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Putting Legal Restrictions Theory to the Test: An Arkansan Experiment, 1861-1863

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Abstract

During the Civil War the Arkansas legislature funded their expenditures primarily through interest-bearing warrants and war bonds. After these issues were made legal tender in November 1861, the discount attributed to them disappeared immediately and they began to circulate widely. By mid-1862 they appeared to be preferred to Confederate notes – which were also made legal tender in November 1861 but required military intervention to support their acceptance. The widespread circulation and potential dominance of legal tender interest-bearing currency is consistent with legal restrictions theory. Confederate notes supplanted the Arkansas issues only after the legislature suspended interest payments in November 1862.

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[W]e the Home Guard, ... having heard of the attempt to depreciate the war bonds by some merchants and dealers, and believing it to be for the interest of those families ... who are *compelled to use them*, ... [resolve] [t]hat we will not trade with or patronize any merchant or dealer who refuses to take the war bonds at par.

(Arkansas *True Democrat*, December 3, 1861) – emphasis in original

Interest-bearing currency is a rarity. Legal restrictions theory suggests that the dominance of non-interest-bearing currency is possible only because of legal impediments that prevent banks or other institutions from offering interest-bearing alternatives (Wallace, 1983).¹ One argument against this approach is that even in a case like pre-1844 Scotland, where banks were not prevented from paying interest on their notes, interest-bearing notes as such were still not offered (White, 1987; Cowen and Kroszner, 1989). Even though interest-bearing notes were issued by both Northern and Southern governments during the Civil War, neither government granted them legal tender status and it is unclear how widely they circulated (Gherity, 1993; Makinen and Woodward, 1999). In the case of the South, their failure to chase non-interest-bearing notes from circulation may actually be explicable in terms of government-imposed restrictions on banks, however (Burdekin and Weidenmier, 2002).

A dilemma recognized by proponents and opponents of legal restrictions theory alike is that the interest-bearing medium must be small enough for transactions purposes and yet be large enough to make interest calculations and interest payments feasible and cost effective (White, 1987). The South's interest-bearing notes were most commonly of \$100 denomination, for example, making them too large to be conveniently used in day-to-day transactions at first -- although as the war progressed this became increasingly less of an issue owing to rapid inflation. One example of a government issuing small-denomination interest-bearing debt is found in post-World War I France. As with the Confederate currency, the interest-bearing securities clearly did not chase non-interest-bearing currency out of circulation. Although at least one department store advertized that they would accept the interest-bearing

bills, Makinen and Woodward (1986) also cite a first-hand account of their not being readily accepted for transactions purposes. While the question of their actual circulation remains unclear, it is significant that these bills were never made legal tender. Thus, they were never put on a level playing field with conventional legal tender non-interest-bearing notes.

There is, however, at least one documented instance where the authorities explicitly conferred legal tender status on interest-bearing securities. In November 1861 the Arkansas state legislature made their interest-bearing war bonds and treasury warrants legal tender instruments receivable both for taxes and in payment of other debts.² This accorded them the same legal status as Confederate notes. The legislature also approved the issuance of small denomination bills and scrapped the prior \$5 minimum. At that point, the discount previously attached to Arkansas' interest-bearing securities disappeared and there is abundant evidence that the notes began to circulate widely. Moreover, the interest-bearing notes appear to have been preferred to non-interest-bearing Confederate notes. Even though Confederate currency was also made legal tender in Arkansas under the same November 1861 Act, the Confederate commander in Little Rock felt compelled to issue repeated orders outlawing discrimination against Confederate money. It was only after interest payments on the Arkansas securities were suspended in November 1862 that Confederate notes clearly supplanted the state issues and become the main circulating medium within Arkansas. The bonds and warrants' rise to dominance after being made legal tender and their disappearance after interest payments were suspended seems quite explicable in terms of legal restrictions theory but very hard to explain otherwise.

1. THE ARKANSAN EXPERIMENT

The first \$2,000,000 issue of 8 percent war bonds with values ranging from \$5 to \$500 was authorized by the Arkansas Secession Convention on May 11, 1861. Additional issues of 8 percent warrants were also authorized as needed by the state treasurer and these warrants were receivable in payment for state debts. Use of warrants and bonds was limited to only two-thirds

of any tax on June 1, 1861 -- with the remainder to be paid in coin or overdue coupons -- and the denominations of the warrants were fixed at \$5 and above. Morgan (1985, p. 71) states that “Arkansas treasury warrants did not circulate well at first.” But on November 18, 1861 the legislature passed a new law whereby any creditor refusing to accept either Arkansas treasury warrants/war bonds or Confederate Treasury notes and bonds for payment due would have no further recourse until two years after the end of the war. At the same time the \$5 minimum denomination for the warrants was removed along with the old requirement that one-third of taxes be paid in coin or overdue coupons. The Arkansas *True Democrat* (January 23, 1862) gives the denominations of the new issues of warrants at \$1, \$3, \$5 and \$10 and apprehended that “they will come into general circulation and take the place of war bonds.” As of September 1862, the assistant state treasurer reported that a total of \$1,447,026.6 in bonds and \$710,288.1 in warrants had actually been issued (Arkansas *True Democrat*, September 16, 1862). Most of these appear to have been small denomination issues of less than \$5 (see Pecquet, 1986, p. 107).

There seems to be no doubt that the state bonds and warrants circulated and were used as hand-to-hand currency after the November 1861 law was passed. In the same month Governor Henry M. Rector (as quoted in the Arkansas *True Democrat*, November 7, 1861) summarized the prevailing situation as follows:

The scarcity of money among the people renders it indispensable that some sort of circulating medium be provided by the state. We are without banks, – ports blockaded – commerce stopped – the precious metals sunk, deep in the vaults of avarice; some sort of paper money must be temporarily supplied, to meet the daily accruing necessities of the people. The war bonds, to be sure, from motives of

speculation, are depreciated now. But ... land sales, and collection of the revenue, will absorb them in twelve months. The first of January next will see them at a premium.

Interestingly, the governor did not even mention Confederate treasury notes as an alternative circulating medium for the people of Arkansas. Available data on the trading of Arkansas debt in Memphis, Tennessee shows an abrupt jump from a 15 percent discount to a 2 percent discount on December 1, 1862 following the passage of the new law (see Table 1). Given the discount typically attached to out-of-state notes (Gorton, 1996) this suggests a very small (or non-existent) discount within Arkansas. Indeed, on December 14 the *Arkansas State Gazette*, one of Little Rock's two major newspapers, explicitly stated that they placed Arkansas paper "on a footing with the best of paper money" (albeit at a 25% discount to specie). The Arkansas debt maintained its higher price until quotes end in February 1862 in advance of Memphis' fall to Union forces later in the year.³

Following the passage of the November 1861 law, the Arkansas war bonds' role as hand-to-hand currency was noted by the state treasurer's office (*Arkansas True Democrat*, January 9, 1862):

A practice has grown up, in various parts of the State, of cutting off the coupons and using them as currency. These detached coupons will not be paid by the Treasurer until the bond from which they are cut is shown to him to be yet outstanding ...

The following response to the state treasurer's notice seen in the *Washington Telegraph* (January 15, 1862) yields further evidence of the importance attached to the war bonds and warrants as hand-to-hand currency:

[T]he decision of the Treasurer tends ... to lessen the facility of circulation which it has been the policy of the State to create for these bonds to the utmost extent. No one takes these bonds as a permanent investment. They are received and paid out like bank bills as currency ...

The state government legislature had previously supported the circulation role of the bonds and warrants by outlawing the use of privately issued fractional currencies (or "shinplasters") in the 1861 legislation (Pecquet, 1989, p. 66).⁴ The state's November 1861 legal tender law and the tax receivability of the Arkansas securities did not, however, give any encouragement to the circulation of these instruments outside Arkansas' borders. The following newspaper announcement in the December 12, 1861 *Arkansas True Democrat* is indicative of the value attached to the state issues for use within Arkansas as well as their lack of acceptance outside the state:

We have about three thousand dollars in Arkansas War Bonds, and Treasury notes, which we wish to exchange for Confederate, Louisiana, or Tennessee money. The Arkansas money pays debts, taxes and purchases lands, besides, bearing interest at 8 per cent., and our only reason for wishing to make the exchange is that we cannot buy paper with it in other States.

When the *True Democrat* newspaper raised its prices on January 30, 1862, its editor published the fact that payment could be made "in current paper, including Confederate notes, war bonds, and treasury warrants (see Dougan, 1969, p. 17). Until publication was suspended in July 1863, the *True Democrat* enjoyed a circulation of 10,000 and, together with the *Arkansas*

State Gazette, represented the major Little Rock press. Elsewhere Captain S. B. Poe, chair of the Merry Green Home Guard in Salinas County, Arkansas, points to Arkansas state warrants not only circulating but being the key transactions medium for the families living in his area of jurisdiction (*Arkansas True Democrat*, December 3, 1861). A January 7, 1862 diary entry by John W. Brown, a Camden, Ark., lawyer and businessman (who later became a funding agent for the Treasurer of the Trans-Mississippi Department of the Confederate Army in June 1864), seems to confirm this predominance of the state currency in the aftermath of the November 1861 law:

Everything in the shape of money is disappearing. Gold 35 to 40 percent over the best currency, even the N. Orleans banks and Government Treasury notes. This state of things cannot last. The War Bonds of Arkansas as they are called is almost the only circulation.” (Brown, 1852-1865, p. 212)

By mid-1862 the continued use of the Arkansas bonds and warrants seems to be accompanied by a reluctance to accept Confederate notes.⁵ The case of the Pike County cotton factory is described in the *Washington Telegraph* (June 4, 1862):

Mr. Merrill receives ... \$1.50 in specie, in lieu of \$2.50 Confederate money, when offered. We must be consistent and acknowledge that to be wrong and indefensible. No man should directly or indirectly discount the money of the Confederacy, who does not intend sometime to leave it. Still the fair prices are payable in our ordinary currency, and he is no more reprehensible than the broker who buys Confederate notes at a discount.

Disdain for Confederate currency certainly does not seem to have been confined to Mr. Merrill. In his first official report after taking command of the Trans-Mississippi District, General Hindman states that in the period following the March 1862 Battle of Elkhorn “Confederate money was openly refused or so depreciated as to be nearly worthless” (United States War Department (comp.), 1885, p. 30). Under his June 2 proclamation, General Hindman found it necessary to mandate that all persons within the district “take Confederate notes as currency at par, in all business transactions” (*Arkansas State Gazette*, June 7, 1862). On June 10 martial law was declared in Pulaski County around Little Rock, with maximum prices imposed for goods and merchants ordered to keep their stores open every day except Sunday to accept payment in Confederate money (see Neal and Kremm, 1993, p. 121). Hindman’s ardent support for the Confederate currency was reiterated and amplified in his General Orders No. 9, issued on August 9, 1862, and reprinted in the August 30 issue of the *Arkansas State Gazette* (emphasis in original):

Confederate money is considered as of equal value with any other, and shall therefore be taken in all business transactions, and in payment of all debts of whatever kind or character. Persons refusing so to take it, subject themselves to the penalties heretofore prescribed in orders.

The state government had itself sought to use an additional issue of treasury warrants to pay the new Confederate government war tax that was due by May 1, 1862. Although the Confederate government officially rejected this offer, it does not seem that Governor Rector really was then forced to sell the \$650,000 in warrants that had been appropriated by the legislature on March 22, 1862 for the war tax payments (Morgan, 1985, p. 72). General Hindman reports that he accepted over \$400,000 in payment of war taxes, disbursing the funds within the state (United States War Department (comp.), 1885, p. 38). Although Hindman does not explicitly state in which form payment was received, Ball (1991, p. 224) concludes that the treasurer “illegally paid [with] \$400,000 of these warrants ...” From this point on the state did, however, turn increasingly towards Confederate currency and Morgan (1985, p. 72) argues that,

as the state's needs mounted, the "interest-bearing warrants became less and less attractive to state officials."

2. WITHDRAWAL OF THE INTEREST-BEARING CURRENCY AND THE AFTERMATH

In November 1862 it was proposed that "all interest bearing paper be withdrawn from circulation and scrip or treasury warrants without interest issued instead" (*Washington Telegraph*, November 26, 1862). Interest payments on the warrants were formally canceled on November 21, 1862 and all tax collections were suspended on December 1, 1862. After interest payments had already been canceled, a supplementary act passed on December 1, 1862 allowed for the provision of warrants of less than \$1 in denomination (*Washington Telegraph*, January 21, 1863). Huff (1964, p. 245) states that by this time people lacked confidence in both Arkansas war bonds *and* Confederate notes. Whereas the reluctance of the Pike County cotton factory to take Confederate notes earlier in the year had led to incensed citizens talking of "taking forcible possession of his factory and using it for the benefit of the community" (*Washington Telegraph*, June 4, 1862),⁶ a December 29, 1862 diary entry by Brown (1852-1865, p. 235) notes that a "sum of \$200 in gold could be bought for \$500 in Confederate currency."⁷

By the end of 1863 the "overextension of state debt and the loss of much territory made the state warrants and war bonds unpopular even in the Confederate-held portion of the state" (Pecquet, 1989, p. 70). Indeed, the state's financial system essentially disintegrated in the face of Northern invasion that culminated in the loss of Little Rock, the state capital, in September 1863 and the retreat of Confederate forces to the far southern portion of the state south of

Camden. The outstanding interest-bearing warrants were belatedly funded through issues of new non-interest-bearing bills that were authorized on October 1, 1864 to cover the principal and accumulated interest on those warrants that had been deposited with the state treasurer (Morgan, 1985, p. 72).⁸ Meanwhile, the dire situation in 1863 was summarized in a March 18 letter from the Confederate Secretary of War:

The army is stated to have dwindled by desertion, sickness, and death from 40,000 or 50,000 men to some 15,000 or 18,000, who are disaffected and helpless, and are threatened with positive starvation from deficiency of mere necessities. The people are represented as in a state of consternation, multitudes suffering for means of subsistence, and yet exposed from gangs of lawless marauders and deserters to being plundered of the little they have.⁹

Eventually people were accepting Confederate treasury notes only because they “were forced to do so by military edict” (Huff, 1964, p. 253) and “shrewd operators got rid of it by buying up land, either from public authorities – who had to accept the currency at face value – or from others who needed the money to survive” (Moneyhon, 1994, p. 120).

The demise of the Arkansas warrants preceded the military collapse, however, and seems to coincide with the suspension of their interest payments in late 1862. In this respect some parallels may be drawn with the Civil War experience in Texas. Under the terms of a pre-war February 14, 1860 law, Texas had a policy of paying interest on any of its warrants that could not immediately be redeemed. On February 9, 1861 the legislature made these warrants receivable for taxes and other monies owed to the state (Morgan, 1985, p. 76). The payment of interest on unpaid warrants was repealed on January 11, 1862, however. Thereafter, as in Arkansas, state warrants were largely replaced by Confederate Treasury notes that, by 1863, “had become the main medium of exchange in Texas and the standard of value” (Morgan, 1985, p. 78). It appears, therefore, that the interest payments were critical to the choice between state

warrants and Confederate notes as the preferred circulating medium. Moreover, the movement away from the use of state warrants appears to have been maintained even as military setbacks made the survival of the Confederate government increasingly questionable.

3. CONCLUSIONS

The Arkansas case strikingly demonstrates how circulation and demand for the interest-bearing state issues was elevated immediately after they achieved full legal tender status. There is no reasonable doubt that they functioned as hand-to-hand currency following the passage of the November 1861 Act. And it may well be that the absence of similar legal tender provisions elsewhere helps explain why there is much less evidence that other interest-bearing instruments (both those of the Civil War era and otherwise) actually circulated. Legal restrictions theory predicts, however, that legal tender interest-bearing currency should not only circulate but also actually chase non-interest-bearing notes from circulation. The evidence on this second point is much less clear cut. There is simply no consistent data on either how widely each currency was used or what premium may have been accorded to the Arkansas money. But, coupled with anecdotal evidence suggesting a preference for the Arkansas issues, discrimination against Confederate notes seems the only plausible explanation for the attempted “support acts” by General Hindman in June-August 1862. The fact that the Arkansas money lost its appeal after interest payments were abolished later in 1862 also appears to accord with the predictions of legal restrictions theory – only after this did the (rapidly depreciating) Confederate currency again become the main circulating medium in the state.

Footnotes

- * The authors thank Michael Dougan, Greg Hess, Harold Mulherin, Gary Pecquet, Janet Smith, Jennifer Ward-Batts and Tom Willett for helpful advice and comments and are grateful to the Reference Department of the University Library of the University of Arkansas at Fayetteville for supplying us with material from their archives.
1. Although Wallace's legal restrictions theory has also been embraced by advocates of separating the medium of exchange function of money from the unit of account function (see Cowen and Kroszner, 1987), we focus solely upon the scope for interest-bearing currency competing with conventional non-interest-bearing notes.
 2. In a smaller-scale, even less documented, episode in what is now Oklahoma, the Choctaw Nation issued \$25,000 in treasury warrants under an October 21, 1862 law that gave these warrants status as currency (Morgan, 1985, p. 98). The warrants were issued in small denominations ranging from 50 cents to \$5 and were issued without the names of the initial recipients appearing on them. In line with the Arkansan experience, Morgan (1985, p. 98) argues that this made the warrants "readily transferrable and served to give them status as a circulating medium." The majority of these warrants is believed to have been issued in early 1863.
 3. During this period Arkansas had no banks and relied upon Memphis, Tennessee, as its financial center. That is why even Arkansas newspapers report only the Memphis quotes. Interestingly, the Arkansas *Daily State Journal* reports the bond quotations as part of their "bank note list" alongside the notes issued by various banks both in and out of state and also Confederate Treasury notes. The constancy of the quoted price against

Confederate currency is consistent with quotations for other state notes and bank notes over this same period -- but does not imply an absence of trading, with all of these notes fluctuating considerably against gold over this same interval. In addition to the quoted value, holders of interest-bearing instruments like the Arkansas bonds and warrants were also customarily credited with accrued interest through the date of the transaction.

4. Although this law does not appear to have been enforced with any rigor, given that the notes of at least one of these issuers, the Washington Exchange company in the southwestern part of the state, remained in common use at late as the summer of 1863 (see Pecquet, 1986, p. 106).
5. The appeal of the Arkansas issues may have been further enhanced when the legislature, during their March 17-22, 1862 session, “backed the bonds and treasury warrants with the public lands ...” (Thomas, 1926, p. 318).
6. Previously quoted by Dougan (1976, p. 107). Similar complaints were apparently voiced in April 1863 against an Arkadelphia thread factory that required ten to twelve Confederate dollars for a block of thread that cost four dollars in specie (*Arkadelphia War Times*, April 29, 1863).
7. Union soldiers may well have added to the inflationary pressures by spending counterfeit Confederate currency within the state. In December 1862 Union Colonel William Ward Orme stated that his soldiers used counterfeit Confederate currency that was printed in St. Louis and distributed to the soldiers free of charge. This same colonel claimed that local Arkansans at that time still “preferred Confederate money to greenbacks” (Huff, 1964, p. 254).

8. Meanwhile, the value of Confederate currency west of the Mississippi was bolstered in 1864 by the Confederate Currency Reform of February 17, 1864. According to that act old Confederate notes were to be exchanged for new notes on a two for three basis. Difficulties in transporting the new notes across the enemy-occupied Mississippi led to currency shortages, and temporarily elevated specie values of notes, in the region (see Burdekin and Weidenmier, 2001).
9. Extract from a letter addressed to General Kirby Smith that is quoted in Snead (1887, pp. 454-55).

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Table 1: Arkansas War Bonds, October 1861-February 1862

Date	Price	Date	Price
1861/10/31	85	1862/1/1	98
1861/11/1	85	1862/1/3	98
1861/11/2	85	1862/1/4	98
1861/11/8	85	1862/1/5	98
1861/11/9	85	1862/1/6	98
1861/11/12	85	1862/1/8	98
1861/11/13	85	1862/1/9	98
1861/11/14	85	1862/1/10	98
1861/11/15	85	1862/1/11	98
1861/11/16	85	1862/1/12	98
1861/11/17	85	1862/1/14	98
1861/11/19	85	1862/1/15	98
1861/11/20	85	1862/1/16	98
1861/11/21	85	1862/1/17	98
1861/11/24	85	1862/1/18	98
1861/11/26	85	1862/1/22	98
1861/11/27	85	1862/1/23	98
1861/11/28	85	1862/1/24	98
1861/11/29	85	1862/1/25	98
1861/11/30	85	1862/1/26	98
1861/12/1	98	1862/1/28	98
1861/12/7	98	1862/1/29	98
1861/12/8	98	1862/1/30	98
1861/12/10	98	1862/1/31	98
1861/12/11	98	1862/2/1	98
1861/12/12	98		
1861/12/13	98		
1861/12/14	98		
1861/12/15	98		
1861/12/17	98		
1861/12/18	98		
1861/12/19	98		
1861/12/20	98		
1861/12/21	98		
1861/12/22	98		
1861/12/24	98		
1861/12/25	98		
1861/12/27	98		
1861/12/28	98		
1861/12/31	98		

Source: *Daily State Journal* (Little Rock, Ark.) -- quotes are “as reported by the Memphis bankers” and do not appear to include accrued interest.