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ABSTRACT

A new approach to explaining the value of colonial paper money that relies on their distinctive character as bills of credit is presented. The market value of these bills is decomposed into their real asset present value and their liquidity premium value. This approach is applied to the newly reconstructed monetary data for colonial New Jersey. New Jersey's bills were structured as zero-interest bearer bonds. They had defined future redemption payoff dates in specie equivalents. The New Jersey government redeemed their bills on time as legislatively promised under a fiscally credible redemption tax structure. The real asset present value of New Jersey bills accounted for at least 80 percent, whereas the value of these bills as "money" accounted for at most 10 to 20 percent, of their market value. Colonial paper money was not primarily a fiat currency. New Jersey's paper money did not depreciate. It traded below face value due to time-discounting; not depreciation. A positive liquidity premium implies that New Jersey's paper money actually traded at an appreciated value over its real asset present value. That liquidity premium was positively associated with the quantity of paper money per capita in circulation and the method of monetary injection.

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