

# THE ECOLOGY OF MONEY

by Richard Douthwaite

## Chapter Three: Government-Produced Money

Although it was open to anyone to find gold and silver, it was not possible for everyone to turn it into useful money. The problem with simply using a lump of either metal for a transaction was that it could have been adulterated with other, cheaper, substances. Moreover, lumps weren't exactly the right weight for every purchase. Andrew Carnegie, the steel magnate and philanthropist, wrote a book about money a century ago in which he described receiving his change in China as: 'shavings and chips cut off a bar of silver and weighed before my eyes on the scales of the merchant.' „The Chinese have no 'coined' money" he explained, "You can well see how impossible it was for me to prevent the Chinese dealer from giving me less than the amount of silver to which I was entitled." Perhaps that was because he was a tourist. Another Chinese merchant would certainly have ensured he received the right amount.

The twin problems of purity and weight were partially solved by the invention of coins. These were standard-sized pieces of metal, containing a specific amount of gold or silver, stamped with the profile of the head of the state (or the symbol of the temple) that had issued them as a guarantee. The first records of coins of any sort are in China, almost 3,000 years ago where rulers from the 12th century BC until 1912 (despite Carnegie's remark) regulated the production of small, round, low value, base metal coins with holes for stringing known as *Œcash*,. Other types of non-round, base metal, Chinese coins, inscribed with an official authorisation go back much earlier. As China only began making high value silver coins in 1890 (after Carnegie's visit), very large quantities of cash were required to make substantial purchases. Its cash coins had no 'intrinsic' value, any more than a shell currency had in the past, or a pound coin has today.

### Currency as a form of tax

Rulers in almost every country have used the currency they issued as a form of tax (see Box 4). In 17th century Russia, for example, Tsar Alexis thought that he could mint 312 roubles out of five roubles' worth of copper, while Peter the Great debased his silver coinage by 42%. Their goal was to maximise seigniorage: the difference between the price they had to pay for the metals their mints used, and the spending power of the coins made from them. However, there were other, more effective, ways in which a ruler could raise tax with his right to mint money. Bracteates were thin silver-alloy coins issued between the 12th and 15th centuries by the rulers of the small autonomous states in the Holy Roman Empire. Initially, the coins, which could be broken into four to make change, were valid only for a year and had to be replaced before holders could use the big autumn markets in most towns. Moreover, as with the other low value coins issued at the time), whenever a ruler who had issued a batch of bracteates died, all the coins bearing his head became invalid and had to be exchanged (at a 20-25% discount), for new ones bearing his successor's features. For obvious reasons, it wasn't long before rulers began to recall bracteates more frequently, sometimes as often as three times a year. In the 14th century

Johann II of Saxony changed his currency no less than eighty-six times in thirty-six years.<sup>20</sup>

Since holding bracteates was rather risky as they could lose up to a quarter of their value overnight, people spent them as soon as they could. And once their day-to-day purchases had been made, they used the remainder on improving their houses and property. Even relatively ordinary people were able to afford fine houses during this period and the tradesmen's guilds were prosperous enough to make gifts of towers, windows and complete chapels to the Church. The construction work meant that there was a high demand for labour and wages were consequently good: an ordinary day-labourer could expect to earn six or eight groats a week, enough to buy four pairs of shoes or two sheep. Working hours were short and there were at least ninety religious holidays a year. It was a time of great prosperity, with (in the words of the German commentator Fritz Schwartz, from whom much of this material is taken), "no difference between the farmhouse and castle."<sup>21</sup> Farmers wore coats with golden buttons and had silver buckles on their shoes.

### **Gold ends a golden age**

Ironically, it was gold that brought this golden age to a close. A bracteate was generally "a totally wretched and ugly little disc of metal, very thin, of low fineness", and due to its low silver content and its liability to be devalued, it was useless for international trade. Realising this, the Genoese and the Florentines issued gold coins in 1252, and Venice followed in 1284. These new coins could act as both a store of value and a means of exchange.<sup>22</sup> They allowed people to build up their assets in ways that did not involve employing others and thus passing their surplus around. Moreover, as the gold coins spread, trading itself became more difficult. "The means of exchange disappeared into socks and mattresses," Schwarz writes, and as money became scarce, interest rates soared, despite the opposition of the Church. Some merchants found it more profitable to sell off their stock and lend out their capital, and a gulf developed between families with an income based on interest and the rest of the population. The demand for labour dropped, wages fell, and unemployment appeared. Moreover, rulers had to find other means of taxation.

Even today, the British government makes a profit out of seigniorage. James Robertson, in a paper based on the work of the Bank of England Monetary Policy Committee,<sup>23</sup> states that between January 1998 and January 1999, the value of the notes and coins in circulation in the UK rose by £1,300 million. As the cost to the Bank of England of printing the notes and minting the coins would not have been high, the seigniorage it earned must have been at a similar level. During the same period, the amount of money created by the commercial banks was £52,600 million, forty times the amount of money the state made. Although the sum the banks created was balanced by liabilities (and was not therefore money which belonged to them in the way the profit from issuing coins belonged to the British Government), nevertheless the interest paid provided a substantial income for the institutions involved.

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#### **Box 4: Devaluation in Britain through the ages**

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Offa, the king of Mercia, issued the first silver coins minted in England, in 760AD, who decreed that 240 pennies should be made from a pound of silver. However, as a result of a series of reductions in its silver content, the value of the penny fell inexorably for the next thousand years. The first devaluation was carried out on the orders of William the Conqueror, who opened a mint at the Tower of London in 1067 and decreed that it would make its pennies out of a Tower pound of silver rather than a troy pound. The Tower pound was 6.5% lighter. He also reduced the purity of the silver itself to 925 parts per thousand. This became known as sterling silver, and coins were made from silver of this standard right up to 1920.

As coins were valued by number rather than weight, it was not just the rulers who had an incentive to reduce the amount of silver they contained - the users did too. They brought their reduction about by clipping or filing the coin's metal away to sell, despite the fact that, if detected, they were liable to the death penalty. It was only in 1663 that the Mint began milling each coin's edges to prevent this being done. Until then, to maintain their appearance, coins were periodically reminted but without adding any more silver.

The first major reduction in William the Conqueror's standard was in 1343, when the weight of a penny was cut from 22 grains of silver to 20.3. By 1346, it was 20, and in 1351, Edward III reduced it to 18 so that he could produce 293 pennies from every pound of silver. During the next 150 years, the weight of silver in a penny was halved, but the value of the metal in terms of other commodities rose so, as Adam Smith pointed out, the price of wheat scarcely varied from 6s. 8d a quarter throughout the period.<sup>24</sup>

Then came the Great Debasement. In 1542, Henry VIII, sorely in need of funds to fight the French, told the Mint to add six ounces of copper to every 10 ounces of sterling silver it used to make pennies. A few months later, the amount of copper was increased to seven ounces per pound, then to ten, then to twelve and finally under Edward VI, to thirteen. The adulteration enabled the Mint to produce much more money than would otherwise have been possible. Prices doubled and Ket's Rebellion broke out in 1549 in protest against the domestic inflation. On the foreign exchanges, the pound lost over half its value. A proclamation that a shilling (12d) would henceforward be only worth 9d set off a national panic. It was left to Elizabeth I to call in all the debased coins, refine out the copper, and re-issue them as 100% sterling silver.

England's first gold coin (a gold penny twice the weight of a silver penny and worth twenty times as much) was issued in 1257 primarily for use in the export trade. Running two coinages whose external value was based on their content of different metals didn't work well. "Even the arrival of one Spanish treasure ship in Cadiz, or the departure of a silver-laden trader for the East, could shift the value-ratio between them by several points", Peter Wilsher wrote in his excellent history to mark the decimalization of the British currency.<sup>25</sup> This was a drag on commerce so Sir Isaac Newton was asked for his advice as Master of the Mint. He advised that silver should be dropped and fixed a price for gold, to which the value of all other coins was to be related. His advice was taken and as Wilsher states: "Trade and society flourished as never before".

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Robertson, like many before him, goes on to argue that rather than this money being created by the banks as a debt (as discussed in Chapter 1), the government should have created it instead. It could have spent this money into circulation in place of some of the money it was collecting in taxes. The banks, he says, rather than creating money, should be limited to credit broking. In other words, they should simply take in deposits from one set of customers and lend them out to others, on exactly the same 100% reserve basis as used by the credit unions and those building societies that have not converted themselves into banks. Robertson advances four arguments for

such a change:

1. The money the banks put into circulation is, in fact, created by society. The banks only do the bookkeeping that brings it into effect. This money is therefore the property of society and should consequently be treated as a source of public revenue, rather than commercial profit.
2. If the state spent the required amount of new money into circulation each year, either taxes could be reduced, or public expenditure increased, or both. The benefit would be substantial as, in the 1998-9 period in which the UK banks lent roughly an extra £50 billion into existence, government spending in the UK was £300 billion.
3. Allowing the banks the privilege of money creation constitutes a massive subsidy to the financial sector. It therefore distorts the way the economy operates.
4. The necessity to pay interest on almost all the money required to keep the economy running bears more heavily on the poor than the rich. It is effectively a regressive tax.

The first three arguments are sound but I have doubts about the fourth. It is certainly true that the poor pay a greater proportion of their income in interest than the rich. Margrit Kennedy shows that in 1982, only the richest 20% of the German population received more interest than they paid.<sup>26</sup> There is little doubt that the same is true in other countries. In the US, for example, the bottom 10% has negative net worth (that is, they owe more money than they could raise if they sold everything they had). In addition, as they are perceived as high-risk borrowers they will certainly be paying a lot of interest on these debts. The fact that money ceased to be created as debt would not cure this problem, however, as borrowing and the payment of interest would still go on. Robertson, though, thinks that ceasing to create money via debt would ease the situation quite a lot, especially if the seigniorage gained by the state when it spent its money into circulation was used to finance the payment of a citizen's income.<sup>27</sup>

Two further arguments were identified in Chapter 1, which could be added to Robertson's list as numbers 5) and 6). In addition, Brian Leslie, the editor of the British Green Party's Land Tax and Economics Policy Working Group's newsletter, *Sustainable Economics*, has suggested the seventh argument that I believe carries a great deal of weight.<sup>28</sup>

5. If new money were spent into circulation rather than being created as debt, the money stock would not contract if, as a result of a change in the economic climate, less borrowing was undertaken and less investment carried out. As a result, the potential level of profit would remain the same. This is a big advantage, as it would make the economy much more stable than it is at present. If firms in a particular industry got into difficulties and went into liquidation, their departure would leave the same money supply, and thus the same potential level of purchasing power, to be shared among the rest of the economy. Demand in other sectors would therefore increase and profits rise, tending to counteract the decline.

6. Spending money into circulation creates a stable economic system that does not have to be kept constantly growing regardless of the environmental and social consequences. Such a system

is therefore more sustainable.

7. Because a high volume of bank lending is required to keep the present money system functioning, the banks shape the way the economy develops. This is because they determine who can borrow, and for what purposes, according to criteria that favours those with a strong cash flow and/or substantial collateral. As a result, the present money system favours multinational companies and the rich and discriminates against smaller firms and poorer individuals. The proposed system of money creation would lessen this bias.

The power of these arguments seems irresistible and I wholeheartedly support Robertson's proposals. The only problem that might arise is that governments could become addicted to economic growth not because it was proving beneficial, but because the increase in the money supply the growth necessitated was an important source of tax revenue. A no-growth economy that was not inflating would not need a larger money supply each year and, consequently, the government's earnings from seigniorage would cease. Robertson is aware of this and knows that governments will be constantly tempted (as were the kings before them) to collect seigniorage by increasing the money supply in circumstances in which no extra liquidity is warranted. The attractions of creating a mini-boom just ahead of a general election would be especially hard to resist. He therefore proposes that decisions on money creation should be taken by an independent body and thus removed from direct political control.