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Government Credit and Money

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[There is] a great and growing Uneafinefs is this country, on the account of the Government Securities being made payable at very distant times, and tho' the Services for which they were given were done long ago yet they can neither demand the Money, for which such Securities were given at present, nor will the Same Securities answer in Taxes. Old Continental Soldiers who have Such Securities are Taxed to the ordinary Taxes and also in the ... Special Taxes for raising New Soldiers, and they cannot get any money for their own former Services, and you can't hear them Speak of this matter, but in rage and flame. ... [T]hey are a fierce Set of men, and the Government will find, that these People, unlesfs they are Speedily Satisfied on those two heads, will in these parts pay no Taxes and that there will not be men enough here to compel them to it.

— Letter from Joseph Hawley to Ephraim Wright, April 16, 178[2]
Joseph Hawley papers, New York Public Library
(Shown in the image below.)

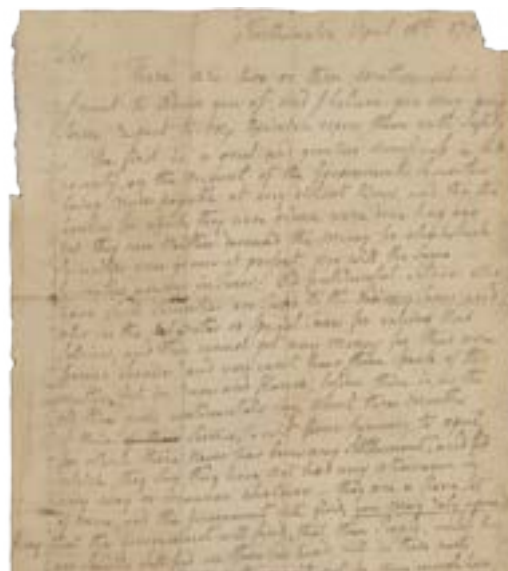
Ely's Rebellion

After Washington's decisive defeat of the British at Yorktown in October 1781, but before the formal conclusion of the War of Independence by the Treaty of Paris in 1783, the Rev. Samuel Ely (1740-late 1790s) led a crowd of farmers in a protest aimed at closing the Hampshire County courthouse, in Northampton, Massachusetts. Ely and his followers felt that Massachusetts's new constitution taxed poor farmers unfairly. Many of them had served in the Continental Army during the War of Independence, and the Commonwealth owed them significant amounts of back pay, against which the veterans held promissory notes. But the General Court (the Massachusetts legislature) had repeatedly deferred and extended payment on those notes, and so the former soldiers were in no mood to pay heavy taxes, especially if the debt they held was one of the justifications of the taxes. Many were also heavily in debt themselves, and closing the court might have stalled foreclosures on their farms.

Ely was a controversial figure. Educated at Yale, he became a minister at Somers, Connecticut in 1769. Theologically, he was a "New Lighter," aligned with George Whitefield and against Jonathan Edwards during the Great Awakening. He had fought in the Battle of Bennington, after which he was court-martialed, but acquitted. Mostly, though, he "was a radical organizer,

constantly fighting against economic inequality according to his interpretation of Christian scripture. He wasn't the sort of Revolutionary whom America's wealthy liked to remember."¹

Joseph Hawley (1723-1788) was a lawyer, legislator, and militia officer in Northampton, and a leader of the American revolutionary movement in Massachusetts. Like Ely, he was a Yale graduate. He was a well-to-do, established figure in Northampton, and a first cousin of Jonathan Edwards. He served in the Massachusetts House of Representatives. He was the type of Revolutionary America's wealthy prefer to remember.



1. J.L. Bell, ["The Memory of Samuel Ely."](#) February 4, 2014. Boston 1775 blog.



When Ely and his mob closed the Hampshire County courthouse, Hawley was able to call out the militia to disperse the crowd, re-open the courthouse, and arrest Ely. But he also understood that the situation that had given rise to Ely's action was unsustainable. So while he had plenty of reason to dislike Ely, he recognized that, if only as pragmatic matter, the claims of Ely and his followers demanded attention:

These old Continental men and other Creditors of the Government, who have done real Service to that Government and who have never received any thing therefor, but worthless Paper money, and Government Securities, many of which they have been obliged to put off for almost nothing to Sharpers were the men, who defended the inferiour court last week against the Mobb which Ely brought to Town, who would have Smashed that court if there was never another court to be held in the county, had it not been for such Brave fellows, who have been thus treated and are still treated as above by the Government. But you may rely upon it That they are on the Point of turning to the Mobb, and if they are not soon relieved and paid off the value of their Securities either in money or by their being made to answer for Taxes, they will become outrageous and the numbers who will side with them will be irrefistable.²

Hawley was correct. From August 1786 to June 1787, as recession deepened in western Massachusetts, farmers there again tried to shut down state courts in an effort to stop foreclosures on their farms. Some may also have hoped to destroy written records of their debts. This is the series of actions we refer to as Shays' Rebellion, which highlighted the inability of both the states and Congress either to pay debts or maintain order under the Articles of Confederation. But would Hawley's proposal to accept Revolutionary War scrip in payment of taxes have prevented unrest, as he suggested? That question turns on the soundness of Massachusetts's credit at the time. The issue is relevant to us today because our monetary system and our economy rest even more heavily on the public credit today than in the 1780s. Stewardship of the public credit — not the avoidance of government borrowing, but an awareness of its role in our economy — is an essential element of sound economic policy.

The Public Debt and Money

When Hawley argued for relief for the "Old Continental Soldiers" holding Government Securities they had received in payment for their military service, he mostly expressed concern for the public order and for the Commonwealth's ability to raise a militia in the future. He didn't seem to be speaking in support of the farmers. He appears to have



had a rather Puritanical view of debt, and his papers include a draft of a creditor-friendly bill for introduction to the Massachusetts House of Representatives. It proposed the type of law that would facilitate the type of foreclosures the farmers were protesting. Yet he proposed that the Government Securities those farmers held be "made to answer for taxes."

What if Massachusetts had permitted its citizens to tender Revolutionary War obligations to pay their taxes? We can't really know, but a couple of outcomes are likely. First, the measure would have provided significant relief, at least to some farmers. That could have reduced the number of foreclosures, also easing pressure on lenders. That, in turn, could have stabilized land values. But most important, it might also have eased the severity of the economic downturn that occurred in the mid-1780s. The reason is that by accepting those securities as payment for taxes, it would have effectively turned them into money. Veterans holding those securities would have become able to negotiate them at prices close to their value in tax payments, rather than at the sacrifice prices at which they had had to sell them to "sharpers." They may even have found themselves able to use the securities as currency in ordinary transactions, because the people to whom they tendered them would be able to use them to pay their taxes as well.

There's an element of alchemy to the business of turning government debt into money, and it doesn't always work. During the Revolutionary War, some soldiers received much of their pay in the form of Continentals, paper currency that the Continental Congress began issuing in 1775. The Continentals were a form of revenue-anticipation notes, issued against future taxes that the Continental Congress intended to collect. When Congress failed to demonstrate either the will or the ability to levy those taxes in the necessary amounts, the Continentals rapidly fell in value — a form of hyperinflation. Some reports describe the peculiarly inverted circumstance of creditors' fleeing from their debtors, who sought to pay them off in the nearly worthless notes. And for quite some time after the Revolution, anything of little value might be described as "not worth a Continental."

2. Hawley letter to Wright, *op. cit.*



The fledgling country's experience with the Continentals provides a clue to help us answer the question of whether Hawley's proposal to allow citizens to use their securities to pay their taxes in Massachusetts, would have succeeded. In general, government securities can form a solid monetary base **if the government's credit is sound**. The weakness of the Continentals reflected the weakness of the Continental Congress's credit. Had Massachusetts adopted Hawley's proposal, its success would have rested on the Commonwealth's credit. If Massachusetts could maintain a sound public credit, then those debt securities could have functioned as money for some time. If not, then high inflation would likely have resulted. That might have reduced the weight of the Commonwealth's debt burden and relieved those farmers that had mortgaged their property, but creditors in the state would have suffered substantial losses. Nothing in Hawley's writings suggested that he would have favored such a large transfer of value from creditors to debtors.

The Importance of the Public Credit

We've grown accustomed to hearing self-styled deficit hawks in Congress lamenting that by adding to the Federal deficit, we are leaving succeeding generations with an insupportable burden, an obligation to pay back in the future the money we are borrowing today. On the other hand, we also hear more dovish politicians claim that deficits don't matter. Both of these views display a poor understanding of the role of the public credit in our monetary system and our economy.

In today's economy Government debt does not circulate as money, but it does provide the underpinning of our monetary system. Banks, and the Federal Reserve, hold Treasury securities on the asset side of their balance sheets. The Fed issues currency and credits banks with reserves on the liability side. Commercial banks leverage their reserves to make loans. In this way, the banking system is the chain connecting the money in our economy to Government debt. So long as the Government's credit is sound, a permanent,

well-supported public debt provides a firm anchor for that chain. But let the credit erode substantially, and the chain becomes unmoored, with unpredictable results.

The importance of a sound public credit rises to the level of consciousness in the public discourse when Congress must raise the debt ceiling, the statutory limit on the amount of debt the Treasury may issue. Remember that Congressional authorization of public spending has two parts, appropriations and funding. The funding, in turn, is generally a combination of taxation and borrowing. Hitting the debt ceiling can become a problem when taxes and authorized borrowing fall short of the sums necessary to meet appropriations. That's why Treasury Secretaries tend to frame the importance of raising the debt ceiling in terms of paying for expenditures Congress has already made. Here's a recent comment from Treasury Secretary Steven Mnuchin, as reported by Bloomberg:

Mnuchin told the Ways and Means panel he wants a "clean" debt ceiling increase not attached to entitlement cuts or other fiscal policy changes. "We can all discuss how we cut spending in the future and how we deal with the budgets going forward," Mnuchin said, "but it is absolutely critical that where we spent money, that we keep the credit of the United States as the most critical issue."³

Perhaps the clearest indication of the importance of Congressional action on the debt ceiling is the similarity of Mr. Mnuchin's reasoning to that of his Obama-era predecessor, Jack Lew, when the same issue arose in 2015. Mr. Lew, in a letter to Congress, said:

The creditworthiness of the United States is an essential component of our strength as a nation. Protecting that strength is the sole responsibility of Congress, because only Congress can extend the nation's borrowing authority. Moreover, as you know, increasing the debt limit does not authorize any new spending. It simply allows Treasury to pay for expenditures Congress already has approved, in full and on time.⁴

Joseph Hawley anticipated in 1782 the use of government debt as the foundation for a monetary system. We have no way of knowing whether his proposal would have worked then, but our system today relies heavily on the credit of the US Government. Treasury debt links fiscal and monetary policy. The economy provides the Treasury substantial capacity to borrow, but Congress still has the responsibility to guard that borrowing capacity, and the public credit in general, with jealous attention. If they fail to do so, they jeopardize the entire monetary system, and with it the economy.

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3. Erik Wasson and Billy House, "[Mnuchin Boosts Urgency for Congress to Raise US Debt Limit](#)," Bloomberg Politics, May 24, 2017.

4. [Letter from Treasury Secretary Jacob J. Lew to Hon. John A. Boehner, Speaker of the House of Representatives](#), October 15, 2015.