

# What is money? It is a social relation!\*

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## 1 Introduction

Historical studies on money provide a conception that money includes social relations between people, and between the public and a state. As the economic system has developed, therefore the form of money has changed corresponding to the changes in specific circumstances of the economic systems involved. However, the nature and the function of money has always been the same as a credit which extinguishes the debt incurred during economic transactions. In other words, all money things are credits without intrinsic value. This viewthe credit and state theory of money (CSTM)is represented by Mitchell Innes and Keynes in early 20th century, and Post Keynesians, Institutionalists, and other heterodox theorists recently. Based on CSTM, this essay will elucidate definitions, origins, and functions of money.<sup>1</sup>

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\*This essay is designed to review controversial issues in monetary economics based mainly on two references: John Smithin ed. *What is Money?* Routledge, 2000 and L. Randall Wray ed., *Credit and State Theories of Money*, Edward Elgar, 2004.

<sup>1</sup>Other controversial issues such as endogeneity of money supply, interest rate determination, monetary and fiscal policies, and effects on the real economy are not much in consideration.

## 2 Money as a social relation

Conventional wisdom of money among orthodox economists and policy makers is that money is a veil of a real economy. The orthodox theory of money traces back to the late 19th century. Menger (1892) raised the commodity theory of money that money is a commodity which is chosen by traders because of its almost unlimited saleableness. That is, the function of money is nothing but medium of exchange. In line with this reasoning, it is natural for Menger and supporters of the metallic theory money that some precious metals (e.g. gold and silver) are used among other commodities because of their natural scarcity, equal geographic distribution, and easy extraction and manipulation (Menger 1892, p.253). Hence, the Mengerian commodity theory of money presupposes that markets predate money and the money is the facilitator of market exchange.

Recent works of Dowd (2000), and Klein and Selgin (2000) reinforce the Mengerian theory of money. First, with the conjectural historical approach, Dowd (2000) argues that the laissez-faire monetary system is superior to any other system in terms of its efficiency and stability. Even though he intends to show the ideal direction of the real world, it is highly problematic in methodological terms. However, considering social relations institutions, organizations, laws, rules, culture, and so on, it is impossible to adequately understand the contemporary capitalist system. Moreover, current instabilities and inefficiencies of the capitalist monetary system are not due to state interventions or regulations. But they are due to the laissez-faire system itself.

Second, it might be interesting to see how money things converge into a dominating money thing as Menger predicted more than hundred years ago. In a pure and simple hypothetical world in which Klein and Selgin (2000) construct, simulation results demonstrate that one commodity eventually becomes a dominant medium of exchange as market transactions are iterated regardless of the degree of its initial marketability.<sup>2</sup> As a result, they conclude that money can emerge spontaneously even where traders have only a very

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<sup>2</sup>In fact, Menger assumed that a certain commodity was more marketable than any other else, and, consequently, this commodity became a dominating medium of exchange (Klein and Selgin, 2000).

dim perception of the marketability of distinct goods, based on very limited random sampling, and even where all goods are equally marketable at the onset of the evolutionary process (p. 232). This model, however, is not only ahistorical but also problematic in the extent that the model presumes that specialization occurs before any trade begins a difficult society to imagine (Wray 11/13/2003).<sup>3</sup> More importantly, the model does not consider any form of credit which has been extensively used in the economy from tribal society to a current capitalist economy.

As Ingham (2000) correctly points out, the orthodox monetary theory is an ideological naturalization of money (p. 30). This argument implies that there is no institution and agency that vest money with its functions in the orthodox theory. By contrast to the orthodox theory, the credit theory of money (CTM) provides accurate insights as to the origin, functions of money and its social implications corresponding to stages of economic development. In short, all money is credit and the credit reflects social relations power relations, conventions, trust, property rights etc. (Innes 1913, 1914, Ingham 2000, 2004, Wray 1990, 1998, Henry 2004, Hudson 2004). As Innes explicitly defines, the Credit Theory is that: a sale and purchase is the exchange of a commodity for a credit the sub-theory that the value of credit or money does not depend on the value of any metal or metals. (Innes 1913, p. 51). From this definition, we can find that the CTM rejects the metallic theory of money, and also emphasize money of account as main function of money. Furthermore, in terms of social relations, the CTM captures the creditor-debtor relation which has existed from the early primitive society. While the form of credit has been changed with the development of society, the basic relational character of the monetary system remains the same. Hence, the belief that voluntary market exchanges generate money as a medium of exchange is totally fallacious and historically ungrounded. Rather, money (as a credit) has existed even without a monetary production economy e.g. ancient Egypt (Henry 2004, Hudson 2004).<sup>4</sup>

Among those who support the CTM, a sociologist Ingham (2000, 2004) has very radical view on the money in the sense that monetary economy

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<sup>3</sup>Quoted from the email and also class discussion.

<sup>4</sup>In their historical inquiry, Henry and Hudson found that general purpose of money differ from fines and tax-like payments originated from temples and palaces of ancient Egypt (Henry) or feudal society (Hudson).

(capitalism) is to be understood as socio-politico power relations<sup>5</sup> between a state and the public. His historical investigation corroborates such power relations: by the 17th century, private credit money and state money (coins) circulated at the same time (dual monetary system), and then, as political power changed (e.g. the change in power relation between the king and parliament, between the state and the public in England), two moneys integrated and finally ended up with the credit money in the capitalist monetary production economy through the establishment of monopoly power of issuing money by central banks (2004, pp.208-212). Further his study goes on to formulate a state theory of money. He argues not only that the acceptability of credit money depends on the states legal depersonalization and negotiability of debt, but also that state is a social entity that sustain social relations. This argument is closely connected with (Neo-) Chartalist approach represented by Innes (1913, 1914), and Wray (1998, 2004). Accordingly, Inghams view of money is more socially and politically extended version of CSTM.

Heinshoh and Steiger (2000) share the idea that the state monopolizes and enforces the circulation of money. They, however, present a different conception of the credit theory of money. They state that money is created in a credit contract but is not itself a credit (p.86). Their money view is based on property rights as the foundation of a capitalist economy. Thus they define money as an anonymous title to properties denominated by money of account. More specifically, money proper is backed by creditors property that can discharge a debt. But the credit secured by the debtors collateral cannot redeem a debt. The property right gives rise to the money proper in the banking system and, in turn, the money proper is lent to the producer through loan contracts as a source of production. In the following sales contracts between the producer and market participants in a goods market, the producer can realize capital which is a means of payment to the previous loan contracts. In doing so, the producer also gains surplus (profit) in the form of interest which is endogenously set by a property premium and a risk premium. Important to their approach, every credit contracts require collateral as a signal of debtors creditworthiness. Without collateral, no credit can be created in the property based capitalist economy. Since the market value of collateral is determined by the expected rate of profit and given interest rates, changes in the market value of assets lead to business

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<sup>5</sup>Using his terms, money is the weapon in the power relation.

fluctuations. That is, if the expected rate of profit is higher than the rate of interest, creditors encumber more property for money. Consequently, the interest rate and property premium decrease and in turn production increases as the source of production, credits, increases (p.95). In short, Heinsohn and Steiger (2000)s account of money elucidates the role of property rights as a social relation to which other CSTM theorists did not pay much attention.

Aglietta and Orléan (2002) present another alternative view on money, named the Institutional monetary theory which is closely attached to the regulation theory. According to them, money is defined as a socially legitimate form of market relations or the expression of the social totality. Separated individuals are integrated and form an ordered society by way of the money since the money is the objective value of all individuals. In this respect, the origin of money is the social trust or faith. Therefore, no matter what the forms of money are, the important thing is the question of how to regulate the monetary systems. This requires the ability to detect the financial fragility regarding the monetary system. This is required in order to construct a proper monetary policy.

### 3 Conclusions

Historical approaches to money provide many implications about origins and the complex social relations involved. The conjectualization or naturalization of theory, on the contrary, is not able to grasp the social aspects of money in the real history and the contemporary capitalist system. Such a historically ungrounded reasoning of money raised by orthodox theorists is greatly favored by capitalists and conservative policy makers. So it is not surprising to see that the orthodox theories serve for the capitalist interests.

The heterodox monetary theory CSTM is an emerging theory in the sense that theory as a process an ever developing entity, not as a perfect product (Glaser and Strauss 1967, 32; Finch 2002). At least, in a theoretical sense, the heterodox view that money is a social relation is a more powerful tool in order to explain the real world. Social relational conception of money, therefore, provides a better basis for the development of monetary policy.

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