California and the Gold Standard During the American Civil War

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In late December 1861 the New York banks stopped redeeming their monetary liabilities in gold or silver legal tender coins. The New York suspension was followed by banks throughout the east and midwest and by the government of the United States. Combined with a subsequent act that declared United States notes (“greenbacks”) to be legal tender, the suspension effectively put most of the Union on an inconvertible paper standard. The glaring exceptions were on the Pacific coast where support for the gold standard was strong and where some states remained on the gold throughout the period of inconvertibility. The western recalcitrance with respect to the greenback standard is an interesting and puzzling episode in the American monetary history. Several questions suggest themselves. What does it mean to say that some far western states remained on the gold standard? Given the presumed supremacy of the federal government in monetary affairs, how were these states able to remain on gold while the rest of the country was on an inconvertible paper standard? What were the consequences of remaining on gold? The purpose of this paper is to explore these issues.

The scope of this paper is limited in two ways. First, although the period of inconvertibility in the east extended from December 30, 1961 to January 1, 1879, I focus on the Civil War period and its
immediate aftermath. This was the period during which the western
commitment to gold was aggressively asserted and was placed under severe
political stress. Second, I limit the analysis to California. Other western
states and territories either adhered to gold (Oregon and Idaho) or contained
strong but defeated support for the gold standard (Washington and Nevada)
but California was the leader and the lynchpin in the western gold standard
movement. If California had abandoned gold, the role of San Francisco as
the financial centre for the coast made it is almost certain that the others
would have also. For this reason, understanding why and how California
remained on gold is fundamental to understanding the coexistence of the
gold standard and an inconvertible paper standard in the United States at this
time.

I. Greenbacks vs. Gold

A. The California Constitution

What was effectively a commitment to gold as money was one
of California's founding principles. At the constitutional convention
(November, 1849) that drew up the basic rules for the state-to-be, the nature
and role of banks and the nature of money were hotly debated [Cross, 1927
#1, v.1, pp. 95-119]. The paper monies then in circulation in the rest of the
country were the notes of several hundred banks incorporated by state
governments. The nation's paper currency supply was chaotic: notes of
different colours, sizes and denominations circulated at varying rates of
discount depending on the distance of the transaction from the issuing bank,
with counterfeit notes and notes of failed or suspect banks intermingled with
those of sound institutions. Bank failures were commonplace. An up-to-date
bank note detector
was an essential tool of business. A number of vocal delegates to the California convention had had experience with (or knowledge of) the monetary disruptions in other states during and after the financial crisis of 1836-37 including the virtual collapse of the banking systems of some states. At the convention the monetary and banking problems of these states were blamed on special privileges associated with bank charters awarded by state governments as well as on excessive issues of paper bank money. That statehood was being sought in the midst of a major gold rush undoubtedly conditioned the debate even though it occurred early in the development of the gold mining, processing, marketing and financing industries with their powerful lobbies. Moreover, the established banks of the region were private (unincorporated) banks who did not have an interest in opposing the provision. In any case, a strong majority of the convention was adamant that there would be no paper-money-issuing banks in the state. The constitution drafted at the convention and quickly approved by the voters included a provision that permitted the incorporation of associations "... for the deposit of gold and silver"

but no such association shall make, issue, or put in circulation any bill, check, ticket, certificate, promissory note, or other paper, or the paper of any bank, to circulate as money [California, 1853 #64, Article IV, Section 34]

1 Gold was discovered in January 1848 and the rush of local inhabitants to the gold fields began that summer. However, the "international" rush really began in 1849. The Convention assembled in September 1849 and the proposed constitution approved by the voter in mid-November. The state was admitted to the Union in September 1850.

2 The first legal expression of what was to become a west coast obsession appears to have been in the "organic" act that created the Territory of Oregon in 1848 (and repeated in the law creating the Territory of Washington in 1854). It provided that the territorial legislature the origins of this provision are not apparent. previous year and was also in It denied the territorial legislature the power "... to incorporate a bank, or any institution with banking powers ...", or to issue a charter

... granting any privilege of making, issuing, or putting into circulation any notes or bills in the likeness of bank notes or any bonds, scrip, bills of exchange or obligations, or granting any other banking powers or privileges .... [US, 1848 #111; US, 1854 #112]

Of the several territories created in the mid-west and west before and after Oregon and Washington none had this provision in their enabling legislation. A law providing for territorial government was never enacted for California. It went directly from being federal land, annexed from Mexico in 1848, to statehood.

3 From time to time, in episodes of financial stress, previous governments had issued Treasury notes in relatively small denominations that were receivable in payment of taxes to the federal government and that may have had some circulation as currency. However, they were interest bearing and were not declared to be lawful money or legal tender [Breckinridge, 1903; 1969 #110, pp. 101-112].

4 Silver dollars were also a lawful money and legal tender but as in the rest of the United States they did not circulate in California at this time. The bimetallic monetary legislation of 1834 and 1837 had
1. **A West Coast Obsession**

California was not alone on the west coast in restricting the incorporation of banks and the circulation of paper money. The 1857 constitution for the new state of Oregon contained a very similar provision [Carey, 1926 #115, p. 423]. Indeed, the first legal prohibition of banks and paper money on the west coast appears to have been in the so-called “organic” act by which the US Congress created Oregon Territory in 1848. This act denied the territorial legislature the power “... to incorporate a bank, or any institution with banking powers ...” or to issue a corporate charter

... granting any privilege of making, issuing, or putting into circulation any notes or bills in the likeness of bank notes or any bonds, scrip, bills of exchange or obligations, or granting any other banking powers or privileges .... [US, 1848 #111].

These provisions were extended to Washington Territory when it was separated from Oregon in 1853 [US, 1853 #112].

The reasons for the 1848 restrictions are uncertain. They were not in earlier organic laws creating new territories and it seems unlikely that they were at the behest of the provisional government of Oregon.\(^5\)

Undervalued silver relative to gold with the result that silver dollars were systematically exported and disappeared from circulation. [Shaw, 1896; 1967 #41, pp. 257-260]. As well as the banks’ own issues, the constitutional provision also effectively ruled out foreign notes which had some circulation in pre-state California. In the early years of the gold rush both foreign coins and coins produced by private assay offices in California also had extensive circulation. The establishment of a branch of the United States Mint at San Francisco in 1854 provided a reliable supply of US gold coins that eventually drove out of circulation both foreign and privately-minted coins [Cross, 1927 #1, v. 1, pp. 121-148].

In his classic history of the northwest Bancroft notes that one of the lobbyist that Oregon sent to Washington, J. Q. Thornton, claimed authorship of the bill [Bancroft, 1886 #116, pp. 759-80]. Quite

A less comprehensive restriction on the incorporation of banks was added during debate in the US House of Representatives a year earlier on a bill to create Oregon Territory [US, 1846/47 #128, p. 169]. The prohibition was subsequently expanded to include paper money by the Senate Judiciary Committee but the bill died when it was tabled just before the expiry of the 1846/47 session of Congress [US, 1846/47 #128, pp. 570-571].\(^6\) The expanded proviso was included in the bill that was enacted in 1848.

appropriately, Bancroft scoffs at Thornton’s claim. The bulk of the bill, with minor variations, was standard for all federal territories, with the basic principles derived from the famous Northwest Ordinance of 1787. The major variations related to the term and powers of the governor and the methods of electing the legislatures. The bank chartering restrictions in the Oregon and Washington acts were unique, but as noted in the text, were introduced in debates in Congress a year earlier. The Northwest Ordinance is reproduced in [Thorpe, 1909 #113, pp. 957-962]. For a discussion of the evolution of territorial government (but without comment on the Oregon banking restrictions) see [Eblen, 1968 #119].

In this context, however, it is worth noting that in an 1846 editorial on the Oregon currency law, the editor of the leading newspaper concluded:

*Could we have our own individual choice of a legal tender, it should be the precious metals only, and to this we believe we will be compelled to come ultimately -- perhaps the sooner the better* [Spectator, 1846 #134].

\(^5\) The original House bill did not have the anti-banking proviso. The amendment accepted by the House of Representatives simply denied the territorial government the right “... to incorporate a bank or any institution with banking powers ....” [US, 1846/47 #128, p. 169]. The Senate Judiciary Committee further amended the bill, adding the provisions prohibiting the chartering of associations with the privilege of circulating “… any notes or bills in the likeness of bank notes ....” [Spectator, 1847a #129]. Both bills denied the territorial legislature the power

... to borrow money in the name of the Territory, or to pledge the faith of the people of the same, for any loan
Johansen asserts that the restrictions were "... obvious prohibitions derived from unfortunate experiences of midwestern states in the railroad expansion period"[Johansen, 1949 #118, p. 490]. This suggests that the provisions reflected a general Congressional concern about banking in new territories. However, while the restrictions were in

whatever, either directly or indirectly [US, 1846/47 #128, p. 169].

The report of the Congressional debates in the Congressional Globe provides little evidence. In the 1846/47 session of Congress the anti-banking amendment was proposed by a representative from Florida. When a territory, Florida had had a bad banking history and it was the banking situation in that territory that gave rise to the anti-banking law of 1836 (see below, p. 4). In presenting the amendment Mr. Brockenbrough noted that

He came from a State which had endured various and great misfortunes; but with the sole exception of the bloodshed which had taken place within her borders, he knew of none so great as the omission to insert a proviso of this kind into the law by which she was erected into a territory. [US, 1846/47 #128, p. 169]

Another southern Representative noted that he was voting for the amendment because, while the US Supreme Court had ruled in the famous case of McCulloch v. Maryland that the federal government had the power to create banks, he did not agree [US, 1846/47 #128, p. 169; Williams, 1819 #135]. His vote was a form of constitutional protest.

The debate over the Oregon bill in the 1847/48 session of Congress was long and intensive but all other issues were overwhelmed by the issue of slavery. The original bill, introduced by Senator Douglas of Illinois was stalled in the Senate. I do not know if it contained the bank chartering restriction. The Douglas bill was replaced by a bill to grant territorial status to three areas, California, New Mexico and Oregon. This bill did not contain the bank chartering restriction. It was tabled in the House of Representatives and died there. A new bill was introduced in the House, passed there and also in the Senate. This bill contained the bank chartering restriction. The only discussion of the bank clause was an attempt by one Senator to delete it on the grounds that it was unnecessary. Given the Congressional veto over territorial legislation the Congress could always prevent the chartering of banks if it so chose. [US, 1847/48a #125, p. 1020]

No law was enacted to provide territorial government for California. It went directly from being federal land under joint military and civil control, annexed from Mexico in 1848, to statehood (1850). The broad prohibition was in an 1836 act that annulled bank charters granted by the territorial legislature of Florida. Similar action
precipitated by what one Congressman called "... the perilous use of paper money..." by the provisional government established by the inhabitants of Oregon before the territory was formally ceded to the United States [US, 1847/48b #124, p. 803; Young, 1906 #126]. Faced with severe financial difficulties and a perceived shortage of gold and silver coins in the region, the provisional government had passed a Currency Act that prescribed

_That in addition to gold and silver, treasury drafts, approved orders on solvent merchants, and good merchantable wheat at the market price ... shall be a lawful tender for the payment of taxes, and judgments rendered in the courts of Oregon territory, and for the payment of all debts contracted in Oregon territory, where no special contract has been made to the contrary._

[Oregon, 1846 #130]

The territorial government was already a sinner. It seems likely that the strong restrictions in the organic law were designed to forestall any further issues of paper money by the territory, territory-chartered banks or merchants.  

I have no evidence that the precedent set by the Oregon Territorial Act gave members of the California Constitutional Assembly the idea for the restrictive banking and paper money clauses. However, that is possible. In any case, the Oregon case emphasizes that the insistence that money be gold was not confined to California. Indeed, with certain qualifications to be discussed below, it became a west coast obsession (see below pp.).

### B. The Greenback Standard.

In this context, the American Civil War created a monetary dilemma for Californians. In the early stages of the war the finances of the federal government were in disarray [Bolles, 1894 #42, pp. 3-42; Hammond, 1970 #62, pp. 1-66]. Expenses were much greater than expected, tax collections were inadequate and the market would not quickly absorb all of the bonds that the government wanted to issue. Heavy reliance was placed on borrowing from large eastern banks. The negotiations between the banks and the government were intense and at times confrontational, particularly when the Treasury revealed proposals for a new type of national bank issuing a new national currency [Bolles, 1894 #42, pp. 20-42; Hammond, 1970 #62, pp. 71-106]. To meet part of their financial requirements, in July, 1861 the government obtained Congressional authority to issue $50 million of non-interest bearing Treasury Notes that were payable on demand in gold coin [Bolles, 1894 #42, pp. 11-16; US, 1861 #45]. Although initially, these “demand notes” were not accorded legal tender status they were in a form suitable to circulate as money.  

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10 The Act also prohibited the Territory from borrowing “in any mode or manner whatever” [US, 1848 #111]. This provision had not been in organic acts for earlier territories [Eble, 1968 #119, p. 190n]. Unlike states, territorial governments had no sovereign status but were extensions of the federal government. Any borrowing by the territory could become an obligation of the United States. Presumably the restrictions was to prevent this happening in a territory that had already demonstrated fiscal imprudence.

11 The minimum denomination was $10, a very large sum at the time. The law specified that they could be used to pay salaries of government employees and so they could be forced into circulation, even without legal tender status. In August a second bill was passed, reducing the minimum denomination to $5 and making the notes acceptable for payments to the government. Possibly because they could be used to pay customs tariffs the notes seemed to have had general acceptance as money. When paid to the government they could be reissued, maintaining the size of the issue. [Bolles, 1894 #42, pp. 11-16]
there, as in the east, they had minimal impact on the monetary system. However, despite the support of eastern banks and the issuance of the demand notes, the fiscal position of the federal government continued to deteriorate.

1. Suspension of Gold Convertibility

Although it was induced by the government’s attempts to cope with its financial situation, the actual suspension of gold convertibility was a private arrangement. It was agreed by the leading bankers of New York on December 28, 1861 and implemented when the banks opened for business on Monday morning, December 30 [Bolles, 1894 #42, pp. 25-36; Hammond, 1970 #62, pp. 150-159]. Banks in other eastern and mid-western states and the government had no option but to follow. The government’s demand notes thus became inconvertible paper money, acceptable for payments to the government but still lacking general legal tender status.

Thus:

*We observe a few Demand Notes of the US Treasury Department floating about the market of the denominations of $5, $10 and $20. They are quite useful for small remittances, and pass usually at par for that purpose, but when exchanged for coin would doubtless be subjected to a slight curtailment [Bulletin, 1861a #63]*

There was no redemption agency in California. Until convertibility was suspended, the notes could be redeemed at Assistant Treasurer’s offices in Philadelphia, New York or Boston.

Bolles erroneously states that the suspension by the banks of the large eastern cities was “followed by the banks throughout the country.” [Bolles, 1894 #42, p. 36]. Banks in California and some other Pacific coast states and territories did not suspend. The government suspended gold payments on its demand notes but continued to service the interest-bearing national debt in gold, presumably to mollify foreign holders of United States bonds.

The impetus to the New York banks’ suspension was a sudden and precipitous drain of gold from their reserves that showed no signs of stopping. Over a three week period in December, 1861, the New York banks’ gold reserves fell by 30%, from $42.3 million on December 7 to $29.4 million on December 28 (Figure 1). Surprisingly, this was not primarily a result of an international drain. Despite the war, the disasters of the Union armies at Bull Run (July 21, 1861) and Balls Bluff (October 31, 1861), the well known precariousness of the federal government’s financial position, and the emerging conflict between the banks and the Treasury over financial policy, there is no evidence of a flight of capital. The American dollar remained well above par until mid-November (Figure 2). Indeed, through the earlier part of the year the dollar was so strong that gold was drawn to New York from Europe contrary to the

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12 Figure 2 shows the implicit price of a US dollar, expressed in Sterling, in the New York foreign exchange market at half-monthly intervals during 1860 and 1861 and Figure 3 shows the same price, daily, from September to December 1861. The raw data are quotations on 60-day Sterling bank bills as quoted in the New York Tribune. In effect, the purchaser of a Sterling bill obtained two instruments: implicit spot Sterling exchange and a 60-day bill on London. The bill could be sold in the London bill market at the prevailing rate of discount for immediate (Sterling) cash. It is the sum of cash received in the London market that determines the implicit spot exchange rate. As was the convention, this rate is estimated using the Bank Rate of the Bank of England as the discount rate [Spalding, 1925 #61, pp. 40-61]. The Atlantic cable was not yet laid: communications with London depended on the periodic steamers. To provide an approximation to the information available to the New York purchaser of a London bill I have used the Bank of England Bank Rate lagged two weeks. This may be too long a lag but small differences in the Bank Rate make little difference in the calculation and none to the overall story of the market at this time.
normal net flow.\textsuperscript{15} The Union apprehension, on the high seas, of Confederate officers aboard the British ship Trent (November 8, 1861) and its implications (including the possibility of hostilities between Britain and the United States) was a prominent theme in financial columns in newspapers on both sides of the Atlantic. This may have contributed to the dip in the exchange rate to par in late November (Figure 3).\textsuperscript{16} However, real weakness in the American dollar did not emerge until early December when the magnitude of the gold drain from the banks was obvious and the possibility of a suspension of gold payments was openly discussed in both the American and the British press. A small flow of gold to Europe began.

Figure 4 reports the \textit{Merchant’s Magazine}’s compilation of the net change in reported specie reserves held by banks and Treasury sub-agencies, monthly, during 1861 together with the major sources of change in these reserves. As is apparent, the net international drain of gold that emerged in December 1861 was very small, less than the net inflow of gold from California. The bulk of the net change in gold reserves was unaccounted for: the residual, attributed to domestic hoarding outside the banks. In this sense, the gold crisis of the New York banks was primarily a domestic affair.\textsuperscript{17}

A bill to permit the issuance of treasury notes with legal tender status was introduced soon after the suspension and following much debate was passed in February 1862. It permitted the issuance of $150 million of legal tender notes (of which $50 million was to replace the July 1861 demand notes) [US, 1862 #47; Bolles, 1894 #42, pp. 43-73]. Additional issues followed in July 1862 and March 1863, making the authorized total $450 million (most of which were issued). In early 1863 the issuance of notes for fractions of a dollar was authorized to meet the need for smaller denomination currency [Bolles, 1894 #42, p. 84]. An open gold market developed and as the price of gold increased it disappeared from circulation in eastern and mid-western states. The eastern and mid-western states were already accustomed to paper money in the form of bank notes; they were now, \textit{de facto}, on an inconvertible paper standard.

2. \textit{California’s Dilemma}

The dilemma facing Californians was profound. On the one hand, many had the deep belief that

\begin{quote}
\textit{The present currency of California is the best, the most perfect, that was ever known to mankind. To hope to improve it, by any element which lessens its value, is hoping to reverse the laws of nature. [Ferris, 1862 #58]}
\end{quote}

conveying gold and hence raising the gold export point temporarily [Econ, 1861 #136; Econ, 1862 #137].\textsuperscript{17} Much of the gold withdrawn from the banks might have been drawn abroad had the suspension not occurred. Indeed, it is possible that some that was in domestic hands was being assembled for that purpose. After the suspension of convertibility, when gold was a commodity in the free market, the historical pattern of net flows to Europe resumed.

\textsuperscript{15} New York was the normal market for California gold and the flow of gold from California was usually much in excess of domestic demands for gold. As a result, under normal circumstances there was a net flow of gold from New York to Europe. The strength of the dollar in 1861 was attributed to the strong European demand for American foodstuffs following a general failure of the European wheat crop. The reported exports of domestic produce from New York jumped from $95 million in 1860 to $131 million in 1861. Imports fell even more substantially, probably a result of the sharp increase in the import tariff [Hunt’s, 1863 #101].

\textsuperscript{16} Paradoxically, the Trent affair probably delayed the flow of gold from the United States to Europe. Because of the threat of war, insurance rates on the Atlantic rose sharply, increasing the cost of shipping.

\textsuperscript{17} Much of the gold withdrawn from the banks might have been drawn abroad had the suspension not occurred. Indeed, it is possible that some that was in domestic hands was being assembled for that purpose. After the suspension of convertibility, when gold was a commodity in the free market, the historical pattern of net flows to Europe resumed.
Gold was considered the only sound basis for a monetary system -- a sentiment tinged, of course, with the self interest of the gold mining community. For creditors, particularly the major San Francisco merchants and banks -- powerful political forces -- the concern was the repayment of debts in a depreciated currency; concern that:

"... a debtor can discharge an obligation in paper of less value than gold, he will pay back less than he borrowed and less than he owes..." [G., 1862 #142]

Some proponents of gold adopted the states-rights argument that the federal government did not have the constitutional power to issue legal tender notes [J.M.S., 1863 #139; J.A.F., 1863 #11; F., 1863 #138]. It is probable that the pro-Confederacy element in the state also supported that gold standard movement as a source of embarrassment and some fiscal cost to the federal government.

On the other hand, most Californians wanted to be seen as loyal supporters of the Union cause, including its fiscal requirements.19

18 The constitutionality of treasury notes being made a legal tender was challenged in a case involving the payment of rent that reached the Supreme Court of California in 1864. The court held that while the power to issue paper money with legal tender status was not explicit in the constitution it was implicit in the Congressional power to choose the means by which it would finance the prosecution of the war. The legal tender notes were declared constitutional. The questions was not definitively settled by the Supreme Court of the United States (not on a California case) in 1871 [Williams, 1871 #143]. On the broader debate of the constitutionality of legal tender notes see [Hurst, 1973 #65; Breckinridge, 1903; 1969 #110, pp. 101-137]

19 Loyalty became a major theme in arguments in support of the use of legal tender notes, not only in California but also in other western states. Thus, for example,

"California can do no greater service to the Union, nor show her loyalty in any manner so fitting, as by at once accepting the Legal Tender Notes, and making them the basis of her circulating medium [R., 1862 #146]."

Shortly after the Treasury Note Act was passed, the financial editor of a major San Francisco newspaper stated the dilemma clearly:

"... the necessities of the Government require paper issues until the immense indebtedness occasioned by the war shall have been fully liquidated, and placed in proper shape for final extinction. In the accomplishment of this end it is both the duty and the interest of all good citizens to render what aid they can. If it be necessary for the support of Government credit and the convenience of creditors that a portion of its indebtedness should, for the time being, assume the character of currency, and be floated for a few years, there can be no objection to this..."

However, the issue must not be excessive, and above all

"A sound specie basis should never be dispensed with. We have the material in abundance -- Why not use it? [Bulletin, 1862b #50]

With the state sharply divided on the issue, those with effective economic power chose to remain on gold and resolved the dilemma by repeatedly arguing that this was not inconsistent with wholehearted, patriotic support of the union cause. The citizens and courts of California soon found loopholes in the legislation to permit them to maintain the gold standard.

II. What Did It Mean For California To Remain On The Gold Standard?

The proposition that California remained on the gold standard requires interpretation.

20 The editor was not concerned not only about over issue of greenbacks leading to their depreciation but the multiplied issue of private bank notes based on a greenback reserve. He advocated that half the bank capital "of the country" be required to be deposited in gold and that bank note issues be limited to double the actual gold reserve. [Bulletin, 1862b #50].
A fundamental aspect of the retention of the gold standard was the maintenance of specie payments by the California banks. While relevant data are not available, there is no evidence of a drain of gold into domestic hoards like that which precipitated the suspension in New York.\footnote{At the time of the New York suspension, all of the commercial banks in California were unincorporated private banks. Despite an earlier editorial campaign for public reporting of assets and liabilities and government inspection, there were no laws regulating banks and requiring financial reporting [Bulletin, 1855a #144; Bulletin, 1855b #145; B., 1855 #148; Cross, 1927 #1, pp. 149-236]. As a result, there are no comprehensive bank data for this period. The first partial information available is for July 1876, when the San Francisco Bulletin assembled data on capital, deposits and cash of California banks from statements published in a newspapers as required by a new law. The first ... notes are currency in New York, and gold is merchandise; while here, gold is currency and notes are merchandise [Bulletin, 1862e #59].\footnote{Here, gold and silver form the circulating medium, and United States notes are bought and sold like any other commodity [Bulletin, 1863b #52].} 

is far too strong. Although they were traded on the San Francisco stock market at prices that fluctuated continuously, greenbacks were not simply “merchandise” in California. Gold coins (or cheques, as claims to gold coins) were the primary payments money in wholesale, retail and financial markets, particularly in San Francisco. However, the US government made payments to its employees and suppliers in California using greenbacks (unless greenbacks were in insufficient supply). \footnote{Ferris’ letter was written very early in the episode which may explain his wildly optimistic assumption about the range of fluctuation in the gold price of legal tender notes.}\footnote{It is not clear whether the wages of government employees were adjusted in accordance with the declining gold value of the greenback. However, there is evidence that in purchasing supplies the government (not surprisingly) was forced to accept the realities of the market place. Thus,}
for the payment of taxes to the United States government (with the exception of import duties -- see below p. 12) legal tender notes were universally used. With the greenback at a deep discount in relation to gold, to have done otherwise would have been foolish. Greenbacks were used for small payments to the east and there seems to have been some use of greenbacks in the rural areas of the state. Indeed, there was strong public and editorial support in the rural areas for the declaration of the greenback as the legal tender of the state and from time to time large shipments of greenbacks arriving at San Francisco were said to be destined for the interior [Bulletin, 1864c #155]. For cash payments for current transactions there was no barrier to the use of legal tender notes. The only issue was the exchange rate at which they would be accepted. It is clear that there was some circulation in the retail trade

... within a few days past her [the federal government's] officers in this city have explicitly recognized the principle for which we are contending by passing Legal Tender Notes at their market value, even at a moment of depression, in the fulfillment of Government contracts [Bulletin, 1862f #147].

24 The government had to accept the notes and as long as they were available in the market at a discount there was a strong incentive to use them. The newspapers contain occasional references to private accumulations of legal tenders in anticipation of taxes to be paid in the near future. As an amusing aside, for the special wartime “direct tax” the state government acted as an intermediary, collecting taxes from Californians and paying a lump sum over to the federal government. The state treasurer created a considerable controversy in 1863 by assessing and collecting the taxes in gold dollars but paying the federal government in legal tender notes, the profit accruing to the state treasury. The representative of the federal treasury in California initially declined to accept the legal tender payment but was informed by the Secretary of the Treasury that the law compelled them to accept the notes [Bulletin, 1862c #55; Bulletin, 1863c #56; Bulletin, 1863d #57].
in San Francisco. However, with the isolated exception of occasional sales, what business was done using greenbacks was at prices adjusted to make them equal to prices quoted in gold dollars (see footnote 25).

At least early in the period they were used to some extent to pay freight on shipments from the eastern states and by a quirk of the wording of regulatory legislation they had to be accepted for payment of fares on street railroads. On occasion, merchants attempted to pay their debts

25 I have noted occasional advertisements early in the period (when the greenback was at a relatively modest discount) proclaiming “US Legal Tender Notes will be received for all cash purchases at Par.” [Jones, 1862 #54; NYLife, 1862 #53]. The advertisements did not run for long periods. It is likely that these advertisements were short-term competitive marketing strategies -- effectively a sales not normal retail practice. However, the financial editor of the Bulletin suggested that the merchants wanted legal tender to pay their federal taxes and that

... the prices of merchandise will doubtless be made to confirm to the value of ... [legal tender notes] ... so that the party offering the notes can hardly be a gainer by it. [Bulletin, 1862n #161].

In a Market Review in October 1864 the financial editor of the Bulletin noted that many newspapers in rural areas of the state

... were openly advocating the use of paper money as a remedy for the ills prevailing in the rural districts...Prudent businessmen, who hold the purse strings and control the movements of commerce, were led by them to adopt a line of policy which has thus far averted the threatened evils .... [Bulletin, 1864c #155].

Presumably the “line of policy” was a boycott of all who insisted in paying in legal tender notes. See below, p. 12).

26 With respect to freight,

In several instances consignees of merchandise have insisted upon paying freights with them, on the ground that the obligation was one of Eastern origin, and therefore, in the absence of stipulations to the contrary, properly payable in the currency there prevailing [Bulletin, 1862h #154].
to banks and to suppliers using legal tender. This provoked a strong
reaction (see below, p. 12).

Thus, the proposition that California remained on the gold
standard is not absolute. The banks maintained gold convertibility but
there was some use of greenbacks in payments. In the words of one
newspaper editor:

_The whole matter is thus reduced to this: We have two kinds of
currency, two prices for goods -- one payable in gold, the other
in Legal Tender Notes. Any person or trader (even the
Government) has his option which of the two to choose._
[Bulletin, 1862g #153]

However, the gold dollar was the accepted unit of account and the
accepted basis for quoting prices and when payments were made using
greenbacks prices were usually adjusted to their gold equivalent. It is in
this sense that California remained on the gold standard.

**III. How Did California Retain The Gold Standard?**

There were three interrelated foundations of California’s
retention of the gold standard: the limited legal tender status granted to

The “stipulations” were soon forthcoming.

_For freight ... upon ships arriving from Eastern Atlantic ports
... currency is generally received, unless the bills of lading
specify, as many of them do, that they are payable in gold
coin [Oregonian, 1862 #152]._

The law regulating the railroads specified that the fares had to be paid in
“lawful money.” A court decision that greenbacks were “lawful money”
meant that they could be tendered for street railway fares, at par
[Bulletin, 1866a #149]. In a later case resulting from an incident in which
an inter-urban railway had ejected a passenger for attempting to pay his
fare with greenbacks rather than gold coin, the court ruled that the
railway had to accept greenbacks. However, the basis for the judgment
is not clear [Hale, 1868 #165].
greenbacks under the federal legislation, agreements among merchants and bankers not to deal with customers who insisted on paying in legal tender notes, and the so-called Specific Contracts Act adopted by the state legislature. The second may have been sufficient for the gold standard to work after a fashion for a time; the first and third added the crucial legal sanction that permitted its continuation for the duration of the eastern suspension of gold convertibility.

A. **Legal Tender Status of Greenbacks.**

Basic to the ability of California to remain on the gold standard when the rest of the nation had adopted an inconvertible paper standard was the nature of the legal tender status of United States notes. Legal tender is a legal concept, a bundle of characteristics conferred on money by statute. As explained, for example, by Breckinridge, there are three kinds of characteristics that might be bestowed on money by legal tender laws: as lawful money for the definitive settlement of financial obligations to the government (e.g., the payment of taxes); as lawful money for the definitive settlement of financial obligations to private individuals and business firms; and as lawful money in cash transactions in the market. The granting of legal tender powers to a particular type of money may be only partial. It may not encompass all three characteristics or any one of them completely. Thus, for example, a particular type of money might be made a legal tender for the payment of financial obligations to the government but not in private transactions; or it might be made a legal tender for the payment of some taxes and not others. The ability of California to avoid adopting the greenback standard in 1861 revolved in part around the limitations ascribed the legal tender status of the greenbacks.
The effect of the federal act of February 1862 was to create two kinds of legal tender money. The 1834 and 1837 acts which specified that the new standard gold eagle coins be “a legal tender of payment” were not repealed or revised (see footnote 29). Standard gold coins remained the comprehensive legal tender of the United States and the various United States mints continued to produce these coins throughout the period of suspension. While the 1862 legislation established United States notes also as a legal tender, it was on a less comprehensive basis. They were a legal tender for “all debts public and private,” for most payments by and to the United States government -- but not for the payment of customs duties or for the payment of interest on the public debt [US, 1861 #45]. In this sense, the legal tender notes were granted only a limited legal tender status. The comprehensive legal tender status of gold coins was unchallenged.

**B. The Merchants’ Association.**

The Act creating the legal tender notes thus cooperated with California merchants by not attempting to make the notes a legal tender “for all payments whatsoever.” There must have been controversies

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27 I ignore full bodied silver coins for the practical reason that while they theoretically had the same status as gold coins they did not circulate.
28 The first charge against the gold received from customs duties was the interest on the debt. This was presumably an attempt to maintain the credit standing of the United States government with both domestic and foreign holders of the debt. Any remaining gold was to be used to retire part of the debt and then for general revenue [US, 1861 #45].
29 This was the wording of the 1792 Act that established the mint, defined the metallic content of American gold and silver coins and declared them legal tender for “all payments whatsoever [Breckinridge, 1903, 1969 #110, p. 88; Krooss, 1969 #44, v. 1, pp. 201-206]. The 1834 and 1837 legislation that reduced the gold content of gold coins used the
about the value of legal tender notes in cash transactions but I have found only two court cases that challenged the right to refuse to sell except for gold coin or equivalent value in legal tender notes in cash transactions -- the railroad cases referred to earlier (see footnote 26). Credit transactions were another story. The sale had already been made; a private debt had been created. Was the merchant-creditor compelled to accept depreciating greenbacks in settlement of the debt?

With small margins in the wholesale and retail trades, even small departures of the gold price of legal tender notes from par could turn expected profits on credit transactions into losses. The problem became much more serious as the greenback issue increased and the exchange rate on greenbacks worsened. Pressure to prevent repayment of debts in greenbacks increased.

The financial editor of the San Francisco Bulletin foreshadowed the solution before the legal tender act had been passed:

*Money lenders can of course very easily guard against loss on that score by stipulating in all obligations for money that payment be made in coin [Bulletin, 1862i #156].*

Merchants were taking the precaution of writing across the face of their bills "payable in coin or its equivalent" [Bulletin, 1862d #59]. Would such covenants be legally enforceable? Perhaps it didn’t matter:

*No borrower ... will offer those notes in payment who expects ever to be accommodated again, if contrary to the wishes of the lender [Bulletin, 1862i #156].*

However, as the economic incentive increased, it did happen. Thus, it was reported that

*... efforts have been made by country dealers to force Legal Tenders in payment of accounts with jobbing houses where expression a legal tender “for all payments.”* [Krooss, 1969 #44, v. 1, pp. 1040-1049]
Gold was expected and in all honor due, the goods having been sold at Gold rates and with a margin of profit in many instances much less than the discount upon those Notes. Such cases compel merchants to adopt measures for their own protection [Bulletin, 1862] #157

Stronger, coordinated measures were required.

In late 1862 the bankers and merchants of San Francisco formed a Merchants Association with the sole objective of forcing gold payments in their credit transactions.

The idea is that this agreement will be signed by all the leading firms of this city, and then all the other city firms, and those up country who have dealings with them will sign it. Then it will be a firmly established rule. If any refuse, or after agreeing to pay in gold, pay in greenbacks at par instead, then his name will be entered into a black book, and the firms all over the state who have entered into the agreement will be notified, so that wherever he may thereafter deal, he will have to pay for his goods in yellow gold in advance [Bulletin, 1862k #158].

The agreement was soon invoked:

A party having a note of hand maturing at bank yesterday, positively refused to pay it otherwise than in Legal Tenders -- of course it was not accepted -- and the name of the drawer has been reported to the Secretary of the Merchant's Association to be entered upon their delinquent list. Members will, of course, avail themselves of the information [Bulletin, 1862m #160].

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30 The agreement itself is presented in [Bulletin, 1862l #159]
31 Presumably the boycott did not work perfectly. Thus, an ad appeared in the San Francisco Bulletin in late 1864:

Greenbacks. Caution is herewith given to all persons doing business with a man named Charles Strassman of the East India Tea Store on Washington Street opposite Maguire's Opera House, that he has been purchasing goods to a considerable amount very lately from the subscribers and paying for them in the above currency, having bought [i.e. contracted for the goods] for gold coin. Castle Brothers, Jones & Co. [Bulletin, 1864c #131]
Unfortunately, the legal status of the campaign to maintain the gold standard was uncertain. If debtor attempting to pay his debt using greenbacks and the tender was refused, would the court accept the tender as discharging the debt, or would it require payment in gold coin? In other words, were greenbacks really legal tender for all private debts, or not? This was an issue for the courts and the legislature.

C. State Taxes.

The first question to be resolved by the California courts was the currency to be used in paying state taxes. The federal legislation had made greenbacks a legal tender for the payment of all federal taxes except import duties but was silent on the payment of state taxes.” A case was taken to the Supreme Court of California in August 1862. Greenbacks had been tendered in payment of San Francisco city and county real estate taxes, which were refused by the tax collector on the ground that California laws required the payment of taxes in the “legal coin of the United States.”\footnote{Paradoxically, the Revenue Act also permitted payment in “foreign coin at the value for such coin by the laws of the United States.” [Perry, 1862 #162]} The court ruled that state taxes were not “debts” because the obligation to pay did not arise out of an\footnote{explicit contract, voluntarily entered into. They were not included in the category “all debts public and private.” Moreover, the federal legislation itself distinguished between “taxes” and “debts” and did not include state taxes in the category of taxes for which greenbacks were to be a legal tender. On this reasoning, the court upheld the collector’s demand for} explicit contract, voluntarily entered into. They were not included in the category “all debts public and private.” Moreover, the federal legislation itself distinguished between “taxes” and “debts” and did not include state taxes in the category of taxes for which greenbacks were to be a legal tender. On this reasoning, the court upheld the collector’s demand for
gold coin in payment of state taxes thus reinforcing the campaign for the maintenance the gold standard [Perry, 1862 #162].

D. Specific Contract Act.

The centrepiece of the legal support for the California gold standard was the Specific Contract Act enacted by the state legislature in April 1863 [Bulletin, 1863e #163]. The effect was to permit enforcement by the Sheriff and the courts of promissory notes that required payment in a specific type of money. In principle that money could have been greenbacks; the intent, of course, was to ensure the legality of contracts calling for payment in gold coin.

The validity of the Act was quickly challenged in court. In an interesting decision the California Supreme Court ruled that the federal Legal Tender Act was not intended or designed to interfere with private contracts. Debt contracts could be written requiring payment in anything -- commodities or types of money -- and they would be enforceable by the legal system providing the provisions were not repugnant to public policy (e.g., a pound of flesh). The phrase “all debts public and private” in the Legal Tender Act applied only to contracts in which the type of money to be repaid was not specified in the contract. The Act reinforced this interpretation by specifying certain types of payments (interest on _________________.

California was not unique in this regard. For example, in an 1862 case the Illinois Supreme Court ruled that a state law requiring taxes to be paid in gold coin was valid despite the federal Legal Tender Act, asserting that

*The jurisdiction of the State on the subject of taxation for all State purposes, is supreme, and over which, the government of the United States can have no power [Peck, 1862 #164]*
the public debt; import duties) that were to be made in gold. The Specific Contract Act thus did not establish a new principle; it was simply “remedial” in the sense that it made certain the rules of the game in California. Debt contracts requiring payment or interest and principal in gold would be enforced by the legal system.

The contract had to be very carefully drawn, however, to meet the legal requirements. Thus, the common requirement in commercial transactions that the debt be repaid in “gold or its equivalent” (see above, p.) was not covered by the Act.

1. “Gold or its Equivalent” Covenants.

Early in the suspension period San Francisco merchants took solace from a court decision in Philadelphia contract had to be very specific about the currency to be paid in settlement of the debt. Thus, a November 1862 extension of a mortgage specified that

... all payments of principal and interest ... shall be made in gold coin of the United States of America ... or of the equivalent of such gold coin if paid in legal currency [Tuttle, 1886 #49, p. 274].

This was drawn before the Specific Contracts Act was passed but the parties presumably meant by “equivalent” the current market value of legal tender notes, the common sense, commercial interpretation. While accepted by the lower court, this interpretation was rejected by the Supreme Court of California on the grounds that the commercial equivalent had not been specified in the agreement and did not imply a certain sum of money.34 In the absence of an explicit agreement to the contrary,

34 Where are we to find the yardstick by which to measure the comparative values of the two different kinds of currency,
In contemplation of law, a dollar in legal tender notes is equal to, and therefore the equivalent of, a dollar in gold coin. In comparing the two kinds of money the law knows no difference in value between them. It recognizes no other standard of equivalents [Tuttle, 1886 #49, p. 276].

If the contract said “gold, or its equivalent in legal currency” the court interpreted the word “equivalent” in a legal rather than a market sense. If it had said “gold, or its equivalent in legal currency at its current market value in San Francisco” the contract could be enforced.

2. **Other Western States**

The success of California’s Specific Contract Act induced the supporters of the gold standard to attempt the same tactic in other western states and territories. Oregon enacted very similar legislation the following year. A similar bill in Washington encountered bitter opposition, passed in the lower house but was tabled and allowed to die in the Senate. In Idaho and Nevada Territories the bills was passed but declared ultra vires by the state courts. The Nevada decision outraged bankers and merchants, many of whom were based in San Francisco. An Attempt was made to enforce the gold standard through mercantile boycotts; I do not know if the attempt was successful.

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which the law says are equal, but which in the commercial world are not equal, and the relative values of which are not the same in any two cities in the country? Shall we seek it in Wall street, Montgomery street, Salt Lake, or Los Angeles? If under any of these peculiar contracts the Courts can enter into a comparison of values between a dollar in gold and a dollar in treasury notes ... it must be because it is expressly so agreed, and there should, at least, be some conventional standard of comparison adopted in the agreement. [Tuttle, 1886 #49, p. 276]
E. National Banks.

The issuance of inconvertible legal tender notes was an emergency measure, intended as a short-term expedient. However, the Secretary of the Treasury, Chase, had in mind a much more important long term reform, involving the incorporation of a new type of note-issuing commercial bank -- National Banks -- that would promote both monetary and banking stability and a uniform supply of paper money. The first of the new banks were chartered in 1862. The concept received a chilly reception in California. Until the national government permitted the establishment of “Gold note” national banks -- banks that maintained convertibility of their notes into gold coin -- no national banks were established in California.

IV. Some Implications Of California’s Retention of The Gold Standard

What were the consequences of California’s retention of the gold standard? The most obvious effects were in the exchange market but there were also important consequences for the general level of prices. Supporters also argued that the resulting financial stability in California attracted capital from abroad with perhaps some effect on the general level of interest rates.

A. Exchange Rates.

Geography separated the financial systems of California and the Atlantic states. Before the Civil War they used the same money but

The mortgage was written in Los Angeles and Montgomery street was the financial district of San Francisco (and the hence the financial epicentre of California)
tortuous, slow and costly sea transportation and expensive overland telegraphic communication meant that making payments in the other region involved significant transactions costs. Money available for payments in the other region was a marketable financial instrument, the price of which fluctuated within a narrow range. It was this dollar exchange market that linked the eastern and western financial systems a just as the Sterling exchange market linked the London and San Francisco financial systems. The rejection of legal tender notes by California in 1862 did not alter this principle but it did dramatically change the nature and behaviour of the California-New York exchange market.

The organization of the San Francisco exchange market at this time is not well documented. The banks had correspondents in major eastern and foreign cities on which they could draw drafts and these drafts were the dominant instruments in the market. It is not clear how many non-bank dealers or brokers there were, but from advertisements in newspapers and irregular price quotations there was clearly a "street" market outside the banks. The market appears to have been competitive with frequent price changes. Most of the exchange was in the form of bank drafts sent by the fastest ships, mainly the thrice monthly mail steamer by way of Panama but also by the so-called "opposition" steamers that also plied this route. As a result, the exchange market was most active at "steamer day" -- the day that the regular mail steamer departed. Quotations are regularly available for

There are occasional references to attempted agreements among banks on the rate but these appear to have been on the rate to prevail on a particular day. Even before the war the rate change frequently and there is evidence that different banks charged different rates on particular days.
these days. Some quotations are available for other days, few in the early years, more in later years. Transit time to New York was about three weeks, involving a steamer to Panama City, a railroad across the isthmus, and then a steamer from Aspinwall to New York.\textsuperscript{36} Transcontinental telegraphic communication between New York and San Francisco was opened in October, 1861, making telegraphic transfers also available for exchange transactions [Hunt, 1862 #167]. However, quotations on telegraphic transfers do not appear in the financial columns until late 1863 and then only irregularly. This suggests that relatively expensive telegraphic transfers were not heavily used as a method of making eastern remittances.

Figure 5 shows the exchange rate for the period 1860-1867 on drafts on New York banks, both drafts payable there in gold and drafts payable in legal tender notes. For comparison, the rate on Sterling bills is also shown.\textsuperscript{37}

Before the Civil War, a business seeking to make a remittance to the Atlantic States or Europe had basically two alternatives: purchase a draft on an eastern or European bank in the exchange market or ship gold coin.\textsuperscript{38} The cost of shipping gold -- express charges and insurance

\textsuperscript{36} The pony express across the continent was faster but both risky and expensive.

\textsuperscript{37} The rates are quotations on (or close to) steamer days found in major San Francisco newspapers (the \textit{Evening Bulletin} and the \textit{Alta Californian}). The rates on Sterling are for conventional 60-day bills. The rates on New York are for sight drafts. Occasionally rates were given for the street market, presumably involving drafts of merchants on merchants. In all cases, however, I have used the figures for bank drafts, the discount on which was less than on street drafts.

\textsuperscript{38} There were other alternatives, of course. When the transcontinental telegraph went into operation, telegraphic transfers were also possible. For exchange payable in gold in New York they were typically 1-2 percentage points more costly than drafts by steamer. Payments to the
placed an upper limit on the price of bank drafts. As is evident in Figure 5, in 1860 the price of drafts on New York on steamer days fluctuated at a premium between 2% and 3%. The cost of shipping and insuring gold coins must have been at or near the upper limit of this range.

The eastern adoption of the greenback standard in early 1862 and California’s rejection of it introduced another payments option, an important new element of risk and a basis for speculation into exchange transactions with the Atlantic states.\(^\text{39}\) For each remittance a decision had to be made whether to fix the payment at the New York end in gold or in currency. In this choice the nature of the payment obligation was undoubtedly important but expectations of the price of gold in New York must also have entered into the decision.

If it was decided to fix the New York payment in gold, still another choice had to be made. It was possible to ship gold coin or to purchase a draft on New York payable there in gold. Gold would be paid for the draft in San Francisco and gold would be received from the Atlantic states were also made using Sterling bills, depending on relative exchange rates.

San Francisco was the central gathering place for gold and silver on the west coast, including gold from British Columbia and from the interior mines in Nevada and Idaho. There was a branch of the United States Mint, many private assayers and an organized market for bullion bars of raw gold and silver that had been assayed but not refined. Prices for bullion fluctuated quite widely and were quoted regularly in the newspapers. Some of the gold was refined and manufactured into coins at the Mint. However, most of it was shipped to New York as bullion. In the years under study, exports of gold and silver accounted for between 70% and 80% of the total exports from San Francisco.

Interestingly, I find no evidence of the emergence of a forward exchange market. While such transactions possibly occurred, quotations for forward exchange did not appear in the financial pages of newspapers.
correspondent bank in New York. The price of the draft would be regulated, as in the pre-war period, by the cost of shipping gold. As is evident on Figure 5, there was a sharp jump in the rate on gold drafts on New York at the outbreak of the war, from a 2% - 3% premium to about a 6% premium. This reflected the increase in insurance rates as a result of the risk of capture of gold bearing New York bound steamers by Confederate forces [Bulletin, 1861b #166].40 The war risk premium fluctuated as the perceived danger ebbed and flowed, with the price falling back to its prewar level at the end of the war.

Making due allowance for war risks, the rate on gold drafts on New York (like that on Sterling bills) was relatively stable throughout the Civil War. By contrast, the price of currency drafts on New York fluctuated widely, dipping as low as $.40 in mid-1864 before settling in the $.70 to $.75 range. For remittances to New York in which the sum to be paid was fixed in currency, the alternative to purchasing a currency draft was to ship legal tender notes and from time to time there is evidence of a large volume of such business. Figure 6 displays the prices of currency drafts on New York (labeled the exchange rate) and of legal tender notes in San Francisco. Not surprisingly, the price of legal tender notes tended to be slightly lower than the rate on currency drafts, reflecting the costs of shipping and insurance. However, fluctuations in the exchange rate on currency drafts were more or less paralleled by the price of legal tender notes in San Francisco, particularly after the initial collapse in the two prices.

In New York the equivalent of the price of legal tender notes in San Francisco was, of course, the reciprocal of the price of gold coin.
Given the transcontinental telegraph, the San Francisco market could be instantly aware of significant developments in the New York gold market, and these would be reflected in trading and price formation in San Francisco. The two series, at half monthly intervals, are plotted on Figure 7. Again, the correlation between the series is remarkably strong.

There are no surprises in these charts. It is clear that all of the arbitrage mechanisms were working as well as could be expected under wartime conditions and given the distances and costs of communication involved. The greenback inflation produced the expected depreciation of the inconvertible paper currency against gold currencies, whether those gold currencies were in Europe, Canada or California.

B. Commodity Prices.

In the Atlantic states the expanding issue of greenbacks was translated into one of the classic examples of a purely monetary inflation of commodity prices. In California it appeared as a depreciation of the exchange rate on New York. In principle, one of the effects of a truly flexible exchange rates is supposed to be the insulation of the economy

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40 Shipments of gold bullion to New York almost ceased during the war because of the risk of capture. Most gold was diverted to Britain and carried on British vessels.

41 The data on the price of gold in New York are from the remarkable record of daily high and low prices for gold assembled and published by Wesley Clair Mitchell in 1908 [Mitchell, 1908 #51]. The prices of greenbacks in San Francisco are from the Evening Bulletin and the Alta Californian.

42 The behaviour of the San Francisco rate on the greenback is virtually identical to that of the Montreal rate on the US dollar at this time [Paterson, 1984 #168].
from price inflation in the country in with excessive monetary expansion. Did this insulation occur in California?

Figure 8 shows annual wholesale price indexes for the greenback states and for California, 1860-1880, each expressed in their local unit of account, greenbacks in the east and gold dollars in the west. In the eastern United States the price level doubled in two years, reaching a peak in 1864. California did not escape inflation entirely but the increase in the price level was much more moderate, about 40% in three years to a peak in 1865. Moreover, the price level returned to its pre-war level much more quickly.

What is not clear from the chart is the extent to which the movement of prices in California represented the importation of the greenback inflation from the east. The big jump in prices in 1864-65 appears to have been largely “real.” Two groups of prices that had a significant weight in the overall price index, “farm products” (including wheat) and “textiles”, increased sharply over these years for reasons that had nothing to do with the greenback inflation. The production of wheat and other breadstuffs had increased over the years such that by the early 1860s they were significant export products. Deficient rainfall

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43 The index for the greenback states is the Warren and Pearson wholesale price index for “all commodities.” [US, 1949 #169, p. 232]. The alternative index for 30 basic commodities shows a significantly more extreme inflation to 1864. The prices included in these indexes are largely from New York. The California index is due to Thomas Berry [Berry, 1984 #170]. I am grateful to Robert Allen for making this publication available to me. Both indexes have been set to the base 1860=100.

44 “Farm Products and Food” has a weight of 0.533 in Berry’s index. Unfortunately, he does not indicate the relative weights of the components of the category, but wheat would have been very large. “Textiles and Clothing” is much less important, 0.052 [Berry, 1984 #170, p. 233].
resulted in a poor harvest in the fall of 1863 and a disastrous one in 1864. Figure 9 illustrates the impact on the price of wheat and products derived from wheat. The issue with textiles was much different. The war had virtually eliminated the flow of cotton from the American south to world markets so that the price of cotton rose sharply. Berry’s index of textile prices rose from 100 in 1860 to 143 in 1865 [Berry, 1984 #170, p. 236]. If the San Francisco wholesale price index is adjusted to remove these two categories of prices the result is as shown in Figure 10. The adjusted price index is far from stable but the apparent effects of the greenback inflation are eliminated. The flexible exchange rate appears to largely insulated California from the greenback inflation.

C. British Banks

One of the strong claims made by supporters of the gold standard in California is that the resulting “monetary stability” attracted foreign capital, helping to reduce interest rates and contributing to the development of the economy. I am unable to assess the general argument regarding the inflow of capital. The relevant data are not available. However, in one area, banking, a substantial inflow can be documented.

During the greenback era six British banks set up operations in San Francisco. One failed (partly as a result of speculations undertaken in San Francisco) and one withdrew after failing to establish a substantial presence in the city. However, four continued operations, two of them as branch operations of banks operating elsewhere (the Bank of British North America and the Bank of British Columbia) and two newly created with the specific purpose of engaging in banking in San Francisco (the London and San Francisco Bank and the Anglo-
Californian Bank). Together they were a substantial and respect presence in the banking industry. It is not possible to review their activities in this paper, but by 1878 they accounted for % of commercial bank capital in the city. The reasons given for establishing these operations included the stability of the financial system and the high level of interest rates (see below, p. 19) as well as an interest in participating in the gold and silver trade and the expanding British commerce with California. Perhaps induced by the retention of the gold standard, they made a significant addition to the capitalization of banking.

D. Interest Rates.

The final aspect of the economy that I want to consider is the behaviour of interest rates. This has particular relevance because of claims by proponents of the greenback standard, not only in California but also in other western states, that its adoption would not only increase in the money supply but would also increase credit and reduce interest rates, stimulating investment and economic activity in the state. This was particularly argued in the rural and relatively remote areas that were not sharing in the general prosperity of San Francisco.

Figure 11 displays short term interest rates in San Francisco and New York together with the Bank Rate of the Bank of England.\(^45\)

\(^45\) The Bank of England Bank Rate is from Mitchell, Abstract of British Historical Statistics. The New York commercial paper rate is from MacAuley. I have compiled the San Francisco rate from reports in the \textit{Evening Bulletin} and the \textit{Alta Californian}. It is the bank lending rate for short term (30 day) loans to their best customers secured by “unquestionable securities,” “first class collaterals and commercial paper.” Rates for “ordinary accommodation upon names alone” were reported to be considerably higher [Bulletin, 1861c #171; Bulletin, 1861d #172]. Frequently a range of rates would be reported which, from occasional comments in the financial column, appear to have been rates...
The first point to notice about San Francisco interest rates is their height relative to rates in New York. While there was considerable fluctuation, until mid 1864 the San Francisco rates were almost consistently above 20% per annum, reaching up to 30%. This was true before the war as well as during it. By contrast, with brief exceptions, rates in New York were in the range of 5% -7% per annum. From mid-1864 significant convergence of San Francisco and New York rates occurred as a result of a decline in San Francisco. This is probably not unrelated to the injection of British capital into the banking business in that city.

While startling, on reflection the level of interest rates in San Francisco is not surprising. With the economic base of the state in the financing, mining and marketing of gold and silver, notoriously unstable industries, business risks were high. Interest rates reflected the scarcity of capital, not a shortage of liquidity. As the economy diversified into agriculture and small manufacturing population grew and the attractiveness of the state for investment improved. The relative scarcity of capital must have been steadily alleviated.

In this context, the behaviour of San Francisco interest rates is perhaps not surprising. While, as we have seen, the economy was not devoid of inflation, the inflation that did occur was largely a result of identifiable exceptional circumstances. It would not have given rise to charged by different institutions. In those cases I have averaged the high and the low rates. Occasionally rates were also reported for transactions outside banks. The range of these open market rates tended to overlap with the range of bank rates with a higher upper rate but the quotations were not consistent enough to make it worth while to attempt to compile them. Similarly, occasionally rates were noted for long term mortgage loans. The term was not noted but the interest rates tended to be lower than those for short term loans from banks. Rates were quoted as per cent per month; I have converted them to per cent per annum.
inflationary expectations that would be built into interest rates. The greenback inflation should not -- and did not -- increase nominal interest rates. Indeed, it is the behaviour of New York interest rates that is puzzling. At least until 1865 the successive issues of greenbacks and the associated rise in prices must have induced expectations of further inflation. If so, these expectations were not incorporated into short term interest rates! However, it has been noted that in New York traditional commercial credit virtually dried up and business was conducted largely on a cash basis. In California, the traditional mercantile credit system, underpinned by the Specific Contract Act, continued to flourish.

V. Conclusions

Did California adhere to the gold standard during the American Civil War? In an important sense, yes. The gold dollar was the standard unit of account, gold coins (or bank deposits convertible into gold) were the standard medium of exchange and credit were extended and repaid in gold dollars. That there was a considerable use of legal tender notes for particular purposes and in some sections of the state is apparent. However, in general, when legal tender notes were used for payments, prices were adjusted to their gold equivalent.

Merchants and bankers attempted to enforce the gold standard by a system of blacklists of creditor who insisted on repaying loans with greenbacks. However, crucial to the maintenance of the gold standard was the Specific Contract Act which required the courts to enforce debt contracts requiring re[payment in gold. Contrary to experience in Nevada and Idaho, the California courts upheld the validity of the Specific Contract Act and their judgment was not appealed to the United States Supreme Court.
The exchange rate for drafts on New York payable in legal tender currency followed the expected pattern, mirroring the price of gold in New York. As a result, San Francisco was largely insulated from the greenback inflation (although it price level was far from stable). Beyond this, the monetary stability that accompanied the maintenance of the gold standard attracted British banks to set up operations in San Francisco, significant increasing banking capital. It is likely that this infusion of capital into banking resulted in the observed reduction of interest rates.