gold, silver) with a stable given value. A greenback system would work provided the amount of money in circulation was limited *per capita.* That way, people would be confident they could redeem gold or silver at any given time for their paper money. Then, Congress perpetuated what Professor Coin called “The Crime of 1873.” It repealed the unit clause of 1872 and replaced the language with this: *That the gold coins of the United States shall be a one-dollar piece which at the standard weight of twenty-five and eight-tenths grains shall be the unit of value.*

“The Crime of ‘73” made silver no longer legal tender in the payment of debts over $5. With this law, Professor Coin argued, the primary money supply was cut in half. Because there was a limited gold supply, all property declined in value in comparison to gold (or gold increased dramatically in value and buying power). Borrowing became the only way to pay outstanding debts, even as falling prices continued because there was not enough real money behind the credit money. Mounting debts and mortgages had created the Panic of 1893.

And there were international implications. The United States had followed England’s example of 1816 by abandoning silver, but many other nations quickly followed America. As the demand for gold increased, so did its purchasing power and prices declined. London arranged all this, according to Professor Coin. Having cornered the gold market, the British wanted America’s Civil War debt paid in gold—$200 million annually. Farmers had to bear the brunt by putting up $400 million in property to secure this $200 million in gold. Written by William Hope Harvey, *Coin’s Financial School* sold hundreds of millions of copies. It perpetuated the belief that America’s economic hard times were the result of a national and international conspiracy against silver.

The Election of 1896: William McKinley (R) vs. William Jennings Bryan (D)
Gold vs. silver was the single most prominent issue in the election of 1896. Gold won.

The election of 1896 was the beginning of a new era in American politics or a “realignment” election. Ever since the election of 1800, American presidential contests had, on some level, been a referendum on whether agrarian interests should govern the country (indebted rural farmers—the countryside—“main street”) or industrial interests (business—the city—“wall street”). This election was the last in which a candidate tried to win the White House with mostly agrarian votes.

Although there were several critical issues in the 1896 election, the fallout from the country’s monetary policy dominated the nominating process. This issue had been at the forefront of American politics for decades but had come to a head during Grover Cleveland’s second administration. The Democratic Party’s response to the depression resulted in major Republican gains in the 1894 house midterms and heightened prospects for 1896. Cleveland had achieved his goals, but in doing so, had also split the Democratic Party over fiscal policy. Some Democrats agreed with Cleveland’s support of the gold standard. These conservative Democrats became known as “gold bugs.” More rural, populist Democrats believed that inflation was the key to raising prices and easing the debt of the farmers. They advocated “free silver”—the unlimited coinage of silver at a ratio of 16 to 1 against gold coins. These populist “Silverites” had made significant gains within the Democratic Party in the 1894 midterm elections, despite overall party losses. 1894 would turn out to be the peak of the populist influence, though that would only become clear in retrospect. In the presidential election year of 1896, the split set up a fascinating political election season.

On July 8, 189, at the Democratic Convention, William Jennings Bryan delivered a stirring speech promoting silver over gold ending with “You shall not press down upon the brow of labor this crown of thorns, you shall not crucify mankind upon a cross of gold.”

As Bryan spoke his final sentence, recalling the Crucifixion of Jesus, he placed his hands to his temples, fingers expanded. With his final words, he extended his arms to his sides straight out to his body and held that pose for about five seconds. It was as if he was offering himself as a sacrifice for the cause. The audience watched in dead silence. He then lowered them, descended from the podium, and began to head back to his seat as the stillness held.

As he moved towards his seat, the Coliseum burst into an uproar. Delegates threw hats, coats, and handkerchiefs into the air. Others took up the standards with the state names on them with each delegation and planted them by Nebraska’s. Two alert police officers had joined Bryan as he left the podium, anticipating the crush. The policemen were swept away by the flood of delegates, who raised Bryan to their shoulders and carried him around the floor. *The Washington Post* recorded, “bedlam broke loose, and delirium reigned supreme.” It took about 25 minutes to restore order, and according to Bensel, “somewhere in the mass demonstration that was convulsing the convention hall, the transfer of sentiment from silver as a policy to Bryan as a presidential candidate took place.”

The United States presidential election of November 3, 1896, saw Republican William McKinley defeat Democrat William Jennings Bryan in a campaign considered by historians to be one of the most dramatic and complicated in American history.

The 1896 campaign is often considered by political scientists to be a realigning election that ended the old Third-Party System and began the Fourth Party System. McKinley forged a coalition representing businessmen, professionals, skilled factory workers, and prosperous farmers. His support was most reliable in the Northeast, Upper Midwest, and Pacific Coast. Bryan was the nominee of the Democrats, the Populist Party, and the Silver Republicans. His strength came from the South, rural Midwest, and Rocky Mountain states.

Economic issues, including bimetallism, the gold standard, free silver, and the tariff, were crucial. Republican campaign manager Mark Hanna pioneered many modern campaign techniques, facilitated by a $3.5 million budget. He outspent Bryan by a factor of five. The Democratic Party’s repudiation of the Bourbon Democrats (their pro-business wing, represented by incumbent President Grover Cleveland), set the stage for 16 years of Republican control of the White House, ended only by a Republican split in 1912 that resulted in the election of Democrat Woodrow Wilson. Although Bryan lost the election, his coalition of “outsiders” would dominate the Democratic Party well into the twentieth Century and would play a crucial role in the liberal economic programs of Presidents Woodrow Wilson, Franklin D. Roosevelt, and

Lyndon Johnson. McKinley did win, and his policies of promoting pluralism, industrial growth, and the gold standard determined national policies for two decades.

A final word on gold
On June 5, 1933, the United States went off the gold standard, a monetary system in which currency is backed by gold, when Congress enacted a joint resolution nullifying the right of creditors to demand payment in gold. The United States had been on a gold standard since 1879, except for an embargo on gold exports during World War I, but bank failures during the Great Depression of the 1930s frightened the public into hoarding gold, making the policy untenable.

Soon after taking office in March 1933, Roosevelt declared a nationwide bank moratorium to prevent a run on banks by consumers lacking confidence in the economy. He also forbade banks to pay out gold or to export it. According to Keynesian economic theory, one of the best ways to fight off an economic downturn is to inflate the money supply. Facing similar pressures, Britain had dropped the gold standard in 1931, and Roosevelt had taken note.

On April 5, 1933, Roosevelt ordered all gold coins and gold certificates in denominations of more than $100 turned in for other money. It required all persons to deliver all gold coin, gold bullion and gold certificates owned by them to the Federal Reserve by May 1 for the set price of $20.67 per ounce. By May 10, the Government had taken in $300 million in gold coins and $470 million in gold certificates. Two months later, a joint resolution of Congress abrogated the gold clauses in many public and private obligations that required the debtor to repay the creditor in gold dollars of the same weight and fineness as those borrowed. In 1934, the government price for gold was increased to $35 per ounce, effectively increasing the gold on the Federal Reserve's balance sheets by 69 percent. The increase in assets allowed the Federal Reserve to inflate the money supply.

The Government held $35 per ounce until August 15, 1971, when President Richard Nixon announced that the United States would no longer convert dollars to gold at a fixed value, thus completely abandoning the gold standard.
The History Channel

Nixon made his decision for the simple reason that the US was running out of the necessary gold to back all the dollars it had printed. Since then, every major currency has become backed by no more than legal "fiat"—the law of the land says you must accept it as payment.

A gold-backed currency cannot overcome the problem that its supply bears no relation to the needs of the economy. The supply of gold is finite. In the 16th Century, the discovery of South America and its vast gold deposits led to an enormous fall in the value of gold—and therefore, an enormous increase in the price of everything else. Since then, the problem has typically been the opposite—the supply of gold has been too rigid. For example, many countries escaped the Great Depression in the 1930s by unhitching their currencies from the Gold Standard. Doing so freed them to print more money and reflate their economies.

On the other hand, as *The Economist* has observed: "the financial system is little more than a set of promises between people and institutions." If there is a severe disruption of the integrity of these promises, gold has shown a remarkable ability to act as a common denominator between currencies because of its unique properties and because so many people believe it has real value. The financial system works because people believe the promises to pay. Gold continues to have value because people think it does.