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M O N E T A R Y P O L I C Y

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A discussion of monetary policy, it seems to me, falls logically into three divisions: first, the development of the authority of the Federal Reserve System; second, a recital of the principal tools; and finally, an analysis of their operation.

Of these three, perhaps the most important is the evolution of the authority of the Federal Reserve System. This is not the academic exercise it might appear to be. Patterns of use of social instruments are shaped by the legal constraints of our institutions. An explanation of how must be preceded by the inquiry of why.

The centralization of monetary authority in the Federal Reserve System is a phenomenon of recent years. Because it is allied with a specific statute, there is a danger in thinking of it as a more or less spontaneous creation of Congress in 1913, which was simply not the case. The Federal Reserve Act was simply the statutory reflection of the stage of economic evolution existing at that time -- a process of evolution that started before the Revolution, and is still continuing. It seems to me this concept of a moving stream is an important one in a discussion of monetary policy, even though the formal statutory framework of the Federal Reserve System is contained in a specific statute. The changes which occur constantly in the environment of the System are reshaping the language of the Act. The System as it is today is a different one than it was a year

ago, and different than it will be a year from now. Perhaps the most important change taking place is the shift from a reactive, defensive force to a dynamic one, but even the role of a reactive agent was a long time developing. There are two main streams of historic development: the first has to do with the centralization of authority in the federal government, as against the rights of the states; and the second, the affirmation by the Supreme Court that the monetary power of the Congress is absolute and not subject to judicial review. The latter has the effect of removing the monetary power from the due process clause -- or to put it even more baldly, judicial acknowledgment that the rights of the sovereign are paramount as against the rights of the individual, where monetary matters are concerned.

There are several major checkpoints in this development. It is almost as difficult to find a beginning as it is impossible to find the end, but perhaps the point of departure was the Mixed Moneys case of the English government in 1604, in which the Anglo Saxon principle of the absolute right of the sovereign in the monetary field received its first expression. This case was a fairly familiar one involving the financing of a war. As part of the financing, Queen Elizabeth struck off a debased coinage for circulation in Ireland only. A creditor refused to accept the coinage. The court forced the creditor to accept the debased coin with this language:

" . . . as the king by his prerogative may make money of what matter and form he pleases and establish the standard of it, so he may change his money in substance and impression, and enhance or debase the value of it or entirely decay and annul it. . . .

" . . . although . . . at the time of contract . . . pure money was current in this kingdom . . . yet mixed money being established . . . before the day of payment . . . may be tendered . . . and the obligee is bound to accept it. . . ."

Shifting our attention then to the Colonies established shortly after this case, we find that the case returned to haunt them. There was almost no metallic source in the Colonies, and England, in a tradition that still obtains for enlightened countries, was understandably loath to permit the exportation of its coin. Accordingly, the Colonists had to resort to a variety of commodities as instruments of exchange. American inventiveness manifested itself, and the bill of credit was an expedient adopted by the State of Massachusetts to at least partially solve this problem. The bill of credit was no more than a piece of paper issued by the Colony of Massachusetts, in which the Colony promised to accept the paper in payment of taxes in the denomination expressed on the face. It had no security whatsoever. Obviously, these instruments were designed to drift into commerce, and so they did, to the anguish of the English authorities. Because it is less romantic perhaps than the Boston Tea Party, the action of the Crown in outlawing the issuance of bills of credit in the Colonies did not receive the attention from historians as a major source of resentment and a condition leading up to the Revolution that perhaps it merits. We must remember that the American Revolution was as much a rebellion of the emerging mercantile class as it was a fight for freedom in a philosophic sense. The bills of credit unfortunately were abused, and the inflation brought about by their circulation was accelerated enormously by the paper money used by the Continental Congress to finance the Revolution. At the time of the Constitutional Convention, understandably many of those gathered to discuss the definition of power of the new government were reluctant to grant the authority to issue paper money. In fact there were

attempts made to prohibit the distribution by the national government of anything other than coin. Fortunately, a few wiser heads prevailed, and although the monetary authority of the federal government was formally limited to a few phrases, the express prohibition was not included. Out of this dialogue came Article I, Section 8, Clause 5 of the Constitution:

"The Congress shall have Power . . . To Coin Money,  
regulate the Value thereof, and of foreign Coin. . . ."

If the Article expression is omitted, then the monetary authority of the federal government of the United States rests on just eleven words, and on this slender expression has risen the whole edifice of national banking, the Federal Deposit Insurance Corporation, the Federal Reserve System, and the general exercise of the sovereign nation in monetary affairs. Of course, the first major issue was the conflict with the states. The inflation continued, and it was obvious to some that a central bank of a sort was necessary. It is a fascinating history, but unfortunately time does not permit any more than a bare bones recital of its formation in 1791, primarily because of the efforts of Alexander Hamilton, and its subsequent demise in 1811 when Congress failed to renew its charter. The reasons for its demise were many, but a few were the distaste of the mercantile class for the financial stringencies imposed by the bank, the success of the bank in attracting foreign capital, especially British, at a time when relations with England were deteriorating, and the Jeffersonian tradition of states' rights. However, the War of 1812, as wars do, brought inflation, and the proliferation of state banks and their note issues, accompanied by rapid depreciation in value, forced a rethink in 1816, and in that year the second Bank of the United States was chartered. In its efforts to

contain inflation and to restore a measure of stability to the circulating medium, which was largely paper money, the Bank of the United States would accumulate notes of state banks and then present them over the counter for coin. Those who have had experience with non-par presentments have an idea of the anger this engendered in the several states. The anger took several forms, but in Maryland it took the form of a tax on notes of the central bank. A cashier of this bank has been memorialized in our history because of his arrest by the State of Maryland for permitting untaxed notes of his branch of the Bank of the United States to go into circulation. His name was McCulloch, and the case was McCulloch vs. Maryland. Not only was it the first case in the Supreme Court involving the interpretation of the eleven words of the Constitution referred to earlier, but it established the right of judicial interpretation of the Constitution by the Supreme Court of the United States. This case doesn't say a great deal about the monetary power. Its main thrust is in its espousal of Alexander Hamilton's argument made thirty years before, that Article I, Section 8, Clause 18 could be extrapolated in the interpretation of specific powers granted. This provision reads:

"The Congress shall have Power . . . To make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof."

In denying the right of the State of Maryland to tax an instrument of the federal government, Marshall had this to say:

". . . Let the end be legitimate, let it be within the scope of the constitution, and all means are appropriate, which are plainly adapted to that end, which are not prohibited, but consist with the letter and spirit of the constitution, are constitutional."

However, the progression towards a strong central government was not without its interruptions. For some of the same reasons, the second Bank of the United States was struck down in 1836 by Andrew Jackson. Andrew Jackson hated all bankers and all banks with a virulence and intensity that has never been equalled. This was the real reason for his action. One of the great American myths, along with Washington and the cherry tree, is that which credits Jackson with taking this action because of a desire for easy money. Quite the opposite was the case. He wanted a return to coin. He had the frontiersman's distaste for sophisticated money instruments. He was abetted by his former attorney general, who had a similar hatred of banks, and whom he had made chief justice. That was Justice Taney. So the bank went into oblivion. However, it was only a transitional setback, for the Civil War, with the familiar pressures of financing war economy, forced an unwilling Secretary of the Treasury, Sam P. Chase, to give his endorsement to the issuance of greenbacks by the federal government. It was obvious that state banks would be unable to do the job, because of the variety of standards of credit of the many banks involved. In 1865, the National Banking Act was passed, and a tax placed by the federal government upon the issuance of state bank notes, which sounded the death knell for their issuance. However, still unresolved were several constitutional questions involving greenbacks. By one of those ironic twists, this same Chase ended up as Chief Justice of the Supreme Court, and it was during his term of office the famous Legal Tender cases involving greenbacks came before the court. It was obvious that his distaste for them still continued. The first case, called Legal Tender I, involved the ex post facto nature of

the greenbacks. That is to say, could a creditor be forced to accept them in payment of an obligation incurred before their issue? This case held that he could not be so forced. Between Legal Tender I and Legal Tender II, however, the composition of the court changed with the appointment of two additional Justices, to bring the court up to nine. With the appointment of the two new Justices, the power balance of the court shifted, and in less than a year Legal Tender I was overthrown, and it was held that the greenbacks had to be accepted in payment of all obligations, regardless of when they were incurred.

Legal Tender III adopted the principle that the power was not limited to wartime, but was a general one. The reconstituted court had this to say:

". . . the question, whether at any particular time, in war or peace, the exigency is such, by reason of unusual and pressing demands on the resources of the government, or of the inadequacy of the supply of gold and silver coin to furnish the currency needed for the uses of government and of the people, that it is . . . wise and expedient to resort to this means, is a political question, to be determined by congress. . . ."

The financial panics, however, were not a thing of the past, even though one of the major sources of monetary inflation had been erased -- that is, the many state banks. Consequently, in 1913 the Federal Reserve Act was passed creating a central banking system, and thus the final capstone was placed on the federal edifice.

Even though the dual banking system is formally espoused by Congress, it is important to remember that this is by suffrage. Witness the national banking cases on which Mr. Saxon has seized so enthusiastically, arising in the first World War period, when the court stated:

". . . it is not competent for state legislatures to interfere, whether with hostile or friendly intentions, with national banks or their officers in the exercise of the powers bestowed upon them by the general government. . . ."

But what about the rights of the individual, as against the monetary power of Congress? The landmark case here is an obscure one, but nonetheless, extremely significant. It is the case of Ling Su Fan vs. United States, and involves the attempt by a Chinese merchant to export from the Philippine Islands silver coinage designed for use in the Islands, which coinage had a bullion value in excess of its monetary value, and the export of which was expressly prohibited. Here the court took a clear departure from the trend that had been developing in the court, and is continuing to this day, in its efforts to protect the individual against the state. This case says that the monetary power is a different kind of a power -- that is to say, what is known as a plenary power, and is an absolute one. To quote from the decision:

". . . it is said that if (a) particular measure . . . operates to deprive the owner of silver pesos of the difference between their bullion and coin value, he has had his property taken from him without compensation, and in its wider sense, without . . . due process of law . . .

"Conceding the title of the owner of such coins, yet there is attached to such ownership those limitations which public policy may require by reason of their quality as a legal tender and as a medium of exchange. . . . They bear, therefore, the impress of sovereign power which fixes value and authorizes their use in exchange. . . .

"However unwise a law may be, aimed at the exportation of such coins . . . there can be no serious doubt that the power to coin money includes the power to prevent its outflow from the country of its origin. . . ."

The final expression was in the Gold Clause Cases of 1935. It is interesting to reread these cases, because it can be done coldly and objectively now, as part of the evolutionary process of monetary power. Those of you, however, who lived through that period remember the intensity of the debate, which was inflamed, highly emotional, and a last-ditch fight against what was considered to be a usurping government. As you may recall, the dollar was devalued as a measure of arresting the outflow of gold in the depth of the depression. There were in existence bonds of the United States, as well as bonds of private parties, on which payment was required to be made in gold. Congress, however, had forbidden the circulation of monetary gold in the United States as part of this same action, specifically in the form of a joint resolution of Congress denouncing all gold clauses as "against public policy". The Court, in a divided decision, upheld the right of Congress to do so in this language:

"We are not concerned with consequences, in the sense that consequences, however serious, may excuse an invasion of constitutional right. We are concerned with the constitutional power of the Congress over the monetary system of the country and its attempted frustration. Exercising that power, the Congress has undertaken to establish a uniform currency, and parity between kinds of currency . . . In the light of abundant experience, the Congress was entitled to choose such a uniform monetary system, and to reject a dual system. . . . The contention that these gold clauses are valid contracts and cannot be struck down proceeds upon the assumption that private parties . . . may make and enforce contracts which may limit that authority. Dismissing that untenable assumption, the facts must be faced. We think that it is clearly shown that these clauses interfere with the exertion of the power granted to the Congress, and certainly it is not established that the Congress arbitrarily or capriciously decided that such an interference existed."

Thus, we have come full circle, to a positive affirmation in this country of the spirit of the Mixed Moneys Case of England in 1604 -- a declaration

that the power of Congress is absolute, and there is no right of the Supreme Court to curb it or inhibit its exercise. Perhaps the most appropriate quotation to close this part is one attributed to Justice Jackson:

"Two of the greatest powers possessed by the political branches, which seem to me the disaster potentials in our system, are utterly beyond judicial reach. These are the war power and the money, taxing, and spending power, which is the power of inflation. The improvident use of these powers can destroy the conditions for the existence of liberty, because either can set up great currents of strife within the population which might carry constitutional forms and limitations before them. . . .

"No protection against these catastrophic courses can be expected from the judiciary. The people must guard against these dangers at the polls."