

WHAT IS MONEY *FOR*?

An elementary question often asked by first-year economics students is, “What is money *for*?” And textbooks have an answer to this question: money is a medium of exchange, a unit of account, and a store of value. Fine. So we use money to exchange things of different value and to compare the values of different things, and with it we are able to do so, not only now, but also in the future. This is a straightforward answer to a straightforward question. But there is more to it than that.

In fact, I do not like the question “What is money *for*?” It is a bad question, or at least a misleading one, because of what it may imply. It is like asking *What are markets for?* Or *What is language for?* *What is the law for?* *What are morals for?* All these are equally questions I do not like. In general, when we ask “What is it *for*?” we imply that the object about which we are inquiring has a specific, limited purpose for which that object has been *designed*. So to ask this kind of question about money (or markets or language or the law or morals) too easily implies design, and therefore a designer.

Let’s change the object and ask the same question to better illustrate this problem. Consider iPods instead of money. What is an iPod *for*? I expect the answer is that, among other things, an iPod is for playing music.

An iPod is an invention that was designed by Apple employees as a purposeful device, meant to play music on the go. We can identify a designer (or a group of designers) who set out with the goal of creating something that does just this. An iPod is the designed instrument with which we achieve the goal of listening to music on the go. So I can buy my iPod (with money!) and listen to my music while I jog.

If we ask the question *What is money for?* we are too easily led to answer it in the same way we answer *What is an iPod for?* That is, we are tempted to think that some genius long ago sat down and thought: “Hmmm . . . barter is not very convenient. The double coincidence of wants that barter requires means that I often go home without what I want simply because the other person did not happen to want what I have to give him today. I should invent something for making him give me what I want even if he does not necessarily want what I have to offer. I will invent an intermediary for exchange that is also a unit of account and a store of value, and call it money!”

To think that money is a clever device invented by some clever individual to fulfill

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some definite “useful” purpose is an act of anthropomorphism: to think, as in primitive societies, that the patterns of order in society are the gift of a great leader or even a demigod. Anthropomorphism is a typical human way of explaining complex phenomena that would otherwise remain unexplained, but it is nevertheless a false way of thinking. We now know that there are human institutions that serve a function, but nobody needs to (or can) design those institutions. Money—like markets, language, the law, and morals—is an example of just this kind of institution. Money is the result of the interactions of many individuals, none of whom had the intention of creating what we call money. To use an expression of Adam Ferguson, an eighteenth-century Scottish philosopher, money is “the result of human action, but not the execution of any human design.”¹ In this sense, money has no “purpose,” and asking *What is money for?* is therefore a misleading question.

Unfortunately, it is difficult to rid ourselves of our tendency to anthropomorphize. This naive belief in an anthropomorphic origin of money is so ingrained in us that, despite our developments in knowledge, we still think of money as created by someone for a purpose. Today this someone is not an ancient demigod but still an omniscient “genius” who knows what is best for us and how to deliver it. We continue to attribute these anthropomorphic creative powers to what we call government—in particular, in the case of money, to the government’s central bank.²

But if today we think of money as the creation of central banks, historically this was not always so. In fact, this has not been the case until quite recently. In most countries of the world, in many cases as recently as less than a century ago, central banks did not even exist. Bank notes were issued by private banks. Even the issuing of coins

was left in private hands: the government would simply certify the authenticity and the weight of the metal content of the coin and protect individuals against counterfeits. When we are led to think that money is a creation of a government’s central bank, we are led to believe that the central bank has a designed purpose in creating money. The central bank’s goal in creating money is to “regulate” the economy. And more often than not, this means that the central bank’s goal in creating money is to “stimulate” the economy.

COINED LIBERTY

A better question to ask, therefore, is simply: *What is money?* Asking this question is a better way even to understand what money is “for.” It is, however, a harder question to answer. Indeed, there are many possible answers to this question. I will focus on just one. The thesis I want to argue in answering the *What is money?* question is: *money is coined liberty*. This answer comes from the nineteenth-century Russian novelist Fyodor Dostoyevsky in his novel *The House of the Dead* (1861). But the real explanation for why money is coined liberty comes from another eighteenth-century Scottish philosopher (and the father of economics), Adam Smith, in his *Inquiry into the Nature and Causes of the Wealth of Nations* (1776).

In that book, Smith tells us that commercial societies are societies where it is more likely to experience a natural system of liberty. Commercial societies are societies where *commerce* is the predominant economic structure. Trade has always existed, but commerce is an institutional setting in which cooperation with strangers, via trade, is the norm rather than the exception. For Smith, commerce is what characterizes commercial societies, just as feud is what charac-

terizes feudal societies, agriculture agrarian societies, and pasture pastoral societies. In all societies there is trade, but in commercial societies impersonal market transactions predominate in the social and economic order. These impersonal market transactions characteristic of commercial societies are possible exclusively through monetarized transactions. Money is necessary (but not sufficient) for a system of natural liberty. Money is therefore coined liberty.

Adam Smith explains that the introduction of monetary transactions transformed the relationships among individuals. With the introduction of money, transactions become impersonal. Before the introduction of monetary transactions, we had personal transactions. What this means is that before we started to use money on a regular basis to pay for wages, rents, and goods and services, exchanges between individuals were based on personal connections as opposed to impersonal ones.

To characterize something as impersonal today sounds distant and cold, whereas something personal is considered warm and nice. So the impersonal server at McDonald's is not as pleasant as the smiling restaurant host who welcomes you by name. But this is not what Smith is talking about. For Smith, a personal relationship in trade is a potentially tyrannical relationship, while an impersonal one is potentially a source of freedom. And here is why. Consider your situation if you have no money to buy food. Your meal depends entirely on the good will of, say, the restaurant host: you are dependent on his will for your meal. You can offer to work for the restaurant owner in exchange for your meal. But you cannot be sure you will have dinner tonight. If the restaurant owner decides to close for a holiday, you have no meal.

Now extend this predicament to most of the other goods and services you need in

your life. And consider what would happen if all of them came from the good will of a single person. You have no money to buy clothes. You have no money to buy shelter. You can get what you want only with an exchange of personal services—which this one person may or may not need. Basically, all you need to survive comes from your relationship with that one person. What you then have is a very *personal* relationship. Yet it can be the most oppressive servitude. You have one master, who may feed you, clothe you, shelter you. But you cannot maintain yourself without this master. It is an all-or-nothing situation. It is complete dependence. With monetary transactions, on the other hand, you lose this potential servitude, and you gain freedom. You now have a thousand masters, rather than one. If you walked away from your only personal source of subsistence, you would quickly find yourself in misery. Now, with a thousand masters, if you do not like one of them, you can walk away without much trouble at all.

In a precommercial society, most transactions would be in kind. As Smith tells us, landlords would rent out their lands in exchange for services from the tenants and would maintain many dozens of other people—their retainers—as tradesmen and artificers. With the introduction of monetary transactions, a great proprietor still maintains as large a number of people as he did before the diffusion of monetary transactions. But now he receives rent in money and pays his tradesmen and artificers in money. Now his retainers “are more or less independent of him, because, generally, they can all be maintained without him. . . . Each tradesman or artificer derives his subsistence from the employment, not of one, but of a hundred or a thousand different customers. Though in some measure obliged to them all, therefore, he is not absolutely dependent upon any of them.”²³ With the introduction

of money, transactions become impersonal, but you also become independent. You now have freedom. Money is therefore coined liberty.

IPODS AND LEGAL TENDER

Smith lived in the eighteenth century, yet what he wrote remains true today. Of course, the institutional framework in which money now lives is different from Smith's time. To understand this difference, we have to add another consideration. Bruno Leoni, a twentieth-century Italian legal scholar, suggests an additional way in which money is coined liberty, one that is especially appropriate to our times. While Smith's basic understanding remains true, what Leoni adds to it is, unfortunately, a more precarious feature of liberty associated with today's money.

Leoni observes that when we think of political freedom—that is, the freedom to make decisions collectively, through a political process—we are dealing with a kind of freedom that necessarily implies coercion. When the majority rules, unless there is a unanimous decision, a minority must also be *ruled*—coercively. The decision of some is imposed on the will of others. If in a group of three governed by majority rule, two want to buy iPods for the group, the third individual will have to pay for something he or she does not want.

Economic freedom, on the other hand, allows each individual to choose according to his or her preferences. One buys as much or as little as one wishes and there is no coercion involved at all. The cost of a decision falls exclusively on the decision maker and on no one else. If I decide to buy an iPod, I am the one who has to pay for it, since I cannot force you to pay for me. And if I want two iPods, I can buy two iPods. But again,

I am the only one paying for them, not you. In theory, at least, money works in the same way as an iPod. I am free to buy and hold as much money as I wish—given my possibilities, of course. And the cost of my choice falls exclusively on me. If money stays within the framework of economic freedom, then money is like any other good, and each individual can choose according to his preferences and face his costs without imposing his decision on anybody else.

Money is like any other good—*unless* money is made into legal tender. Money is made into legal tender by legislation. Legal tender money is that kind of money a creditor cannot legally refuse in discharge of a debt due to him. When legislation (the government) makes money legal tender, money stops being an instrument of economic freedom and becomes part of a process of political decision making. This is not conducive to individual liberty. In Leoni's words: "Legal tender money is itself a striking example . . . of a group decision the result of which is that some members of the group are sacrificed for the benefit of others, while this could not happen if the former could freely choose which money to accept and which to refuse."⁴

When money is legal tender, in other words, it loses part of its freedom-enhancing characteristics and becomes an instrument of political coercion. How so? Money as legal tender can become an instrument to force people to accept as the fulfillment of a contract something they did not intend to accept when they made the contract. Say, for example, that I contract with Apple to have an iPod delivered to me now, and that I will pay them \$100 in six months. Today with \$100 I can also buy four books at \$25 each. If in these six months there is high inflation, so that prices double, \$100 in six months will buy only two books, as their price is now \$50 each. But if the dollar is legal tender, I am legally liable to pay Apple only \$100—

that is, the equivalent of two books, rather than what we originally agreed on, which was the equivalent of four books. I benefit, at Apple's expense. Apple is forced to accept my payment, which is now only half of what we originally agreed on. I pay for half, and Apple is forced to pay for the other half. On the other hand, if dollars were not legal tender, I would not be able to force part of my payment for my iPod onto Apple. Apple could refuse payment in dollars and ask me to pay in another currency for the equivalent of the price of four books. When money is made into legal tender, money may lose its property of being coined liberty and become coined tyranny instead.

Now, with legal tender, if I were a large debtor, I would rejoice at inflation and welcome it. "A mark is a mark" was indeed declared in Germany after the First World War. Germany hyperinflated and therefore paid its incredibly large war debts with relatively little trouble—if one excludes the costs imposed on some of its citizens and on its creditors. With legal tender, the larger my

debt, the more I benefit from inflation (or, even better, hyperinflation), as I am able to pass more of my costs on to someone else. If I were not only a large debtor but also the only producer of legal tender money, I would have every reason to incur large debts and then inflate them away. I would benefit from my purchases, while I would be able to force my costs onto my creditors.

Let's return to why I do not like the question *What is money for?* If with this question we are tempted to believe that money is a deliberate creation of an entity, such as a government's central bank, and if we are tempted to believe that the purpose of money creation is to control the economy, we too readily come to accept the distorted result, which transforms money into an instrument of coercion. If we accept the idea that money is an instrument of the government to regulate (which is to say, in most cases, to stimulate) the economy, then it follows that the more money the government creates, the more the government can "grow" the economy. All this really means, however, is that



Money: another clever device, like an iPod?

the more money the government creates, the more “free lunches” it can offer to some at the expense of others. The more money the government creates “to stimulate the economy,” the more favors the government is able to offer its supporters and the more it is able to bill someone else for it against their will.

This is dangerous for at least two reasons. First, it leads us to forget the true nature of money, as a purposeless institution created by the interaction of many without their intention. Second, it leads us to forget that the economy itself is also an order that is generated by human actions but not by human design. And the implications of these misrepresentations can prove disastrous. To attempt to control something that is not really within our control is like playing a “game [that] will go on miserably, and the society must be at all times in the highest degree of disorder,” as Adam Smith tells us in another of his books, *The Theory of Moral Sentiments*.⁵

In the era of legal tender money, we do not see that degree of disorder. Are Smith’s words an exaggeration? Maybe, maybe not. Let’s look more closely at today’s money. The euro is an example of money invented like an iPod and governed through a political decision-making mechanism rather than through a logic of economic freedom. The euro was designed by a small group of individuals with the stated purpose of politically unifying and economically stimulating the countries of the European Union. What happened? Large debtors such as Greece, Italy, and Spain welcomed the euro with open arms. They continued with their unsustainable spending and managed to pass some of their bills to the thriftier Germany. But a free lunch cannot go on forever. When Germany refuses to keep paying for Greece’s endless expenses, what we see are riots in the streets of Greece—very significant disorder, indeed. Greece does not want to decrease its

expenses, and Germany does not want to pay for them anymore. Greece and Germany may try to pass the bill to the International Monetary Fund. But to whom will the IMF pass the bill? Greece’s default now seems inevitable, and it is unlikely Greece will be able to stay on the euro much longer. It is possible that the euro itself may not be able to survive, throwing a great many countries into chaos.

But that is Greece, we may say. That is Europe. Those are faraway places. Yet the situation in the United States is not much different. The United States may not see riots in the streets, but we are pushing ourselves further and further from the natural system of liberty that is founded on a “purposeless” money. The reckless expenses the U.S. government has incurred are, unfortunately, not free. The bill will be forced on someone. The Heritage Foundation’s Index of Economic Freedom saw the United States sliding from third place in the year 2000 to tenth place this year, one of the largest declines on record. When we forget that money is coined liberty, when we forget that money is an institution generated by human action but not by human design, when we accept the superstition that money is designed by someone for a specific purpose, when we accept that money should be legal tender monopolistically created by a government’s central bank to control the economy, money becomes coined coercion.

IS THERE HOPE?

Is there hope that Americans will come to their senses and realize the dangers in asking *What is money for?* Is there hope that we can go (back) to thinking in terms of that sounder question *What is money?* Maybe. The current eurozone crisis and the economic situation in the United States offer us

an opportunity to raise fundamental questions about economics, and in particular to rethink our models and beliefs about money. To recover a true understanding in these matters will be an uphill journey, but at least we have someone who has provided a road map. In 1976 Friedrich Hayek addressed the question of legal tender money, and he proposed a solution in a small book titled *Denationalization of Money*. Going back to a system where money is “produced” privately may be too difficult today. We have national currencies that are politically stable, even if they are not necessarily economically stable. Even under these circumstances, we could still treat money as part of a system of economic freedom, rather than part of the system of political decision making. We could do so by retaining these national currencies but letting different national monies compete with each other, just like different kinds of MP3 players compete with each other. Individuals could then choose which currency they wanted to use in transactions, just as they can now decide which MP3 player they want to buy. The government would still “produce” money, but government money would not be legal tender. Contracts could be fulfilled in any currency chosen by the parties involved. The “for” in the question *What is money for?* would drop.

Let us say we were able to reintroduce a system of competing monies. If I am a large debtor, I would still want a soon-to-be-inflated money with which to discharge my debts. Governments would still want their central banks to inflate. But if I am a creditor, I would not choose a money that would force me to pay for that inflation. I would avoid that currency. In addition, the government could not force me to accept its currency as payment for its debts. Central banks would therefore have fewer incentives to inflate, since there would be no point to inflating anymore. All national monies would become more stable, and government spending would be more reasonable. Contracts would be more predictable. Money would be brought back into the territory of economic freedom, where it naturally belongs.

One might be tempted to dismiss this proposal out of hand. After all, one might say, having competing monies is unrealistic! But which view, really, is more unrealistic? To think in terms of monies competing within a spontaneous economic order of individual freedom? Or to think that the government’s central banker is the semidivine genius who steers the economy through the creation of money? Money is not a device for controlling the economy. Money is coined liberty.

- 1 Adam Ferguson, *An Essay on the History of Civil Society* (Cambridge: Cambridge University Press, [1767] 1995), 3:2.
- 2 Friedrich Hayek, the 1974 Nobel laureate in economics, reminds us indeed that “the superstition that it is necessary for government (usually called the ‘state’ to make it sound better) to declare what is to be money, as if it had created the money which could not exist without it, probably originated in the naive belief that such a tool as money must have been ‘invented’

- and given to us by some original inventor.” F. A. Hayek, *Denationalization of Money: The Argument Refined* (London: The Institute of Economic Affairs, [1976] 1990), 37.
- 3 Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (Indianapolis: Liberty Fund, [1776] 1981), 420.
- 4 Bruno Leoni, *Freedom and the Law* (Indianapolis: Liberty Fund, [1961] 1991), 142.
- 5 Adam Smith, *The Theory of Moral Sentiments* (Indianapolis: Liberty Fund, [1759] 1984), 234.