

The History and Evolution of Money

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In the beginning there was BARTER

- ❑ Barter is the exchange of a good or service for another good or service.
- ❑ Barter requires a “double coincidence of wants” for a transaction to take place.
- ❑ A barter economy has fewer exchanges, exchanges that are made are more time consuming, and less specialization is possible.
- ❑ The frustrations associated with barter led people to create **MONEY**.

Money



- Over time many different items have served as money.
- To serve as money an item must be SCARCE.
- In addition, it must be:
 - Portable
 - Durable
 - Divisible
 - Familiar (Uniform)
 - Acceptable
 - Stable in Value

Origin of the Word

- Money comes from the Latin word “moneta.”
- Juno (Hera) Moneta was the deity that protected and oversaw finances in the early days of Rome.
- Mythology tells us that Zeus punished Hera by tying her between the earth and sky with a golden chain. Hera broke the chain and all the gold found on earth originates from fragments of that chain which fell from the sky and became human’s mone (money).

The Three Functions of Money

- ❑ **Medium of Exchange** – acts as a go-between to make it easier to buy and sell goods and services or pay debts. Allows buyers and sellers to avoid the difficulties associated with barter exchanges.
- ❑ **Store of Value** – allows people to transfer the purchasing power of their present money income or wealth into the future, ideally without a loss of value.
- ❑ **Unit of Account** – serves as a way to measure and compare the value of goods and services in relation to one another. It also allows people to keep accurate financial records.

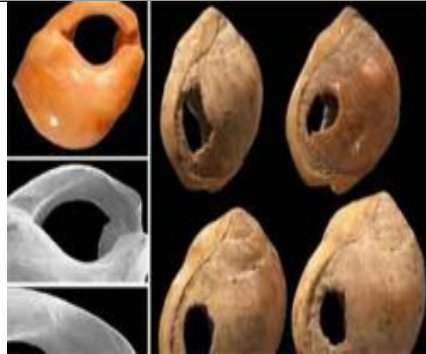
Early Forms of Money



- ❑ Some argue that Livestock (anything from cows to sheep) were the first and oldest form of money
- ❑ The use of cattle in exchange can be traced back as far as 9000-6000 BC

Early Forms of Money

- ❑ Other historians argue that shells (particularly Cowrie Shells) are the earliest form of money.
- ❑ Cowrie shells being used as money can be traced to China in 1200 BC.



Cowrie Shells

- ❑ There are indications that the use of shell jewelry in the form of strung beads may date all the way back to 100,000 BC.
- ❑ While this is impossible to prove, we know that jewelry has long been used to store and display wealth.
- ❑ We can trace shells being used as currency into the middle of the 20th century in Africa, making shells the most widely and longest used money.

Commodity Money

- Many early forms of money were items which were useful in their intrinsic value as well as their monetary properties.
- These are known as commodity money and include:
 - iron nails (in Scotland)
 - Pigs
 - Whale's teeth
 - Bread (in Medieval Iraq)
 - Spices

Salt and Spices

- From about 550 BC, accepting salt was synonymous with being paid. This was the origin of the term SALARY.
- Pepper also served as commodity money beginning a few hundred years BC.
 - In 408 AD, Alaric I demanded 3,000 pounds of pepper as ransom for Rome
 - "As dear as pepper" is a French saying
 - In England, a minimal rent is referred to as "peppercorn rent."

Commodity Money



- An Okpoho manilla (or bracelet) was an early form of money in Nigeria.

Commodity Money

- The Katanga Cross was an archaic form of money from West Africa.



Limestone “Coins”

- On the Micronesian Island of Yap, huge limestone rocks were formed into coins.
- Some of these coins were 9-12 feet in diameter and weighed several tons.
- Because of the size, the large stones were often placed outside the owner’s house as a status symbol.
- Because they were so heavy, promises of ownership were traded instead of actually moving the coin.
- This is actually an early move to “representative money.”



The First Metal Coins

- Bronze and copper replicas of shells were manufactured in China by the end of the Stone Age and the Lydians (modern Turkey) coined gold and silver around 560 BC.
- These could be considered the earliest form of metal coins.



Metal Coins

- ❑ Soft metals like gold and silver were problems because they suffered wear and deformation in daily use.
- ❑ Fortunately, they were easily alloyed to cheaper metals to improve durability.
- ❑ The purity of soft metals could be determined by using a touchstone, but it required several steps and mathematical calculations.
- ❑ Standard coinage was introduced to simplify the process.

Standard Coinage

- ❑ As part of the standardization process, coins were pre-weighed and pre-alloyed.
- ❑ As long as the manufacturer knew the origin of the coin, no touchstone was required.
- ❑ To protect the process, governments began to stamp the coins with an emblem that guaranteed the weight and value of the coin.

Issues with Metal Coins

- ❑ While metal based coins had the advantage of carrying the value within the coin itself, it also encouraged manipulations.
- ❑ Clipping of coins to recycle the precious metal became a problem.
- ❑ Governments began to assert that the value of the currency was in the emblem and debased the currency by lowering the precious metal content.
- ❑ The simultaneous existence of gold, silver and copper coins in Europe resulted in traders valuing gold coins more than silver coins and distorting their relative value.

The Move to Representative Money

- ❑ The system of commodity money evolved into a system of representative money.
- ❑ It really began with banks issuing paper receipts to depositors indicating that the receipt was redeemable for the precious goods being stored.
- ❑ Soon the receipts were traded as money because everyone accepted them as being “as good as gold.”

Impact of Representative Money

- Representative paper money made the practice of fractional reserve banking possible.
- Bankers were able to print receipts above and beyond the actual amount of precious metal on deposit.

Paper Currency

- The first paper banknotes appeared in China in 806 AD.
- Paper money was used in China from the ninth through the fifteenth centuries.
- The use of paper money stopped in 1455 because overproduction of paper notes led to high inflation.



The Gold Standard



- While the move to representative money provided a sense that money was backed by gold, it was not official.
- Gold was officially made the standard of value in England in 1816.
- Banknotes had been used in Europe for several hundred years, but their worth had never been directly tied to gold.

The Gold Standard in the U.S.

- In the U.S., the Gold Standard Act was officially passed in 1900. It helped lead the way to the establishment of a central bank.
- The system struggled through a depression and two world wars before finally being disbanded in the 1970s.



Fiat Money

- ❑ The next major breakthrough was the introduction of Fiat Money.
- ❑ This was money that was not backed by reserves of another commodity.
- ❑ The money is given value by government fiat (Latin for “let it be done”) or decree.
- ❑ The introduction is accompanied by **legal tender laws**, whereby debtors are legally relieved of the debt if they offer to pay off the debt using the government’s money.
- ❑ The refusal to accept this form of payment is illegal and at different times in history even invoked the death penalty (ancient Rome, post-revolutionary France).

Paper Money in the U.S. (1700s)

- ❑ *1690* - The Massachusetts Bay Colony issued the first paper money in the colonies which would later form the United States.
- ❑ *1775* - American colonists issued paper currency for the Continental Congress to finance the Revolutionary War. The notes were backed by the "anticipation" of tax revenues. Without solid backing and easily counterfeited, the notes quickly became devalued, giving rise to the phrase "not worth a continental."
- ❑ *1781* - To support the Revolutionary War, the Continental Congress chartered the Bank of North America in Philadelphia as the nation's first "real" bank.
- ❑ *1791* - After adoption of the Constitution in 1789, Congress chartered the first Bank of the United States until 1811 and authorized it to issue paper bank notes to eliminate confusion and simplify trade. The bank served as the U.S. Treasury's fiscal agent, thus performing the first central bank functions.

Paper Money in the U.S. (1800s)

- ❑ *1861* - On the brink of bankruptcy and pressed to finance the Civil War, Congress authorized the United States Treasury to issue paper money for the first time in the form of non-interest bearing Treasury Notes call Demand Notes.
- ❑ *1865* - Gold Certificates were issued by the Department of the Treasury against gold coin and bullion deposits and were circulated until 1933.
- ❑ *1877* - The Department of the Treasury's Bureau of Engraving and Printing started printing all U.S. currency.

Paper Money in the U.S. (1900s)

- ❑ *1913* - After the financial panics of 1893 and 1907, the Federal Reserve Act of 1913 was passed. It created the Federal Reserve System as the nation's central bank to regulate the flow of money and credit for economic stability and growth. The system was authorized to issue Federal Reserve Notes, now the only U.S. currency produced.
- ❑ *1929* - Currency was reduced in size by twenty-five percent and standardized with uniform portraits on the faces and emblems and monuments on the backs.
- ❑ *1990* - A security thread and microprinting were introduced in \$50 and \$100 notes to deter counterfeiting by technologically advanced copiers and printers.
- ❑ *1996* - Additional security features are added to a newly redesigned \$100 Federal Reserve note. The note incorporates both familiar and new features, while remaining recognizably American. Redesigned lower denominations are being introduced at the rate of about one denomination per year.
- ❑ *1997* - The new \$50 bill is introduced. The second note to be redesigned to include new security features, the reverse side also includes an enlarged number 50 in the lower right-hand corner to aid the low-vision



The Future

- Money has to be mobile, so as to move from hand to hand with ease. Money needs to be flexible: incarnating itself as coins, paper, bonds, stocks or zipping electronic impulses. Money needs psychological acceptance: The population must unblinkingly accept the fact that a plastic card or flimsy paper is of great value.
- Checks and Electronic Transfers
 - See **The Story of Checks and Electronic Payments** available from the New York Fed.



In Summary

- Money needs consistency and staying power: Money can't be allowed to hyperinflate to nothing in a week, or to be usable only on leap years, or to change its colors with the fashion seasons. Money needs to be perfectly fungible: One dollar is always exchangeable for any other, no matter what its source. And, lastly, money needs authority to issue it, to manage it, to back its value and to chase off rival systems of money.



- Lessons on History of Money (in your handout)
 - AP Economics
 - EconEdLink Online lessons
- Lessons on historical development of U.S. money and banking system – The Fed Today
 (http://www.federalreserveeducation.org/fed101_HTML/fedtoday/FedTodayAll.pdf)

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