Words That Should Appear on Paper Money

Introduction

I wrote a paper with a former colleague, Ake Lonnberg, entitled *Who Signs the Banknotes and Why?*[1] where we examined the category of persons who signed sovereign banknotes across the world.

Many banknotes were signed only by central bankers, others by central bank and government/treasury officials but very rarely by government/treasury officials alone. The United States is one of those rare cases, its Federal Reserve Notes are signed *only* by two Treasury officials, the Secretary of the Treasury, and the Treasurer of the United States.

That was the "who" part of *Who Signs the Banknotes and Why?* In the "why" part we explored the link between who signs notes and various legal and de facto financial support mechanisms governments provide to their central banks. In the conclusion of the redrafted published version of the paper—*Central Bank Finance and Independence*—I provided a model central bank recapitalization arrangement aimed at balancing central bank financial independence and accountability.

In this note I consider a somewhat different issue: what *words* should appear on paper money? Words that would clarify *what* rather than *who* stands behind paper money—what gives it "value" beyond that of finely engraved paper—the implicit contracts being offered by those who sign banknotes and to what extent we should believe them.

Bringing clarity to this question is particularly important now that central banks are creating monetary contracts at unprecedented rates.

Some observers claim, "the only objects one may obtain from the state[2] for one $5 bill are five $1 bills", then allege neither banknotes nor deposits at the central bank are genuine state liabilities, merely intrinsically worthless pieces of paper or bytes in the cloud that can be exchanged only for other intrinsically worthless objects. From this they deduce that "money printing" creates no new state liabilities, is "free finance", and a great way to finance government spending[3].

That argument is, to be frank, silly. It is like saying "the only objects I may obtain from the bus company in exchange for a round trip ticket are two one-way tickets for the same destinations, therefore the ticket is not a genuine liability of the bus company". Obviously, this is false. The bus company is liable according to the terms of carriage on the ticket(s) to accept the ticket(s) in exchange for providing a service, i.e., to take you to your destination and back.

There is not one country in the world of which I am aware where the government accepts neither its own currency nor central bank deposits in payment of taxes, fees (for passports, licenses, state tuition, court ordered fines, etc.), and in satisfaction of regulations such as those requiring posting bond or holding liquid assets. Often government issued money is the *only* accepted payment media or "ticket".

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[1] The research for that paper was incorporated into an article by Ake in Central Banking, *Who Signs Banknotes*, and by us, more conceptually, in *Issues in Central Bank Finance and Independence,* IMF Working Paper # 08/37, 2008.
[2] To be concise I consolidate the central bank and treasury into "the state".
[3] At the same time advocates of private cryptocurrencies express moral outrage at state money creation without limit and portend catastrophic consequences for fiat money monetary systems.

In what follows I will discuss wording on paper money during the epoch when it represented a liability of the government to exchange paper money for gold or silver coin. I will then move on to discuss what might usefully be written on fiat paper money to clarify that it is a liability of the State.

Historical wording when paper money represented a warehouse receipt for gold and silver coin

When paper money was essentially a transferable warehouse receipt for precious metal the wording on notes tended to be straightforward and clear:

"This certifies that there have been deposited in the Treasury of the United States of America twenty dollars in gold coin payable to the bearer on demand" (US $20 Treasury Note Series of 1922).

"This certifies that there has been deposited in the Treasury of the United States of America one silver dollar payable to the bearer on demand" (US $1 Silver Certificate Series of 1928 A)

"This certifies that there is on deposit in the Treasury of the United States of America one dollar in silver payable to the bearer on demand" (US $1 Silver Certificate Series 1935 E).

The key points in all the texts above are that:

- the stated obligation of the Treasury is transferable to anyone—payable to bearer;
- the stated quantity of metal/coins is payable on demand—not an obligation that will be fulfilled at some future date (such as would be the case for a bond);
- precious metal in some form equivalent to the stated dollar value is in the possession of the Treasury. I mention "in some form" because the language differs slightly in that respect over time— "gold coin", "silver dollar" and "silver". "Gold coin" suggests the possibility of redemption in various gold coins with aggregate weight equivalent to the $ amount of the note as established in law (the gold weight of the legal "dollar"), "silver dollar" suggests redemption in a specific sized coin whose silver and subsidiary metal content was established in law, while "silver" is somewhat more amorphous.
- In no case did the paper money specify the weight of the metal backing the note.

Though the difference between a warehouse receipt for $1 in "silver" and $1 in "silver dollars" or "gold coins" may seem only semantic it is not.

The weight of silver contained in a silver dollar was determined in law and the physical coin was imprinted with the words "one dollar". The legal definition of one dollar expressed as a weight of silver could instantly be changed by the legislature but the silver contained in a physical silver dollar could not—it required melting the coins, debasing, and then reminting them[4].

Despite these variants, it was relatively easy to concisely word the "warehoused metal" payable to bearer on demand notes. In the US it was also common to have legal tender language printed on the notes such as "these notes are legal tender for all debts public and private". This legal tender language is often misunderstood. A note with legal tender properties may not be the exclusive means of payment

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[4] Roosevelt reduced the gold value of the dollar on January 31, 1934. Prior to this, all gold coin in circulation had been requisitioned by the Treasury and subsequently melted into bars for deep storage at Ft. Knox, Kentucky. Consequently, there was never a need to remint new coins with lowered gold content.

and it is only legal tender for “debts” or “dues”, i.e., owed amounts. It is legal for a shopkeeper to state up front, i.e., before a debt arises, that certain or no legal tender notes are accepted.

Once paper money is no longer a warehouse receipt, what is it and what to say about it?

Fiat money legal tender wording

In some countries notes continue to contain text as if they were warehouse receipts when they are not.

On Bank of England £5 notes, aside the large image of HM Elizabeth II, appear the words “I promise to pay the bearer on demand the sum of five pounds”. Elsewhere appears “London” (presumably the place where the bearer would be paid the sum on demand) and “For the Governor and Company of the Bank of England /s/ Chief Cashier”. That the chief cashier is the signatory to the promise once again seems to denote that an exchange of the note for “cash”, i.e., something other than five £1 notes is possible.

The text on the 2008 Reserve Bank of Zimbabwe one hundred trillion dollar note states “I promise to pay the bearer on demand one hundred trillion dollars” “for the Reserve Bank of Zimbabwe /s/ Governor” “Harare 2008”. The RBZ also issued “Bearer Cheques” in earlier years of various denominations such as the $20,000 note of 1st December 2003 that stated, “pay the bearer on demand twenty thousand dollars on or before 31st December 2005” “for the Reserve Bank of Zimbabwe”. Those bearer cheques, of significantly lower paper and engraving quality than the notes, presumably were issued in lieu of notes of higher quality (and higher denomination) that were expected to be forthcoming in the future. The RBZ no doubt realized that by the time enough new notes were printed and distributed the country would be needing much higher denomination notes so decided to save costs with an interim issue of cheaper small denomination notes expected to have a short circulation life. The “bearer check” concept made sense, essentially telling the population that in a short space of time, once the legacy notes had fallen in value significantly, they would be able to exchange say 50 for a single million dollar note. Of course, such thinking was hardly likely to bring down inflation expectations!

An interesting spin on the notion that paper money may contain a promise to deliver money in the future are certain Confederate States notes issued during the US Civil War. A note issued in 1864 states “Two Years After the Ratification of a Treaty of Peace between the Confederate States and the United States of America the Confederate States of America will pay ten dollars to bearer”. Naturally, it is less than clear what the bearer should think “ten dollars” would comprise at that time.

In all these cases mystery surrounds the “implicit contract”. What exactly *is* the Bank of England cashier promising to pay (under the watchful eye of Her Majesty)—certainly not 5 pounds of sterling silver. Why write on a Z$100 note that the central bank will pay the bearer Z$100? In a sense, the syntax of note wording has been preserved yet the subject of the promise is missing. “Hamlet without the Ghost”.

Nor does “legal tender” language seem to be widely employed.

Bank of England notes do not presently contain language pertaining to legal tender.

Zimbabwe notes do not mention legal tender.

US Federal Reserve notes no longer “make promises” but do retain “legal tender” language.

Euros and other modern note designs often simply exhibit the denomination and name of the issuer. In the case of the Euro this might be the result of conserving the space that would be necessary to spell out in multiple languages some concept of promise or liability.

The wording on US National Bank notes, issued under the US National Banking Act of 1863 during the Civil War, although a mouthful, does provide useful insight into the implicit contract, i.e., the true "backing" behind fiat money notes. On the face is stated: "This note is secured by bonds of the United States deposited with the U.S. Treasurer at Washington". On the reverse: "This note is receivable at par in all parts of the United States, in payment of all taxes and excises and all other dues to the United States, except duties on imports, and also for all salaries and other debts and demands owing by the Unites States to individuals, corporations & associations within the United States, except interest on the public debt"[5]. Here we can see the explicit obligation of the state to accept its notes, or notes endorsed by it, in payment of taxes and similar fees.[6]

Conclusion

The wording of US National Bank notes provides clear guidance for an understanding of the implicit contract offered in sovereign banknotes. Consistent with this, the United States Treasury today explicitly recognizes that Federal Reserve Notes are liabilities of the Treasury (in addition to being liabilities of the Federal Reserve Banks). Hence the signatures of Treasury officials on the physical notes.

Alan Greenspan, while he was Chairman of the Federal Reserve Board stated that "Central banks can issue currency, a non-interest-bearing *claim on the government*, effectively without limit. They can discount loans and other assets of banks or other private depository institutions, thereby converting potentially illiquid private assets into risk less *claims on the government* in the form of deposits at the central bank. That all of these *claims on government* are readily accepted reflects the fact that a government cannot become insolvent with respect to obligations in its own currency"[7] (Italics added).

Greenspan was thereby stating that both physical central bank notes (e.g., Federal Reserve Notes) and deposits at central banks (e.g., Federal Reserve Banks) represent private claims on the government, that is, they are government liabilities to the private sector.

The words on currency should clarify that government has an unqualified obligation to accept paper money it issues at par in payment of all taxes and public charges. This would illustrate the connection between future taxation and government expenditure to the value of paper money, deposits at the central bank, and other government financial liabilities. It is rather odd that most persons connect the issuance of bonds to future taxation but fail to do so for state currency even though bonds are nothing more nor less than promises to pay the bondholder currency in the future.

To clarify these issues, I suggest language be added to banknotes that they be accepted at par and without reservation for all taxes, fees, and payments due to government.

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[5] This mirrors language contained in Section 20 of the US *National Banking Act of 1863*.

[6] At that time interest on the debt and customs duties were still to be paid in gold or silver coin although by then both the United States and the Confederate States had abandoned the gold standard.

[7] Greenspan, Alan, 1997, "Central Banking and Global Finance," remarks by the Federal Reserve Board Chairman at the Catholic University Leuven, in Leuven, Belgium, January 14, 1997. Available at: http://www.federalreserve.gov/boarddocs/speeches/1997/19970114.htm

Yes, mere words, yet mere words are the matter of laws, constitutions, judicial decisions, and all other implicit contracts among citizens mediated through the overarching social contract of government.

No contract is worth the paper it is written on but that does not mean all contracts are worthless.

Central Bank Archaeology
March 2021