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Money Isn't a Gift from the State

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August 27, 2017

I've begun working on a new book on the gold standard. In the first chapter I plan to discuss the origin of money, as a preliminary to discussing how silver and gold became the world's dominant commodity monies.

Money is a market-born institution.

The topic of the origin of money has become controversial in recent years. The dominant view among economists (for good reason), suggested by Adam Smith in the eighteenth century and fleshed out by Carl Menger in the nineteenth, is that money is a market-born institution.

Convergence on one or two commodities as the common media of payment emerged from the actions of barterers seeking more effective trading strategies, without anyone aiming at the final result. But this view has lately been challenged by a resurgence of the "state theory of money," also known as Cartalism, which argues that governments played an essential role in the establishment of money.

Money's Origins: A Cartalist View

Cartalists have made the valid point that extensive specialization in production could not have preceded the development of commonly accepted media of exchange; rather, greater specialization and wider acceptance of media of exchange must have developed together.

But this is a useful expositional caveat rather than a refutation of the Mengerian theory. While a lecturer spelling out the Mengerian theory (and I have done this myself) may ask the listener to imagine a highly specialized producer (say, an asparagus farmer) entering a moneyless market and meeting frustration in attempts to trade directly (say, for a plaid shirt) in order to dramatize the difficulty of direct barter, this should not be taken to suggest that, as a historical matter, societies developed extensive specialization and trade before the emergence of money.

"State acceptation delimits the monetary system."

Indeed, because it starts from the premise that finding a well-matched trading partner (who "has what you want and wants what you have") is very difficult, Menger's theory implies the opposite. As Adam Smith himself emphasized, the division of labor is limited by the extent of the market, and the extent of the market is limited by the ease of trade.

The classic source of the Cartalist view is *The State Theory of Money* (1924) by the German economist George Friedrich Knapp. Knapp's rejection of a market evolutionary account, it appears on close inspection, is more a matter of wordplay than of substance. Rather than regarding "money" in the conventional way as any medium of exchange commonly accepted in the market, and so viewing the explanatory challenge as how to account for a particular commodity coming to play that role, Knapp focuses his attention on what he calls public money.

The test of a public money, in his words, is that “the money is accepted in payments made to the State’s offices,” namely in tax collections. Knapp (1924, p. 95) declares:

“State acceptation delimits the monetary system.”

A market process cannot endow a payment medium with state acceptance; only the sovereign state can do that. Mengerians would reply: True enough, but this does nothing to contradict Menger’s logical evolutionary account of how a commonly accepted means of payment arises without state action.

The anti-Mengerians, in the words of sympathetic economist Charles Goodhart, “are those who argue that the use of currency was based essentially on the power of the issuing authority (Cartalists) — i.e., that currency becomes money primarily because the coins or monetary instruments more widely are struck with the insignia of sovereignty.”

Precious metals have a number of properties that make them superior media of exchange.

The claim that state power or sovereignty is essential or primary for any currency to become a commonly accepted medium of exchange, however, is plainly at odds with the historical fact that privately issued banknotes without sovereign backing were the dominant media of exchange in the eighteenth and nineteenth centuries where they were allowed. And with the fact that privately minted silver and gold coins were widely accepted when and where they were allowed (which was much rarer), as in gold-rush California.

While Knapp (1924, p. 134) recognized the fact of the widespread use of private banknotes, he simply classified them — by definition — as outside the system of public money. A note-issuing private bank and its customers “form, so to speak, a private pay community; the public pay community is the State.”

Why Precious Metals?

Turning from the question of origins to the question of why silver and gold became the most popular commodity monies, out of a large set of contenders that included salt, cowrie shells, and oxen, one naturally wonders what the Cartalists have to say on the second question. The answer turns out to be: nothing helpful.

Menger’s approach lends itself to a decentralized account of why silver and gold emerged as the most commonly accepted, pushing other candidates to the margins. Put yourself in the position of a trader in a market where there are a variety of commodity exchange media (the market has not yet converged). You sell your produce for a physical payment medium which you then carry around with you until you spend it away in purchases.

In this situation, it pays you not only to consider which media are most popular with other traders, but also which media involve the least cost or hassle in acquiring, carrying to the next transaction, and trading away.

As textbooks during the nineteenth century emphasized, the precious metals have a number of properties that make them superior media of exchange in such a setting. Compared to other commodities, silver and gold score high on (1) portability or preciousness, allowing you to carry around high purchasing power with little bulk; (2) durability, not spoiling between the date of acquisition and a later date of spending; (3) divisible and fusible, like any metal, allowing pieces

to be made in a range of sizes to suit a range of transactions, and allowing small change to be given; (4) stable in value across the seasons, unlike foodstuffs that are cheap right after the harvest but dear six months later. These properties enhance their widespread acceptance.

An important technical advance came with the introduction and spread of coinage in Turkey and Greece during the 7th to 5th centuries BCE. Unlike raw nuggets straight from the mine or variously refined precious-metal bars, coined pieces of silver and gold gained a major additional advantage: they became (5) uniform in size and quality, so that traders need not incur the cost of testing (or the risk of not testing) each piece for its weight and its fineness (percentage of pure silver or gold content). Early coining entrepreneurs could have profited, as later mint masters in California did, by charging for the service of converting raw silver or gold into easier-to-spend uniform coins.

With the spread of coinage to India, the Middle East, and Europe, merchants found silver and gold payments easier to make and to accept. The use of bulky commodity monies like shells and salt dwindled. Market convergence on the precious metals in coined form reflected a "survival of the fittest," namely of the most convenient media for hand-to-hand exchange.

The Cartalist approach, by contrast, doesn't provide a distinct theory as to how silver and gold came to dominate other commodity monies. In the Cartalist view the sovereigns of various lands must have chosen to preferentially accept silver and gold, of course, but why? It seems reasonable to suppose that sovereigns made the choice because they, like other transactors, were aware that coined pieces of silver and gold score high on the five useful properties listed above. If so, then sovereigns did not alter but merely reinforced the market process already underway.

Leading Cartalists have made other suggestions, however. Anthropologist David Graeber, author of Debt: The First 5000 Years, states in an interview that:

… coinage seems to be invented or at least widely popularized to pay soldiers — more or less simultaneously in China, India, and the Mediterranean, where governments find the easiest way to provision the troops is to issue them standard-issue bits of gold or silver and then demand everyone else in the kingdom give them one of those coins back again."

The economist L. Randall Wray (2000, p. 46) likewise states, "Coins appear to have originated as government 'pay tokens' (in Knapp's colourful phrase), as nothing more than evidence of debt." Silver and gold coins, in other words, should be understood as state-issued tax-anticipation tokens, their value resting on a state-imposed obligation to pay them back.

This account fails to explain, however, why governments chose bits of gold or silver as the material for these tokens, rather than something cheaper, say bits of iron or copper or paper impressed with sovereign emblems. In the market-evolutionary account, preciousness is advantageous in a medium of exchange by lowering the costs of transporting any given value.

In a Cartalist pay-token account, preciousness is disadvantageous — it raises the costs of the fiscal operation — and therefore baffling. Issuing tokens made of something cheaper would accomplish the same end at lower cost to the sovereign. (By the way, note also Graeber's equivocation "invented or." Proposing that governments enlarged the acceptance of coins, after the market economy had already begun using them, is categorically different from proposing that governments invented coinage. Menger himself had no problem with the former proposition, but he rejected the latter as an unfounded prejudice.)

Wray offers in passing (p. 46) the conjecture that kings likely minted coins “in the form of precious metal to reduce counterfeiting.” But a sovereign imprint on silver or gold coins is not in any obvious way harder to counterfeit than the same imprint on iron or copper coins. So the bafflement remains.

The notion that full-weight silver and gold coins are mere tokens, deriving their value from the future tax liabilities they discharge, is in clear conflict with the historical experience that large-value silver and gold coins issued by (say) the Spanish national mint circulated well outside the set of Spanish taxpayers. (Small-value silver coins, which sovereigns debased and did treat as overvalued tokens, were another and more Cartalist story.)

Large-value coins were used as media of exchange among participants in an international trade network that operated beyond any one nation’s boundaries. They were valued by holders who had no tax obligations to the state of the issuing mint. In the international market, coins issued by various national mints were valued against one another in proportion to their precious metal content, not in proportion to the nominal values at which national tax offices accepted them, where the two values differed. These facts indicate a market source of the moneyness of large-value silver and gold coins, not a tax-acceptance source.

Wray denies that coins were valued according to their precious metal content, as it conflicts with his maintained view that even full-weight precious metal coins were merely tokens. He even denies (p. 47), rather surprisingly, that kings debased their coins, i.e. reduced their precious metallic content below the standard, since “it would make no sense” when they are mere tax-discharging tokens to begin with. The histories of state-issued Roman and medieval silver coins, however, shows repeated debasements.

Once sovereigns monopolized the mints they took advantage of the propaganda value of stamping their own faces on the coins, of course. But as far as we know coins were already in use among merchants before that happened. Very early coins from ancient Lydia, in what is now Turkey, were not inscribed with human faces but rather animal figures.

The Ancient History Encyclopedia states:

It appears that many early Lydian coins were minted by merchants as tokens to be used in trade transactions. The Lydian state also minted coins."

Regarding Lydian coins inscribed with the names Walwel and Kalil, the British Museum comments:

It is unclear whether these are names of kings or just rich men who produced the earliest coins.” Regarding a nearly contemporary ancient Greek coin bearing the legend “I am the badge of Phanes.”

The Museum comments:

We cannot be certain who this Phanes was, but it seems that he was placing his badge on coins as a guarantee of their quality.”

It is possible, of course, that in surveying the literature I have overlooked a more plausible Cartalist account of why sovereigns chose very expensive materials, silver and gold, for their tax-anticipation *tokens. If anyone can point me to such an account, I would be grateful.*

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