The Origin of Money – 4000 B.C. - 1700 A.D.

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Forerunners of man lived upon the planet several million years ago. But the unique social order of man – civilization – emerged only four to five thousand years ago. Historical and archaeological evidence suggests that the institution of money evolved coterminously with civilization among all the institutions of life on earth; therefore, civilization and money are but young and fragile reeds. Their growth and development occurred only recently and today their very existence is threatened with extinction. But modern civilization is unthinkable without money as even a moment's reflection suggests. Why is this so? What accounts for the appearance of money in the civilized affairs of men? In fact, what is money?

The economist defines money as a medium of exchange. It is the token we supply in order to effect payments for the goods we demand. Money is also a standard, a unit of measure, by which we value economic goods. Money units express prices which are the vital information necessary for efficient exchange. Other experts describe money as a store of value. Many different forms of money have been selected in the market order to serve the practical purposes of working people. True money is more or less a permanent receptacle in which we save part of the value of our labor for future contingencies. The money of history is no ivory tower abstraction. In fact, it was a real article of wealth until recently. All monies are, but convenient and desirable substitutes for all the wealth we produce. It is the superior marketability of money over other forms of wealth which makes it generally acceptable in exchange for other real goods and services.

It seems that money evolved through a historical process unlike that of trial-and-error or natural selection. But money as we know it, standardized and certified coins, originated as an act of human creativity around 700 B.C. in the cradle of civilization – the Near East. Throughout history many crude forms of money were tried and discarded. Each form of money had to meet the test of acceptability established by working people – because it was they to whom money was supplied in return for the product of their labor. Seeking ever more marketable and efficient articles with which to transact business efficiently, the merchants, farmers, and workers of different cultures attempted to advance beyond the commerce of barter and potlatch by means of different early currencies – cattle, iron, and in the 7th Century B.C., gold and silver coins. Over time freely acceptable, widely circulated, stable forms of money did evolve – and some of these early monetary tokens, i.e., coins, survive unto this very day.

In a word, money is a commercial and political institution of the market with a long history. Like the wheel, money is an invention of civilized man. But as some forms of the wheel have worked better than others, so is it with money. Not all forms of money are equally acceptable to free

men. Nor do all wheels rotate evenly. Like a wheel without its spokes, money without real substance tends to break down. As with all breakdowns, disorder follows. The breakdown of money is associated with the depreciation of its value, or the decline in its purchasing power. This social disorder goes by the name of inflation. Ours is an era where in the monetary institutions have broken down. Historians will recall our times as the age of inflation. Instead, inflation is a monetary breakdown, a decline in its value. Inflation means the destruction, or the overturning, of an essential instrument of the market place, the political institution of stable money. The endurance of civilization is linked to this institution. When an overturning of stable political institutions occurs, it is called revolution. Inflation is a price revolution. It often precedes a more thoroughgoing political revolution. Inflation prevails in America and the world today because of a breakdown in the trust that men once had in the dollar. Working people no longer gladly accept and hold the dollar. They try to get rid of it for something real such as a house, a car, antiques, or coins – almost anything real and lasting. Producers and consumers have lost faith and trust in the dollar because the U.S. government and the Federal Reserve System have created more dollars than Americans desire to hold. Excess dollars have been created because the government has overproduced paper and credit in order to pay for its colossal deficits and also in order to manipulate the economy, prices, demand, and employment levels. As a result, the paper dollar has ceased to be real money. Ultimately, paper money is neither an article of wealth nor is it linked permanently to anything of real value.

It may be worth a moment to reflect upon this view in order to determine its merit. We know from history that civilization advanced beyond the primitive conditions of a barter economy by means of commodity money. Commodity money requires human effort to be produced – copper, gold, silver, wampum. A barter economy consists in the moneyless exchange of one man's goods for the goods of another. The transition from a barter economy to a money economy was the first and most important commercial revolution. Instead of each family storing varied goods – such as wheat and wood to exchange directly for the goods of others – cows, tools, and coal – civilized man gradually learned to substitute an indirect, more economical means of exchange. Over a long period, working men and women invented money – simple, convenient tokens – which they labored to produce or obtain in order to exchange them for the goods they desired. To supply money for goods and goods for money indirect exchange, is the hallmark of commercial civilization.

It may be that the long historical transition from the barter, economy was marked by many different forms of indirect premonetary commerce, such as potlatching and other primitive forms of investment and risk-sharing. Potlatching means to give a gift with the hope but not the certainty of a return. Potlatching is superior to barter because barter cannot always work. For example, what I produce may not be desired by the person to whom I try to barter it. Indeed, such a person may supply me in exchange with a product which I do not desire. Thus, to potlatch, to "give" my supply of goods to others, hoping that later they would reciprocate,

actually advances the social order beyond inelastic direct barter. Everyone continues to produce without an immediately satisfying barter. Potlatching overcomes the rigidity of barter and tends to encourage indirectly the unconditional production of wealth. Production in a potlatching community goes on as if all members freely invest goods in one another, receiving in exchange unwritten "promissory notes", which are the implied liabilities of their grateful fellows. These implicit liabilities form the invisible currency, the money, of a community of unconditioned producers. These claims of the producers, the circulatory system of commerce, are redeemed by gifts of goods from the debtors in the future. Thus, the recipients of gifts make good on the essential faith and trust entrusted to them by the giver. The counterpart of the gift – the liability of the receiver somehow to repay the producer – is repaid in kind with interest. As George Gilder puts it, this productive circle of givers, or investors, increases the sympathy of its members for the special needs of one another. Potlatch amplifies barter, making it more efficient by the currency of faith. Barter and potlatch are way stations of exchange on the road to commercial civilization.

Civilization is characterized by a monetary economy. A monetary economy is one in which indirect exchange dominated. The institution of money separates into two transactions the primitive single transaction of bartering goods directly in exchange for other goods. In the market economy, men make demands with money in exchange for a supply of goods. The supplier is primary. The demander is contingent. Settlement takes place only because the supplier of goods is willing to accept the money as a substitute for goods. The supplier of goods can hold it, the money, or he can in turn make a demand with the monetary token for goods. In this process of indirect exchange, a fundamental purpose of money is to economize scarce resources. It reduces the working capital otherwise invested by the producer in a wide array of goods for which money is an acceptable substitute. Money diminishes the storage space required for large and varied inventories held perforce by each family in a barter economy. Real money also reduces the inherent risk of other forms of indirect exchange such as potlatching, which depend upon an implied currency of invisible debt. These invisible claims were replaced by the diffusion of dependable coin or currency, riskless firm monetary claims. Coin permeated the "overcapitalized", inefficient, barter economy and induced a mutation in the scale and character of economic institutions of pre-commercial civilization. Along with the wheel many joined parochial communities to one another enlarging the fellowship of production. In a mere four thousand years money transformed the closed economy of the tribe into the open and integrated economy of the whole world.

As with all human inventions, civilization increasingly improved upon its money. Ancient merchants found in money, above all, an article of wealth, universally acceptable storage and in exchange for which they could obtain from farmers and artisans the products of painstaking labor. Working people had good reason to accept good money. Farmers and artisans often did not want the goods in the neighborhood which others wished to exchange. Sometimes the

producers did not even know exactly what they wanted in exchange for their goods – after their basic, life-giving needs were satisfied. At other times suppliers wished to sell the products of their labor but had no desire at all to purchase any other goods right away. They desired to defer repurchases; that is, perhaps unconsciously at first, they decided to save the product value of their effort and intelligence. By means of money they realized that they could produce, exchange, and save efficiently and reliably; because real money, hard coin, was one of the most marketable, valuable, and lasting articles of wealth on the market. Working people understood metallic currency. Coined wealth was stored labor. Money also enabled workers to wait before buying. Money was a concrete symbol of work with an irrevocable right to future work products. It enhanced their options, their freedom to provide for themselves as they pleased, and to lay up for their children in the future. Good money could be inherited and passed on. Money was a sacred link between work, family, past and future. It was no less than the life blood of an enduring culture. Thus money became the hemoglobin of commercial civilization.

Not every article of wealth could qualify as money. The necessary and enduring properties of real money emerged only gradually in history. Certainly, no economists created it according to an abstract design. In fact, true money evolved with the dynamic advance of social order. The first standardized and certified coins appeared in Lydia, Asia Minor, around 650 B.C. The Lydians discovered and used a natural mixture of gold and silver, called electrum. In this coin, as we shall see, centuries of commercial evolution and experimentation had bequeathed an equitable and efficient form of money. Lydian coins exhibited specific properties, uniquely suitable to perform the functions of money. They were small and made of scarce commodities; men exerted great effort and intelligence to produce them. Thus these primitive coins were very valuable to all who produced and desired them. As a store of value, they were solid and enduring. As a medium of exchange, these coins were convenient, compact, and universally acceptable. More of this kind of money could only be produced, over time, by the steady application of reasonably stable quantity of capital and labor. Thus, the coins were a useful measuring rod by which to meter out the value, or the price, of the other products of human intelligence and labor. No one from the local "Bureau of Engraving" inaugurated such a coin from purely abstract considerations. Nor was it foisted upon civilization. It was not a forced currency. Instead, after centuries of experimentation and innovation, traders and customers came freely to select these coins for their intrinsic properties which they maintained over long periods of time.

Merchants and artisans perceived that precious metal coins were easily handled. They were also divisible, immutable, storable, attractive, and easily exchanged among the merchants of many tongues in the Levant. Also, the test of time had proved their worth as a market institution and enhanced their marketability. Because of the enormous labor and time invested to discover and produce them, they were prized and very valuable to all. The high value of these coins, relative to their small size and light weight, made them easily tradable for large

quantities of other goods. The high value-to-weight ratio also made them an ideal means of saving the value of one's work and invention. Enterprising producers withdrew some of their working capital from costly warehouses and concentrated its amorphous value in secure coin. History showed that the value of these coins endured. In a very uncertain and risky world, merchants discovered that their purchasing power remained reasonably stable from year to year and generation to generation. Moreover, with money coins, real wealth could be stored in very little space, whereas to save other forms of real wealth required big buildings and elaborate security arrangements. But the simplest explanation for the universal acceptability of money coins by uneducated artisans lies elsewhere. Plain working people could intuitively and directly compare the production value of their own effort to the value of the effort of those who had produced the lasting money which they and their parents desired to hold for future contingencies.

Money continued to evolve and change its form as commercial civilization gradually engirdled the earth. During the modern era, merchants and bankers learned to substitute inexpensive and easily handled paper for coin. At first paper money consisted of bank notes or bill often-change, convertible or exchangeable at a constant rate into a weight of gold and silver. The monetary token had become more abstract. A certified piece of paper came to represent contractually, a certain quantity of real money – coin or bullion. The paper was suffused by means of convertibility with a monetary life of its own. It circulated in place of coins and bullion because it was even more convenient, divisible, and easily secured. Moreover, convertible paper currencies conserved still further the scarce mineral resources previously invested in the production [17th century – silversmiths and goldsmiths – fractional reserve – Bill of exchange – security liabilities of short maturity – real bills banking was the merger of the two] and circulation of precious bullion or money coins. One can see in the evolution of this commercial institution that money served as the great conservator of a civilization born of scarcity.

Double entry bookkeeping developed in 14th century Italy, whence the simplified ledger accounting basis for the development of a "fractional" reserve banking system emerged. In such a banking system a new kind of "abstract" money developed, called book entry bank deposits, credit money, or checking accounts, sight liabilities, or demand deposits. The banks held bullion or coin reserves against this new credit money. The reserves were equal to a "fraction" of the total monetary circulation, hence the phrase fractional reserve banking system. But, even so, the value of the new monetary symbols, the check and transferable deposit, were upheld in the same manner as the value of paper currency. Evolving as they did in the 17th and 18th century, bank deposits or credit money were convertible into a fixed weight unit of the original coin or bullion money they represented. The coin and bullion, held by the banks in reserve, were surely for what were essentially warehouse receipts for deposits of real money – gold and silver. European goldsmiths and silversmiths of the 17th century were in part the forerunners of modern commercial bankers, just as producers, merchants, and shippers at

about the same time elaborated more fully the medical practice of trading on credit. Commercial banking joined these two trade – gold and silver deposit banking and credit bills – practices in an organic fusion which confuses to this very day the concepts of credit and money. By the 17th century goldsmiths had discovered that all those who deposited gold money for safekeeping, for a fee, did not need their gold at once. Deposit receipts for the gold could be presented on demand (hence demand deposits) to reclaim the gold on deposit – but it never occurred that all deposits did so simultaneously. Goldsmiths developed the practice of lending at interest a portion of the money (gold bullion and coin) to others for short terms, hold always in reserve (hence fractional reserves) only a portion of the money on deposit in order to redeem that regular percentage of claims (deposit receipts) presented for redemption in coin or bullion. Over time these fledgling bankers learned that a regular percentage of depositors made their claim daily – except during periods of financial panic and war. Rules of thumb developed from this experience and thus bankers came to believe that about 10% of deposits should be held on reserve to meet the depositors' demand for cash. But this rule of thumb was no more than the distillation of historic wisdom about the recurrence of claims by 10% of coin and bullions depositors on any one day.

Commercial banking also traces its development to the early institutions of credit. Trading on credit is an ancient practice, but early modern Europe developed the institutions of credit to the point we know them today. The essential instrument of credit arose because the entrepreneur often did not have the cash, coin or bullion, to pay for the desired invention of production. But he did have a creditworthy reputation and the goods he needed, say cloth or metals for a productive process, were visible security for a loan. Thus the suppliers of cloth would ship his goods to a textile maker, who could not pay cash, along with a bill of exchange, a trade bill of credit. The bill always accompanied the goods. Upon arrival, the textile maker received the goods, checked the invoice, signed the bill of exchange, returned the bill with security documents to the shipper (the cotton producer or merchant), the security documents provided that the cloth was pledged to the shipper until the textile maker completed the process of production, generally in 90 days, sold the processed goods for cash and therewith remitted payment to the shipper, whereupon the bill of change was required and cancelled. Note that the bill of exchange, a liability of the textile producer, was a form of currency, set by both the supplier and producer in place of scarce cash (coin). It entailed a credit risk, like potlatching, but much less so, since the sale of goods for the bill was secured by the goods themselves.

In a way such an exchange of goods for bills of exchange, secured by the same goods, may even be considered a sort of barter – the cloth for the signed bill of exchange secured by the processed cloth.

Banking in the 17th century merged the function of the goldsmith, who accepted gold and silver on deposit, with the function of the merchant who extended credit through bills of exchange. The 17th century banker accepted not only money i.e., coin and bullion, against the issuance of deposits, but he accepted bills of exchange from merchants and producers against the issuance of deposits and bank notes. Thus all suppliers were unable to receive cash for their sales if they did not desire to hold the credit bills of the buyers until maturity. Commercial banking grew out of the need for financial elasticity in the commercial process of exchange. That is, all producers who desired real money, instead of the short-term promissory notes of their customers (the buyers), could, through the mediating of goldsmiths and bill-merchants turned bankers, obtain the money by discounting the bills at the bank.