

# Financial Fraud: Mr. Paulson and the New Yazoo Land Scandal

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Present discussions of the mortgage mess are lapsing into an unreal world. Advocates of the \$700 billion bailout are now rounding up a choir of voices to proclaim that the problem is simply a lack of liquidity. This kind of problem, we are told, can be solved “cleanly” (that is, with no Congressional add-ons to protect anyone except the major Bush Administration campaign contributors) by the Federal reserve “pumping credit” into the system by buying securities that have no market when “liquidity dries up.”

What is wrong with this picture? The reality is that there is much too *much* liquidity in the system. That is why the yield on U.S. Treasury bills has fallen to just 0.16 percent – just one sixth of one percent! This is what happens when there is a *flight to safety*. By liquid investors. Many of which are now fleeing abroad, as shown by the dollar’s 3% plunge against the euro yesterday (Monday, Sept. 22).

The question that the media avoid asking is what people are trying to be safe *from*? The answer should be obvious to anyone who has been reading about the junk mortgage problem. Investors – especially in Germany, whose banks have been badly burned – are seeking to be safe from fraud and misrepresentation. U.S. banks and firms have lost the trust of large institutional investors here and abroad, because of year after year of misrepresentation as to the quality of the mortgages and other debts they were selling. This is Enron-style accounting with an exclamation point – fraud on an unparalleled scale.

How many tears should we shed for the victims? The Wall Street firms and banks stuck with junk mortgages are in the position of fences who believed that they had bought bona fide stolen money (“fallen off a truck”) from a bank-robbing gang, only to find that the bills they bought are counterfeit – with their serial numbers registered with the T-men to make spending the loot difficult. Their problem now is how to get this junk off their hands. The answer is to strike a deal with the T-men themselves, who helped them rob the bank in the first place.

There is a long pedigree for this kind of behavior. And it always seems to involve a partnership between kleptocratic insiders and the Treasury. Today’s twist is that the banksters have lined up complicit accomplices from the accounting industry and bond-rating companies as well. The gang’s all here.

In view of the mass media these days calling Henry Paulson the most powerful Treasury Secretary since Alexander Hamilton, I think it is relevant to look at two leading acts of Mr. Hamilton that represent remarkable precursors of Mr. Paulson’s present \$800 billion “cash for trash” deal with the Bush Administration’s major Wall Street campaign

contributors.

The two most appropriate parallels are the government's redemption of "continentals" – paper money issued by the colonies during the Revolutionary War – and the Yazoo land grants. During the Revolution, states had issued paper currency to pay the troops and meet other basic expenses. These paper notes had depreciated, hence the term "not worth a continental" (not least because of large-scale counterfeiting by the British to cause economic disruption here). In the crisis, men with hard cash went around buying continentals at a great discount. In one of the most notorious and debated acts of the Constitutional Convention, the new United States Government redeemed this depreciated paper currency at par.

It was like the Treasury today buying junk mortgages at face value. But it is in the ensuing Yazoo scandal that we find a perfect combination of financial and real estate fraud on a magnitude that helped establish some of America's great founding fortunes, creating dynastic wealth that has survived down to the present day.

The Yazoo land fraud in Bourbon County, Georgia is one of the most notorious incidents of our early Republic. In January 1795 the state sold 35 million acres to four land companies for less than 1½¢ an acre. This was the result of bribery arranged by James Wilson – whom George Washington subsequently rewarded by naming him to the Supreme Court. (Moral: Crime pays.) To add insult to injury, the state was paid in depreciated currency, the "continentals." So great was the outcry that a new state legislature was elected, and revoked the sale in February 1796, accusing its beneficiaries of "improper influence."

But a month before this new legislature was convened, one of the companies (the Georgia Mississippi Land Company) sold over 10 million acres, nominally at 10¢ cents an acre, to the New England Mississippi Land Company, which was quickly organized for just this purpose by some eminent Bostonian speculators, headed by William Wetmore. Only part of the money actually was paid in cash, and the transaction was largely a paper one. The company quickly hired agents to begin selling shares to the public. Widespread speculation ensued in many states, each new investor becoming a partisan urging the national and state governments go along with the original fraud.

New fraudsters jumped on board. Patrick Henry ("Give me liberty, or give me death") headed up the Virginia Yazoo Company, which made a deal with Virginia Governor Telfair to buy twenty million acres of land at a penny an acre – paid for with the worthless continentals. The public was furious, but the "free marketers" of the day asked, what was wealth, anyway, but a reward for risk-taking.

After the Yazoo land was turned over to the federal government in 1803, a series of Congressional investigations reported that the Boston company actually had paid little if any of the purchase price. (This is now called debt leveraging.) But the company sued, and lobbied Congress for over a decade to get compensation for its paper losses – that is, its lost opportunity to profit from the transaction. In 1814, in the turbulent aftermath of the War of 1812, Congress passed an indemnification act compensating them and other Yazoo investors with \$8 million of public funds.[\[1\]](#)

This settlement helped establish a fateful legal precedent known as the doctrine of innocent purchasers possessing certain vested rights. The ruling was steered through the Supreme

Court by James Wilson, who in 1782 (along with Robert Morris as the bank's president, and Gouverneur Morris) had obtained from Pennsylvania's legislature a charter for the Bank of North America on terms similar to those of the Yazoo land claim.

As Charles Beard has pointed out in his classic *Economic Interpretation of the Constitution*, James Wilson, the two Morrises, and two other bank directors (Thomas Fitzsimmons and George Clymer) acted as delegates to the Constitutional Convention, where they shaped America's laws so as to facilitate their de-accessioning of public property and obtained special rights and charters for banks and other monopolies. (The word "privatization" would take nearly two centuries to enter the lexicon.) After the Bank of North America was so mismanaged that a money panic ensued, Pennsylvania revoked its charter. Wilson sued, arguing "that the original act was a grant of a VESTED RIGHT. That the charter could not be repealed without 'IMPAIRING VESTED RIGHTS, and the rights of innocent parties.' The legislature yielded, and in 1787 it reincorporated the bank. Thus originated the clause that Wilson had inserted in the present constitution forbidding any state to pass legislation impairing the obligation of a contract. And out of it has come Supreme Court decisions that have given this country the blackest record of validated land frauds and bribery known in history," for it blocked state legislatures and Congress from undoing the results of overt bribery. (The story is told in Thomas L. Brunk, *American Lordships, or A Brief Insight into the Suppressed History of Land Sharks and Their Control Over Government and Industry* (Sioux City, Iowa, 1927, p. 84).

The Supreme Court had ruled (in response to John Marshall's pleading the Fairfax land-fraud case in Virginia) that what mattered was not the methods used to obtain a grant or contract, but the fact that innocent purchasers would be injured by repealing such contracts once they had been entered into (Chandler 1945:74,390). Even outright frauds were held irrevocable by subsequent legislation, on the ground that once a business claim was sold to an innocent purchaser, undoing the deal would be unfair. The unwitting buyer would be left holding the proverbial bag. Myers (1936:217) finds this to be "the first of a long line of court decisions validating grants and franchises of all kinds secured by bribery and fraud."

The new doctrine provided a motive for privatizers to cash in quickly by selling out shares of fraudulent transactions to speculators and other buyers, who could then ask the state to "make them whole" for having injured them in revoking their wrongful purchase! Likewise today, polluters and real-estate holders are suing the government to be compensated for public laws that prevent them from making money by violating ecological and other real-estate regulations. Their demand is to be made whole for gains they allegedly would have been able to make had such public laws not been passed!

The "innocent purchaser" and "vested interest" doctrines made it hard to undo fraud, if only because the alternative was to restore the misappropriated asset from the stock-buying public to the state. The Supreme Court ruled it preferable to let the first thief legitimize his fraud, leaving the "innocent buyers" in possession of the stolen property. Possession became, *ipso facto*, nine-tenths of the law. The moral of this story was that once you obtain public assets, even through bribery, it is yours, at least if you make the transaction complicated enough and involve enough "innocent parties" to make any restoration of the *status quo ante* hopelessly complicated.

The Yazoo incident is only exceptional for its size and the fact that it became a precedent for future practices. In 1835 the Senate Committee on Lands reported: "The first step necessary to the success of every scheme of speculation in the public lands, is to corrupt

the land officers, by a secret understanding between the parties that they are to receive a certain portion of the profits.”[\[2\]](#)

Sixty years later, in 1895, Iowa’s Governor William Larrabee wrote on how the system had been perfected (largely by the railroad robber barons): “Outright bribery is probably the means least often employed by corporations to carry their measures. ... It is the policy of the political corruption committees of corporations to ascertain the weakness and wants of every man whose services they are likely to need, and to attack him, if his surrender should be essential to their victory, at his weakest point. Men with political ambition are encouraged to aspire to preferment, and are assured of corporate support to bring it about. Briefless lawyers are promised corporate business or salaried attorneyships. Those in financial straits are accommodated with loans. Vain men are flattered and given newspaper notoriety. Others are given passes for their families and their friends. Shippers are given advantage in rates over their competitors. The idea is that every legislator shall receive for his vote and influence some compensation which combines the maximum of desirability to him with the minimum of violence to his self-respect. ... The lobby which represents the railroad companies at legislative sessions is usually the largest, the most sagacious and the most unscrupulous of all. ... Telegrams pour in upon the unsuspecting members. ... Another powerful reinforcement of the railroad lobby is not infrequently a subsidized press and its correspondents.”

Gustavus Myers’ *History of the Great American Fortunes* (1936, pp. 218ff.) gives the details of this and other frauds that have shaped American history. The moral is that great gifts to insiders have effects that will last centuries. That is what is being threatened today with Mr. Paulson’s “clean” giveaway to his Wall Street clients.

The moral is that there is a great danger in having a Treasury Secretary represent insider financial interests rather than the national interest.

## NOTES

[\[1\]](#) Myers *History of the Great American Fortunes* (New York 1936):216ff. and 1912:181-84, 258-64, Brunk 1927:147f., and Chandler 1945:388f., drawing on *Senate Docs.*, 18th Cong., 2nd Sess., Vol. II, Doc. No. 14, and *Sen. Docs.*, 24th Cong., 1836-37, Vol. II, Doc. No. 212, and *Wheaton’s Reports*, Supreme Court, IV, 255). See also Albert James Pickett, *History of Alabama (to 1851)*, (Sheffield: 1896).

[\[2\]](#) *Senate Docs.*, 23rd Cong., 2nd Sess. IV, Doc. No. 151 (March 3, 1835), cited in Myers 1936:218.

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