THE THEORY OF MONEY

CHAPTER I

MONEY: THE MEDIUM OF EXCHANGE

MONEY is the medium of exchange, and where there is no exchange there will be no need for money. If we can imagine a community of which every member provided for himself, built his own house, made his own clothes, found and cooked his own food, and sought out his own amusements, we shall see that in such a community money would be a useless commodity, just as useless, indeed, as it would be to a Robinson Crusoe. Each being sufficient to himself would have no use for the productions or the accomplishments of others, and would set no value upon them. With no wish to purchase there would be no need for money, and money, therefore, would not exist. But, man being a social animal, we cannot expect to find societies of self-sufficing individuals such as we have imagined. We do find, however, in forms more or less perfect, self-sufficing *communities* the members of which use little or no money. Such communities have practically no external trade, as their members find in each other's activities satisfaction for all of the small number of wants which they possess. Within the community the use of money is avoided by the simple but clumsy method of barter. Even at the present day we may find, in India or in Russia, villages having practically no connection with the outside world, and of which the members, living on the produce of their own fields, make each a yearly contribution in kind towards the support of a village priest, a potter, a carpenter or a scavenger, who supplies his services in return. Such moneyless societies, however, are rapidly disappearing amidst the stress of competition encountered from without, though in the sheltered study of the communist philosopher they continue to arise in more ambitious and more stable forms.

In the present constitution of society, however, it would seem that the adoption of a "money" is essential to industrial progress. The most productive methods and the most skilled workmen can only be employed in response to a very large demand; and a large demand implies considerable division of labour. Were everyone to make his own loaves and his own beer, instead of entrusting that work to bakers and to brewers, the average excellence of both bread and beer would certainly be lowered; but, as man cannot live by bread alone and still less by beer, the very existence of bakers and of brewers, devoting their whole time to the production of one commodity, depends upon their being able to exchange the greater part of this one commodity for the products of others. The division of labour, in short, depends upon exchange of products, and everything which facilitates exchange will facilitate division of labour. It is as an aid to exchange, and hence to the division of labour, that the invention of money has proved of such vast importance to mankind.

It will be instructive to notice some of the difficulties to which the business of exchange is subject in the absence of a monetary economy, and from which it will be freed by the adoption of a "money." Without money exchange can only be carried on by means of barter, and barter is subject to many inconveniences. In the first place there is the difficulty of bringing about a *coincidence of wants*. Thus, if a man wishes to buy a pair of boots, and has a coat to give in exchange, he will have to find not merely a man who wishes to part with a pair of boots, but a man who wishes to part with a pair of boots in exchange for a coat, and such a person may not be immediately discoverable. When Dr Wallace was travelling in the islands of the Malay Archipelago, where no proper currency existed, he sometimes found great difficulty in getting food because the men who had the food did not want any of the articles which Dr Wallace possessed. He therefore took to carrying about with him knives, cloth, sago-cakes, and other miscellaneous articles with which to tempt the varying tastes of the native traders. Another instance of this difficulty, quoted by the late Professor Jevons in his *Money*, is that of a singer from the *Théâtre Lyrique*, who, in the course of a professional tour round the world, gave a concert in the Society Islands. Her remuneration was a share of the receipts, and eventually materialized in three pigs, twenty-three turkeys, forty-four chickens, five thousand cocoanuts, and considerable quantities of other fruits. Here there was certainly no coincidence of wants. The Society Islanders, no doubt, wanted to hear Mlle. Zélie sing, but Mlle. Zélie certainly did not want five thousand cocoanuts.

What is obviously needed in such a case is the existence of a commodity which would be equally acceptable to all persons, or, at any rate, to all persons inhabiting a particular neighbourhood, and which, therefore, would be taken about by all who wish to trade in that neighbourhood. Such a commodity, as we shall see, need not necessarily be a metal, neither need it be something which is desired, as gold is by us, almost solely for purposes of exchange. A commodity has often been adopted as the medium of exchange because it is the principal product of the community—such as cattle in case of pastoral tribes, tobacco in tobacco-producing countries, and so on. By virtue of the existence of such a *medium of exchange* those who wish to buy and those who wish to sell are enabled to make their needs coincide. Everyone who wishes to buy will couch his offer in terms of the one recognized commodity which is acceptable to all. Everyone who wishes to sell will be prepared to sell in exchange for that commodity which, by reason of its general acceptability, is immediately available for further exchanges. Had such a medium of exchange existed in Melanesia, Dr Wallace would not have been obliged to buy, at the cost of painful experience, the knowledge of what particular articles were most acceptable to the Malays. He would have provided himself with *the* article of general acceptability—the "money" of Melanesia—and, armed with this, could have gone forth upon his travels freed from the anxiety that somewhere he might find a jaded savage to whom knives or sago-cakes did not appeal. The case of Mlle. Zélie is somewhat different. Here, of course, it might well have been that what was "money" in the Society Islands was not "money" in France. For the purposes of trade between different countries it is a great convenience, though not a necessity, to have an international "money"—a commodity such as gold bullion—which is freely acceptable all the world over.

A further difficulty of exchange in the absence of money is due to the necessity, under such circumstances, of fixing the terms of each bargain separately. Where bread is exchanged directly for beer, beer for hats, hats for shoes, shoes for pipes, and so on, a general price-list would be almost impossible. Such a list would require every article to be expressed in terms of every other article. A pair of shoes, for instance, might be entered as equivalent to sixty loaves of bread, to one hundred and twenty pints of beer, to six pipes, to two top-hats, and so on, *ad infinitum*. The man who asked for a top-hat might be told the price in terms of any of these equivalents, and might be quite unable to tell whether that price was extortionate or otherwise. There would be, in fact, no *common measure of value*. All buying and selling would be immensely complicated. Immediate relief, however, would be obtained by the general adoption of one commodity in terms of which all prices were to be expressed. If, for instance, corn were taken as that commodity, corn would become the common measure of value. A man wishing to buy a top-hat would then be told the price thereof in terms of corn, and, having been accustomed to buy and sell in terms of corn, would know at once whether that price was a fair one.

It is generally the case that when a commodity has been adopted as the medium of exchange it has also been adopted as the common measure of value. The reason is obvious, for where it is the custom to pay for all purchases in, say, tobacco, it is obviously convenient to express the price of such purchases in tobacco also. If, for instance, the medium of exchange were tobacco, whilst the common measure of value were corn, a man buying a hat priced at a bushel of corn would have to find out the equivalent of so much corn, as expressed in tobacco, before he knew how much tobacco to give for the hat. This identification of the medium of exchange with the measure of value is, however, by no means essential, and instances of its absence are fairly common. A homely example may still be found in the Island of Guernsey, where prices are expressed in francs but the coins commonly in circulation are English silver. The medium of exchange, that is to say, is the shilling, whilst the common measure of value is the franc.

So far we have dealt with those functions of money which facilitate exchange, and which thus have an enormous importance in giving free play to the division of labour and consequent development of trade. We have still to deal with another important, but less essential, function of money, *i.e.* the function of acting as the *standard of value*, or as it has been better termed, the *standard of deferred payments.* As the common measure of value, money is used to compare the relative values of "present" goods; as the standard of deferred payments it is used to compare the relative value of "present" goods with that of "future" goods. The most important example of this latter use is found in the case of loans. If, for instance, a man borrow a ton of coal on an agreement to pay back two tons of coal at the end of twenty years, he may be said to take coal as his standard of deferred payments. If, at the time he borrowed, coal was scarce and valuable, whilst at the time fixed for repayment it happened to be plentiful and of little value—in other words, if there is a "depreciation of the standard"—it is obvious that the borrower will benefit and the lender will lose. If, on the other hand, the standard *appreciates* between the date of borrowing and the date of repayment it is the lender who will benefit and the borrower who will lose. Such uncertainties, due to variations in the standard, are naturally bad for trade, and it is important to adopt as the standard of deferred payments a commodity which shall be as stable as possible. Owing to the fact that the money commodity, used as the medium of exchange, has almost necessarily been adopted as the common measure of value for present goods, so it has been adopted also as the common measure of value for future goods—that is, as the standard of deferred payments. As it so happens, the money commodity of modern commerce is a fairly stable one as regards its value; but, apart from the obvious convenience of using the same common measure of value for future as for present goods, there is no reason for using the *money* commodity, or, indeed, any other *single* commodity, as the standard of deferred payments. Thus, during the sixteenth century, when silver was the common measure of value, *corn* was required by statute to be the standard of deferred payments in drawing the leases of certain college lands. That is to say, whilst prices of present goods were expressed in shillings, engagements on account of the future rents of these college lands were expressed in bushels of corn. It could also be arranged that the standard of deferred payments should be a composite standard. The unit might consist, for instance, of a pound of iron combined with a bushel of wheat, an ounce of tea and a pound of cotton. But this extension will be referred to subsequently at greater length.

In addition to the three functions of a medium of exchange, a common measure of value and a standard of deferred payments, a fourth function—that of acting as a *store of wealth*—has been attributed to the " money " commodity. By this is meant that " money " may be used (1) to accumulate in anticipation of extraordinary expenses, and (2) to transmit wealth from place to place. But so far as the first purpose is concerned it would seem rather an occasional and accidental use of the money commodity, rather than a use of that commodity *qua* money. In some cases, of course, the principal form of wealth is used as money, as were cattle by some pastoral tribes, and in such cases any accumulation of "money" is necessarily identical with an accumulation of wealth. As regards the second purpose also, it may be sufficient to point out that export is a non-monetary use of the money commodity.