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What Did J.P. Morgan Mean?

The following exchange occurred on December 18, 1912 when J.P. Morgan – the most influential American financier and banker of his time – was called to testify before Congress.

> Mr Untermyer: *I want to ask you a few questions bearing on the subject that you have touched upon this morning, as to the control of money. The control of credit involves a control of money, does it not?*
>
> Mr Morgan: *A control of credit? No.*
>
> Mr Untermyer: *But the basis of banking is credit, is it not?*
>
> Mr Morgan: *Not always. That [credit] is an evidence of banking, but it [credit] is not the money itself. Money is gold, and nothing else.*

Samuel Untermeyer was chief counsel of the Pujo Sub-Committee of the House Committee on Banking and Currency, which was formed to investigate the influence of Wall Street bankers and financiers over the nation's money and credit. He was attempting to determine whether a "money trust" that controlled American business and finance existed and if Mr Morgan was part of it.

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The above exchange is just a small part of more than three hours of testimony by Mr Morgan, but it is the most revealing part of their discussion about money. It hits upon a point not often understood today that, as Mr Morgan put it so precisely and succinctly: "Money is gold, and nothing else".

It is noteworthy that he is often misquoted to have said 'gold is money, and nothing else', which is also true but misses the important point. It is clear that Mr Morgan was defining money in a way that is unfamiliar and therefore baffling to the modern mind, so the quote is frequently altered, whether wittingly or not, to make it understandable today. No doubt further confusing and perhaps somewhat shocking to the modern mind, Mr Morgan – who a century later remains a pre-eminent historical figure in American finance – did not say that 'money is the dollar'; it is only gold and nothing else.

Nor was Mr Morgan defining gold. His statement simply highlighted how gold is used, not what it is, which can be defined as a natural element ranking number 79 on the periodic table.

Yet there is much more to Mr Morgan's words, and indeed, both replies to Mr Untermyer's questions. A deeper analysis will reveal what Mr Morgan and everyone else listening to his testimony obviously understood about money and credit. If they didn't have this clear understanding, Mr Morgan would have been asked to explain his definition of money. No such questions were asked.

So what did Mr Untermyer and others in that Congressional hearing know then that many do not understand now? What did Mr Morgan mean? And what was it that they intuitively recognised about money and credit that is not widely realised today?

Mr Morgan was defining more than just money. He was revealing the essential nature of the process by which people are paid for their labour, which in turn is the backbone of our capitalist society. Money comes from the market process, not government.

Money comes into existence like every other good and service. They all are a result of labour diligently applied to a task completed over time to produce a useful outcome. A farmer produces food, a builder a house, a manufacturer a car, and so forth. All of these items are useful products. Similarly, useful services are provided by a barber cutting hair, a waiter serving food, etc. And to address Mr Morgan's point, a gold miner expends labour and time to produce a useful good we call money.

Bankers in stark contrast spawn money-substitutes called dollars, euros, francs, pounds, etc., but just like artificial sweeteners are not sugar, money-substitutes are not money. These currencies are forced into circulation by legal tender laws, which perforce have largely displaced the circulation of gold as currency. The unfortunate result is that gold's inherent features and attributes have become unfamiliar to many who then fail to recognise gold's true nature and usefulness.

National currencies like the dollar, euro, franc, pound and all the rest are based on credit, and not expended labour. Consequently, they can be best described as 'debt-currency', a befitting term purposefully chosen to express their true nature by revealing their complete and total reliance upon credit.

A talented, hard-working and honest individual will have more ability to borrow on credit than one without these qualities, and credit can be useful. With credit one can obtain goods and services today based on the trust that payment for them will be made in the future by the labour of the individual using credit.

Similarly, banks grant loans on the expectation – and hope – that labour will be expended in the future to repay the loan. So one can borrow a debt-currency from a bank on the trust that it will be repaid. But sometimes that trust is broken. Not all promises are kept, so credit involves the uncertainty of repayment and clearly establishes a fundamental difference in risk between money and debt-currency.

All debt-currencies have counterparty risk, but gold does not. The reason is simple. Debt-currencies are a financial asset. They are not tangible, nor is their value derived from expended labour. More precisely, they are liabilities of banks, and as any accountant knows, it is a bank's assets – and not its liabilities – that have value.

Debt-currency is backed by credit, specifically the loans on bank balance sheets. If these loans are not repaid, the bank's ability to honour its liabilities – the bank's debt-currency – is impeded, adversely impacting that bank's debt-currency. If the loan defaults are sufficiently large, it can lead to bank runs and ultimately, bank failures.

As Mr Morgan explained to Mr Untermyer, credit is not money. Therefore, dollars are not money, and just circulate as debt-currency in place of money. This reality – that national currencies are liabilities of banks – explains why they have counterparty risk, and more to the point, makes it clear why money is gold.

When you pay for some good or service with a gold coin, a tangible asset that is the product of expended labour – gold – is being exchanged for something else of substance and value that is also the product of expended labour, namely, the good or service being purchased. With gold, the exchange is extinguished the moment the good and gold change hands, but contrast this result with the dollar or any other debt-currency.

When dollars are used to purchase some good or service, the exchange is not extinguished. An item of substance – the good or service – is being exchanged for credit in the form of a money-substitute circulating as debt-currency. The good has not been paid for because the seller receiving the dollars now has counterparty risk. The exchange won't be extinguished until the seller off-loads those dollars on to someone else in some other exchange to purchase a good or service, which is the hidden meaning of Mr Morgan's testimony that was widely understood in 1912, but less so today.

Only money can pay for the purchase of a good or service; only a tangible asset extinguishes an exchange. Gold has been money for 5,000 years, though other tangible assets have been used from time to time, generally as a matter of expediency in extraordinary or emergency circumstances, or in the case of silver, to provide coin in small denominations for low value exchanges.

So what would have been the result if the earth had been formed without any gold? It seems logical to conclude that money would never have emerged from pre-history, meaning the market economy would never have emerged from pre-history either.

So gold is special. It has been central to the development of civilisation. And gold is unique. Other tangible assets deteriorate, tarnish, rot, get used up, depleted or worn out and sooner or later disappear, while gold gets accumulated and does not disappear. Except for the inconsequential amount of gold lost from abrasion of coins or from shipwrecks and buried hoards yet to be located and recovered, all the gold mined throughout history still exists, whether fabricated into bars, coins or other forms.

Throughout history gold has been mined because it is used as money. Even though gold today does not circulate as currency as widely as it did in 1912, it still is money.

Mr Morgan's testimony occurred just several years after the Panic of 1907 and the collapse of Knickerbocker Trust Company, one of the larger banks in New York City at the time. We've seen bank runs in recent decades, but these have happened within a debt-currency world. Historically, bank runs were driven by the need for safety, or in other words, to preserve one's wealth by avoiding counterparty risk. Safety was achieved by converting the fleeting and impermanent promises of debt-currency into gold, the ultimate safe-haven. A bank owes you your debt currency, whereas gold is money you own.

The last real bank run into gold occurred during the Great Depression, which is out of nearly everyone's living memory. That explains why so few people are paying attention to the risk of using debt-currency; they have not had the opportunity to learn from experience.

There is an ancient saying that wisdom begins by calling things by their right name. Mr Morgan chose his words in that Congressional hearing accurately and wisely.

"Money is gold, and nothing else."