MONEY: ORIGIN AND VALUE

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1. Introduction

Just as we could never imagine the human race developing civilizations without some kind of language, money—as the most universal medium of exchange—is the means to have complex economic interactions possible. It is not independent of a market place, but is a dependent solution to help partially overcome the many problems and limitations of a barter (non-money) system. It is our task to understand money's origin and value, with the latter having implications for the former.

2. Voluntary Trade Naturally Leads to Money

Our reliance on an economy is obvious. We as particular individuals generally do not produce our own food, clothes, shelter, or entertainment. There is rather specialization in production. If we had to produce everything ourselves, our standard of living would be nearly non-existent. The population number could be nowhere near where it is now. When we trade and cooperate with each other, we gain benefits we could not get in isolation. A market-based economy, in short, has it that in order to get what *you* want, you have to give to others what *they* want. Thus, voluntary cooperation pressures us to think of others so that we may improve our own state of affairs. Rather than trade encouraging "every man for himself," it requires us to think of improving the affairs of others in order to improve our own.

In fact, two people who are about to trade expect, at that moment at least, to become better-off than they otherwise would be. Exchange is a mutually beneficial affair, arising from the participants having opposite preferences in regards to the things exchanged. One person values X more highly than Y and the other values Y more highly than X. When they trade X and Y both participants believe they will psychologically gain or "profit." The person who valued X more highly than Y gets X; and likewise, the person who valued Y more than X gets Y. That's exactly why the voluntary trade took place; that is, it's a necessary precondition.

Yet what becomes clear is that trade is extremely difficult, if not impossible, in a barter economy with no money whatsoever. Exchanges necessitate a situation where there is a "double coincidence of wants." That is, in a direct exchange, the owner of X must want Y and the owner of Y must want X. This is a major hurdle to which to jump over in order to trade. It may turn out that the owner of Y has no desire for X, but the owner of X has a desire for Y. Or imagine a philosopher having to find a farmer willing to exchange food for watching a lecture on Plato! Hence in each and every exchange there is this major hurdle. The range of possible exchanges will thereby be very limited and the economy dreadfully primitive.

Indirect exchange is a natural solution to the problems of direct exchange. To reiterate: the owner of X wants Y, but the owner of Y doesn't want X. Let's call the owner of X "Bob" and of Y "Lisa." Bob can still try to find someone who has Y and wants X. However, his chances will be even *greater* if he asks Lisa what she wants (or anyone else like her with Y). Perhaps Lisa answers Z. Then Bob might search for someone who has Z, buy it from that individual, and then sell it to Lisa for Y. Bob would then value Z only insofar as it *facilitated* a trade to get Y. Symbolically, this indirect exchange might be put this way: $X \rightarrow Z \rightarrow Y$. In any case, nevertheless, a double coincidence of wants still needs to occur. Getting Z required the acceptance of X. It is still a disorganized, slow, and inefficient way to do things.

It should be manifest why indirect exchange develops. Exchange possibilities greatly increase. By wanting to expand trading opportunities, and thus wanting to overcome the difficulties of barter, people will engage in indirect exchange in addition to direct. As economist Jörg Guido Hülsmann, professor at Université d'Angers, puts it: "indirect exchange provides … [us] with additional opportunities for cooperation with other human beings. It extends the division of labor. And it thereby contributes to the material, intellectual, and spiritual advancement of each person" (Hülsmann, 2008, 22).

Even better is a common medium of exchange. In his popular work *What Has Government Done to Our Money?*, the economist Murray N. Rothbard introduces the layperson to the economic-historic development of money. He writes: "If one good is more marketable than another—if everyone is confident that it will be more readily sold—then it will come into greater demand because it will be used as a medium of exchange" (Rothbard, 2005, 26). In other words, an item that has widespread demand on the part of the public can be a good candidate to act as a money. Recall the example of Bob. He has many different needs and so wants many different items beyond Y. If he acquires a sufficient amount of *Z*, and if *Z* is valued by many, many people in his community, his chances to acquire what he wants becomes increasingly likely. That is, anyone's chances to exchange will be *greater* if they obtain a *Z* that is "marketable," i.e., highly desirable to many people. Conversely, if *Z* is not that marketable, it won't facilitate trade much.

By obtaining a *marketable Z*, an individual has thereby opened up his trading opportunities to a higher degree. The higher this degree is, the more wealth creation prospects he has. The value he places on such an item, unlike other items, is that they help him in acquiring other things. So Bob values *Z* for its *exchange* value as opposed to its potential *use* value. As long as one entrepreneurial individual can perceive the opportunities in indirect exchange and for acquiring a *marketable Z*, a society can economically evolve out of the primitive barter stage. Others can see what Bob does. There will therefore be an increasing demand for a *marketable Z*. The interconnection of the economy will increasingly intensify. It will push other individuals, who otherwise might not be bright enough to see the advantage of doing so, to follow the lead. "The result is a reinforcing spiral," wrote Murray Rothbard. "[M]ore marketability causes wider use as a medium which causes more marketability, etc. Eventually, one or two commodities are used as general *media*—in almost all exchanges—and these are called money" (ibid). So as some people adopt a medium of exchange, their demand adds a new "layer" of demand for such an item. There was a *prior* demand for that item and now there is a *new* demand for it as a medium of exchange. That, in turn, will increase marketability even more with ever greater demand. An increasing number of individuals will thus shift to this item as a medium of exchange. Truly, the very fact that more are using it makes it better in its functions. That's what creates a "reinforcing spiral." It is this process which brings to life moneys that are used as general mediums of exchange.

Historically speaking, moneys in more developed societies have tended to be silver, gold, and copper. As Guido Hülsmann explains: "The reason is … that their physical characteristics make them more suitable to serve as money than other commodities" (Hülsmann, 2008, 27). This makes perfect sense because they are highly valued commodities, especially silver and gold. Moreover, in the search for a *marketable Z*, there is an incentive to look for something that is recognizable, that has a fairly stable supply, has great divisibility (without losing value), is portable, is durable, is homogenous (such that one unit is like another), etc. Nowadays, to be sure, there is only paper money. This has not been the case historically. Yet what is important to understand here is that money developed as a solution to the deficiencies of barter.

With the development of money, the severe limitations of barter go away. The market economy becomes integrated. Practically everything can be bought and sold in terms of money. An item will tend to always have a money price. There will thus be more exchanges and productions of products and services. Increased specialization becomes possible. The standard of living will thus rise. Money, in addition, allows people to easily calculate. Things can be referenced to their money price. Exchange ratios arise. The question of how to direct scarce resources to fulfill the most wanted desires of individuals becomes possible to answer with a common, universal medium of exchange. The entrepreneur can now more easily see what lines of production are (relatively) more profitable than others. He can compare them. Of course this, too, raises the standard of living exponentially. The businessman can see his profits and losses. He can calculate his capital and income. If he makes profits, he can judge that he has taken his limited resources and produced something consumers value more highly than those input costs. Conversely, if he makes losses, he has been shown to waste resources because the costs of production were higher and would have been better used elsewhere. Money thus develops the pricing system, which helps direct the traffic of the market. Any complex society needs the pricing system to direct scarce resources which have alternative uses.

3. Grasping the Origin of Money Requires Understanding its Value

Paper ("fiat") money is a relatively new development, but developed out of monetary systems that were based in such "hard" commodities as silver, gold, and copper. This corresponds to Ludwig von Mises's analysis, who was an important economist and mentor (for example) of Nobel laureate F. A. Hayek.

In his classic *The Theory of Money and Credit*, Mises faced a difficulty that has implications for money's origins. For Mises to explain the value of money forced him to overcome the circularity that was present in the theories at the time. It was said that money's subjective value (in how we perceive it and use it) comes from what it can objectively (in number prices) be bought for or buy, and for what it can objectively be bought for or buy is dependent upon money's subjective value. Hence: *circularity*. Put differently, Bob values money in terms of what he can get with it, yet what he can get with it depends upon the money. Mises wrote: "[Money's] objective exchange-value cannot be referred back to any sort of use-value independent of the existence of this objective-exchange value" (Mises, 1953, 103). Consider today. We have paper money and certainly its use-value can't explain its objective value in exchanging. The paper money in use is generally not valued for it being art. It has no value in being food to eat nor do people use it as decorative wallpaper in their private homes.

The way out of this predicament additionally solves money's origins. Mises wrote that the past's objective exchange-value helps give rise to subjective expectations about using the money for the future. And that that objective exchange-value derives from the further past's subjective value imputation relative to the objective-exchange value even more previously, and that this objective-exchange value derived from the subjective value relative to the objective-exchange value from the ever further past. Thus the value of an item that's considered money in the present was once valued in the past for its use-value when it was not valued as a money (or a medium of exchange) (Mises, 1953, 121). The result of logically taking steps back, be aware, doesn't result in an infinite regress because this process takes us back to its temporal pre-money existence stopping point. This tells us that the value of money is the upshot of market processes—we might even say social evolutionary processes—of individuals buying and selling goods which creates a framework of prices in which to work off of. That is to say, the preexisting price ratios creates a framework *today* to *then* work off of and modify. Bob happily takes money because he has a future expectation that it will be useable to get what he wants tomorrow, and that is derived from his observations of how people used money yesterday or, more generally, in the past.

Robert Murphy in his popular book *Choice*, which helps to summarize some of Mises's difficult ideas, explicates that "Mises introduced the time element to escape the apparent circularity." Again, the circle is broken once the temporal component is understood. "Today's purchasing power [of money] is derived from individuals' expectations about tomorrow's purchasing power, expectations that are themselves based on yesterday's purchasing power" (Murphy, 2015, 183-4). Nevertheless, then a seemingly new problem appears. It seems that Mises's argument "suffer[s] from an infinite regress" that leads nowhere (ibid). Yet that, too, Mises solved. As shown concisely above, rather than the regress going back forever, it goes back to when an item emerged as a medium of exchange.

Another consequence of understanding these inferences is that money must arrive spontaneously on the market. It is a product of freedom, i.e., of voluntarily buying and selling. This explains why there is no historical case of money first starting out as purely paper with what would be entirely arbitrary numbers written on them. It follows what was referenced above to Rothbard and the "reinforcing spiral." Mises explained why the history of money is what it is. An item that becomes money requires a *pre*-money demand. It needs to have some value to start with. There needs to be a *framework* established to work in. From this, however, it does not follow that money cannot become a purely paper money in the future. And, obviously, that is what has happened.

Paper money use to be a substitute *representing* gold or silver. In that way, it had a non-monetary value in the past.

4. Conclusion

A comprehensive understanding of money's value requires not only a recognition of its role as a facilitator of trade, and thus a catalyst of intensifying and extending the division of labor, but additionally requires an appreciation of its origins. It is dependent upon a pricing framework that is a network of economic relationships of the past, the present, and of future expectations. Part of Ludwig von Mises's genius was to see the temporal component of money in order to understand its value. Like language, money is an indispensable market phenomenon that helps to integrate society together. Money is necessary, although not sufficient, for prosperity and civilization; that's its value.

References

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