<u>Evolution of Money (2/1/2011)</u> Econ 310-008

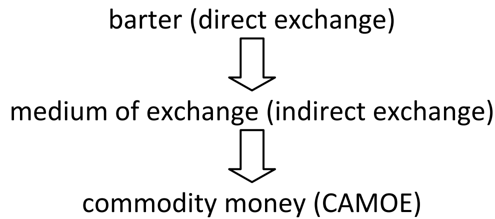
<u>Definitions</u>

- ***invisible hand*** (Smith) – self-interest drives actors to socially beneficial behavior
- ***spontaneous order*** (Hayek) – coordination that results from human interaction, but no conscious design
- ***degree of marketability*** – more highly marketable goods are easier to sell for a "good price" (best price with full information)
- ***network effect*** – the value of a good increases the more people use it
- ***uniform*** – purity can be tested at low cost (biting, sounding, or assaying)
- ***assay*** – chemically test the quality of metals
- ***durable*** – no extra carrying cost due to spoilage
- ***divisible*** (and fusible) – payment can be tailored to purchase size
- ***portable*** – high ratios of value to bulk
- ***stable value*** – not subject to seasonal variations
- ***coinage*** – the process of fashioning monetary metal into standardized marked discs
- ***seigiorage*** – profit that results from producing coins (difference between face value and metal value)
- ***outside money*** – full-bodied coins and other full-bodied commodity money (asset for holder, not a liability for someone else)
- ***inside money*** – bank issued money (asset for holder, a liability for issuing bank)
- ***banknote*** – bank-issued claims to outside money not in any customer's name, but redeemable to the bearer
- ***par*** – full value (no discount)
- ***public receivability*** – government accepts fiat money for tax payments
- ***legal tender*** – court forces acceptance of fiat money for debt repayment
- ***forced tender*** – government forces use of fiat money for spot transactions

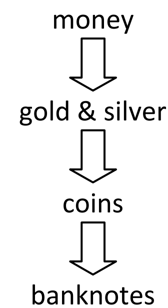
<u>Principles</u>

- Carl Menger theorized that money came about through evolution from barter – aka, through the "invisible hand" (Adam Smith) or spontaneous order (F.A. Hayek).
- Traders carry an inventory of various media of exchange, preferring the most marketable commodities.
- Most civilizations converged to gold and/or silver.
- When traders from two regions with different commodity monies came into contact, the better of the two monies spread to the other region.
- Coins first appeared in ancient Lydia (Turkey) and China.
- The earliest coins were punched, later coins were stamped, finally coins were minted.
- Merchants would mark a piece of assessed gold to avoid the cost of re-assessing upon payout.
- Private mints were common around gold and silver mines.
- Marketability of coins was discontinuously greater than marketability of unminted gold.
- Marketability of money was discontinuously greater than that of other commodities.
- Banks began as money changers in medieval Italy.
- At first people wheeled money back and forth from the bank to make transactions. Then they would meet at the bank to make transactions. Next checks were used drawing on customer accounts. Finally banknotes redeemable on demad were innovated.
- Widespread use of banknotes preceded widespread use of checks.
- Note-porters for banks began with unilateral redemption. Then they would meet in the middle conducting bilateral clearing. Clearinghouse associations (CHAs) were invented for multilateral clearing.
- There is no market path to fiat money.
- F.D.R. left domestic gold standard in 1933. Nixon left international gold standard in 1971.

Mengerian Evolution



Neo-Mengerian Evolution



Spontaneous order examples

- money
- language
- Darwinian evolution

Par acceptance of banknotes

- banks as note-changers
- note deuling
- mutual par acceptance pacts

Characteristics of good money

- uniform
- durable
- divisible
- portable
- stable value

Public acceptance of fiat money

- Familiarity/Inertia
- Public Receivability
- Legal Tender
- Forced Tender

Justifications for mint monopoly

- seigniorage
- propaganda
- ending debasement

Typical path to fiat money

1. government gives a monopoly on note issue to a single institution
2. its liabilities become widely accepted
3. government suspends redemption permanently