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CHRISTIAN ECONOMICS IN ONE LESSON

Part 6: Money

by Gary North

And Abram was very rich in cattle, in silver, and in gold (Gen. 13:2).

The Hebrew word for silver is frequently translated as **money**. In biblical times, the precious metals served as money. They were also regarded as signs of wealth. Abram's case is obvious. Abram was rich. The text tells us what his wealth consisted of: cattle, silver, and gold.

Cattle can be used for many things: food, hides, fertilizer, beasts of burden. Cattle can be used to trade for other goods and services. They are also a lot of trouble to care for. Gold and silver were less versatile than cattle in Abram's day, though not in our own, where they can be used in chemical and electronic processes. In Abram's day, they could be used to make jewelry and idols. What else? Not much. Yet they were major components of his wealth. Why? What did gold and silver do that was so valuable?

What they did was serve as items of trade. Other people wanted gold and silver, so Abram could trade with strangers. He was a stranger in Canaan (Gen. 23:4), but he could buy a burial place for his wife with his silver (Gen. 23:16). The money made it possible for him to buy favor from others. They were willing to provide him with what he wanted because he had what they wanted: money.

But why did other people want his money? To answer this question, we must first answer another: What is money? To this question there are many very confused answers.

Confusion Over Money

Monetary theory has always been a topic of debate that has led to widespread confusion. Everyone has money, but hardly anyone can explain precisely what it is. The modern world finds it impossible to define money or even count it. Economists commonly speak of monetary aggregates known as M-1 through M-5. There are arcane measures known only to specialists. In terms of international trade, there may be additional ways to define money. What constitutes money in these measures? Silver? Not any more. Gold? Sometimes, but it is infrequently used today in actual exchanges between individuals. Central banks exchange gold, most of which is stored in piles in the privately owned Federal Reserve Bank of New York and at the airport depository in Zurich. The famous U.S. gold hoard in Fort Knox is never audited by an independent firm, so it may not actually all be there. Critics made this accusation in the mid-1970's, but Congress refused to order a full-scale audit. It would not be in the political interests of incumbent politicians if an independently conducted audit disclosed that tens of billions of dollars worth of the nation's

gold reserves are missing. In any case, Fort Knox is said to be mostly gold coin melt and therefore cannot be used in international exchange in its present form: too much copper content.

What else is regarded as money today? Paper money, bank checks, bank passbook savings accounts, and money-market fund accounts are all considered components of one or another definition of money. But what about overnight bank repurchase agreements? What about slot machine tokens in a gambling casino? Federal law in the United States prohibits the use of casino tokens to buy dinner in the casinos that issue them, which indicates that these tokens have functioned as money in the past, which is why the government passed the law. Defining money gets very complex.

What about counterfeit money? It surely functions as money if it passes for money. In what way is a high quality counterfeit bill different from a piece of paper issued by the government, or as the case usually is, by the government's licensed monopoly, a privately owned central bank? Neither form of paper money is legally backed by gold or silver. Both forms stimulate the economy when new bills are printed and spent into circulation. The only technical distinction would seem to be that the counterfeiter has violated the central bank's copyright law.

Why is there such confusion about money? Because, to paraphrase Forrest Gump, money is as money does. If something functions as money, it is money. Even illegal counterfeit money can serve as money, which is what governments greatly fear and resent. Someone is willing to exchange goods and services for money. Someone else is willing to hold it rather than goods as a form of wealth. What does it mean to function as money? How does money function?

Robinson Crusoe

Economists love to use the story of Robinson Crusoe to begin the mysteries of economics. In the original book, Robinson was the rebellious son of a Puritan father who wanted him to pray, study, work hard, and amount to something. Robinson refused to listen and wound up on a deserted island. The book ends when he is rescued from the island. This is just as well. The thought of generations of economists trying to explain the rest of his life is fearful; they can barely make sense out of his island experience.

Robinson was all alone until Friday showed up. He had no use for money. What he wanted was tools, which he got from the ship before it sank. He also made tools. The economists love to show how Robinson had to spend time making tools in

order to increase his income. The time he invested in tool-making cost him the berries that he might have picked. If Robinson's story came at the end of the textbooks, readers would have to suffer through Robinson's marginal utility analysis of berries vs. tools, or even worse, Robinson's indifference curve between berries and tools. But since he only appears toward the front of the textbooks, we have been spared all that. Be thankful for small blessings.

In neither the original story nor the textbooks is Robinson interested in money. He does not search the sinking ship for a box of coins. He would rather have had fish hooks than coins. "You can't eat gold!" (Also, you cannot eat checks, credit cards, and Federal Reserve Notes.) The textbooks hasten to explain that money is not used for the goods it can produce directly. It is used for what it can buy from someone else. But if there is no one else around, and there is no likelihood that there ever will be, then money serves no purpose. "Money is as money does; therefore, money isn't as money doesn't."

When Friday appears, there is still no use for money. The two of them work together. They share in the work and they share their production. Each can see what the other owns. If one of them wants what the other has, he can offer to trade something for it. There is no reason to hoard money; it would be wiser to hoard durable consumer goods or tools.

This is not to say that Friday might not want to trade for a shiny gold coin with someone's picture on it. But he would want it for its beauty or its uniqueness, not for its serviceability as a medium of exchange. He would want it for its physical properties that bring him pleasure: as a consumer good, not a means of exchange. In an economy with a low division of labor, barter is the means of exchange, not money. Trade is direct, not indirect.

When Marketing Gets Complex

An increase in the division of labor increases specialization, output, and the complexity of putting things together, whether physical things or information-based processes. When each person concentrates on doing what he does best, meaning most profitably, things as a whole get confusing. The more people there are who are adding their output to the production process, the more confusing it gets.

No one knows how to make a pencil. Leonard Read discovered this when he was writing what became his most famous essay, "I, Pencil." To make a pencil, you must know how to grow and harvest trees, cut them into the right shape, manufacture paint, produce the carbon, form the lead, produce the eraser's rubber, form the metal band that bonds the eraser to the wood, and construct the machines used to produce every tool that is used in the process. Do these machines use oil? You must understand that side of the business. Then there is the electricity used to run the machines.

The degree of social and economic complexity required to produce a simple pencil is such that natives living on islands would be initially astounded at the miraculous pencil. Who could make such a thing? The gods, perhaps. Or a society so profoundly advanced that its representatives constitute a threat to the way of life of the island.

Could any society produce a pencil if it did not also have money? Apart from money and the price signals that money imparts, how could all the production decisions in the making of a pencil be coordinated? Who would be so all-seeing as to be able to coordinate such a process? If men could not use money to order wood, paint, lead, rubber, and metal, how could they obtain these resources? By trading pencils for more paint? But then the pencil manufacturer would need pencils to begin making pencils, so how would he produce the first

pencil? Also, once the paint manufacturer had a few thousand pencils, why would he sell any more paint in exchange for more pencils? Repeat this story up and down the chain of suppliers. Then multiply it times all the goods offered for sale in a single department store.

God is all-seeing enough to do it, but why would He make a pencil this way? He would just speak the words, and He would have a perfect pencil (no eraser needed). But somewhere in between God's knowledge and the goods for sale in the local department store there is knowledge sufficient for bringing all these things onto those shelves. The question is: How does this knowledge get put to such productive use? Answer: through the free market. Through the division of labor. Through money.

Money Talks

The knowledge needed to produce a pencil is vastly greater than any person has. But it is not greater than the knowledge that a million people have. The question is: How can the pencil-producer buy the specific knowledge necessary to produce a pencil? Answer: by buying products that were produced by people who knew how to produce them. He buys the output of their combined bits and pieces of knowledge.

But the problem is, how can anyone assemble such knowledge? What common language can men discover that allows all the technicians in all the world to compare the value of each other's knowledge, case by case, product by product? What common language can overcome the babel of specialized knowledge? The common language is **price**. Prices are denominated in money. Money is like the universal translator in *Star Trek*. Most people speak the language of money. Some speak it more fluently than others. These people we call entrepreneurs.

What is a price? It is a statement of the terms of exchange. Everything offered for sale is offered at a price denominated in a particular currency. In a money economy, almost every exchange is based on money. Money is the common denominator of exchange. This tells us that **money is the most marketable commodity offered for sale**. This is the best definition of money: the most marketable commodity.

We rarely exchange our output directly for our income. The number of people who would want to accept one of my articles in exchange for whatever it is he offers for sale is very limited. I cannot buy bread with essays. As a seller of words, I seek to locate people who want to pay to read them. I want a large market. But I do not buy that many items. I want to sell my articles to people who do not produce the items I consume because I want to sell a lot of articles, but I do not consume that many items. I can achieve this goal by selling my articles for money. The money is more marketable than my articles are. Everyone wants more of my money; not many people want any more of my articles.

A high division of labor is possible because we all seek money. We are eager to sell the products of our highly specialized knowledge and skills in exchange for the highly unspecialized commodity, money. Someone says to me: "A penny for your thoughts." I respond: "How about a thousand dollars?" Somewhere in between these two numbers is the economic basis of an exchange. I can understand the word "penny." He can understand the word "dollar." We both understand "a" and "thousand." We can now explore the possibility of making an exchange.

Many Moneys

There are signs in Washington State, the state next to the Canadian border, "No Canadian money accepted." I have never seen a sign in British Columbia: "No U.S. money

accepted." British Columbia specializes in tourism; Washington State does not. The net income from sales lost by a particular Washington State business that places such a sign on its wall is less than the trouble and expense of exchanging Canadian money twice: at the point of sale (compute the exchange rate and make change in U.S. money) and at the bank (avoid getting stuck by the bank by a less competitive exchange rate). This is not the case in British Columbia. Few Americans know that America's largest trading partner is Canada; few Canadians can forget it. Both nations call their currencies "the dollar," but for decades, the Canadian dollar has traded at a discount.

Sometimes governments pass laws that are supposed to establish the terms of trade between currencies, but this does not work for long. Buyers and sellers of goods across borders will eventually set the terms of trade - prices - of the currencies. A government might set the price too low in order to stimulate exports. "Our currency is cheap, so you can afford to buy more of our goods!" This strategy will always fail. If a government sets its currency's price too low, people will start buying up more of the underpriced currency. Pretty soon, people who want even more of the underpriced currency (at the artificially low price) will have to stop buying so many goods and services from that country. Or they will start buying the underpriced currency at an illegally high price on some illegal currency market. The real price of the currency rises: either people have to pay more to buy the actual currencies (meaning they can afford to buy fewer of that nation's goods) or else they will have to stop buying so many of the nation's goods because they cannot locate people who will sell them the currency at the artificially low price. In both cases, the country with the artificially low-priced currency loses export sales. It does not matter that the government says that its currency is worth less; the free market says that it is worth more, and it reacts accordingly.

The decisions of millions of people to buy and sell goods and services with this or that currency is what sets the price of these currencies in relation to each other. Money is the most marketable commodity. As a particular currency becomes more widely used to make exchanges, it becomes the dominant form of money.

Characteristics of Money

It takes a lot of effort to find gold. It takes a lot of effort to mine gold. People expend time and money to discover and develop gold mines because they want what gold will buy. But why does gold buy anything? One reason is that it takes so much money to mine it.

Money is the most marketable commodity. Which commodities have served as money throughout history? Gold and silver. What characteristics do they share? They are both shiny. They are both popular as jewelry. They have both been used in religious worship. The ancient world represented the sun with gold and the moon with silver, identifying both orbs as divinities. Both metals are rare - difficult to produce in large quantities. This means that with high demand, they have high value in relation to their weight and volume. "A little gold goes a long way," both in terms of what it will buy and how far it will be transported. As metals, both can be cut into measurable pieces. Both are durable and retain their brilliance, especially gold.

Money has these four characteristics: predictably high value long term in relation to weight, transportability, divisibility, and durability. Anything that has all of these characteristics can become money, but in the history of man, gold and silver have been the moneys of choice. Market participants made this choice long before civil governments did.

It is this long tradition of gold and silver as moneys outside of government and beyond the power of government that has reinforced the use of these metals as money. A person sells goods and services for money because he expects to be able to buy what he wants for money later on. It is the historic value of money that establishes its character as money. Sometimes people speak of the **intrinsic value** of gold and silver, but this is incorrect. Gold and silver have **historic value**. Men impute value to scarce economic resources. They determine what something is worth to them as individuals, i.e., what they are willing to give up in order to buy it. The composite of all men's imputations in many markets produces a widely observed market price. Historically, gold and silver have been highly valued by large numbers of people. This means that there has been a ready market for gold and silver. This long tradition has reinforced to the near-monopoly status of these two metals as the premier universal moneys.

Money Substitutes Can Become Money

If I write an IOU or warehouse receipt for an ounce of gold, 99% fine, it will not circulate in the economy as if it were worth an ounce of gold, 99% fine. Not enough people know who I am. Besides, I might die. It might take a lawyer to get me to honor my obligation, and the lawyer's fee will be higher than the value of the gold. Without widespread belief that I will redeem the IOU on demand with an ounce of gold, the IOU will not be equal in value to the gold that is backing up my IOU. But if a major bank issues such a receipt, it may command a price as high as gold. If a powerful national government issues such a receipt, it will almost certainly command a price as high as gold.

The substitute for gold is heavily reliant on the good reputation of the organization that issued it. But if that reputation is high, there are a lot of people who will treat the substitute as if it were gold. The same is true of silver. There are warehouses that are universally trusted. If they issue receipts, the market treats these receipts as the same as gold. The receipt may even be better than gold, since the warehouse is storing the gold. For commercial transactions, it is cheaper to send around the pieces of paper than it is to send around heavy bars of metal.

Temptation arises when the organization with the good reputation decides to cheat. It can debase the precious metals with cheaper metals. This way, he can issue more receipts for 99% fine gold than he actually has in his vault. These receipts function as money. He can spend them into circulation or sell them for other forms of money. Who will ever know? Isaiah warned the princes of Israel, "Thy silver is become dross, thy wine mixed with water" (Isa. 1:22). If there is not some independent third party who lawfully searches the vaults and tests the metals regularly, no one may find out unless the receipt-issuer gets greedy and issues so many that some people start cashing in the receipts. Or maybe some angry employee will tell the authorities, or begin to spread rumors. A rival firm might profit from exposing such a debaser. There is risk. The loss of his reputation could become very expensive. So, he has an incentive not to cheat, at least not in this obvious way.

But what if he cheated in another way? What if he were to issue a few extra IOU's that are not backed up by gold or silver in the vault? He can sell these receipts for money, or trade them for goods and services. In effect, rather than debasing the metals, he debases the IOU's. But all the IOU's look alike.

This is a form of counterfeiting. Who gets hurt? First, if word gets out that there is not enough gold or silver to back up the IOU's that have been issued, there may be a run on the vault. Holders of IOU's come down and demand their gold. If the warehouse owner runs out of gold, those who did not

come down in time will wind up with no gold.

Second, if no one finds out, the new IOU's with nothing behind them will circulate as money. There has been an increase in the number of receipts for gold but without an increase in the supply of gold. Prices denominated in gold will rise or not fall, as they would have fallen without the increase in the number of IOU's. Those who still hold gold or receipts for gold suffer a loss of capital because the value of their gold has fallen as measured by what their gold will purchase. The loss per holder may be small, but this loss is multiplied by the number of people who have held gold.

On the whole, such private counterfeiting is limited in scope compared to what a government can do a government does not face competition from other warehouses. Its money has few competitors. It can issue lots of IOU's for gold or silver and not suffer a run on its vault. It can even cancel the terms of the warehouse receipt and raise the price of gold. The U.S. government did this in 1934. In 1971, the government ceased to redeem gold it had promised to foreign central banks. In 1963, the U.S. government ceased to honor silver certificates: no more silver on demand. Who is going to call the government to account? Who brings sanctions against the government?

Answer: the free market. The value of American currency began to fall in the 1930's, and it has never stopped falling. As the U.S. money supply has increased, year by year, sellers of goods and services have raised their prices. The American economy is like an auction at which the government from time to time passes out money to all the bidders. The prices bid for most of the items offered for sale keep rising.

Money Substitutes Can Cease Being Money

Sometimes, the government goes so far in creating new money that the economy becomes highly inflationary. The public expects prices to keep going up. They rush out and buy things, just to escape the depreciating money. People borrow money, but goods, and then repay the loans with cheap money. Lenders then raise interest rates to help offset the expected loss in the money's purchasing power. If this continues, the result is economic breakdown: hyperinflation.

This has happened often enough during wartime. It happened to the "continental," the colonial currency, during the American Revolution (1776-83). There was a terrible hyperinflation in the Confederacy during the American Civil War (1861-65). There were two hyperinflations in Germany: one after World War I (1921-23) and the other after World War II (1945-48). The worst inflation on record was Hungary's after World War II. The Chinese inflation after World War II led to the fall of free China to the Communists in 1949.

On the whole, most of the time, governments do not inflate their currencies so much that people lose faith in both the currency and the government. If governments did do this very often, their moneys would not function as money. But this can happen. The Austrian economist Ludwig von Mises once remarked: "Only governments can take valuable things, like paper and ink, and make them worthless."

Why Governments Inflate

Governments do not like to raise taxes. Taxpayers resent higher taxes and may rebel. Politicians who raise taxes sometimes are defeated at the next election. So, politicians prefer to use find other ways to spend money on what they think their constituents want government to do for them or to

their competitors. Governments have the treasury issue debt certificates called bills or bonds. They persuade investors to buy these bonds. This increases the government's debt. The problem is, this debt must be paid for: interest payments and - this never happens any more - the steady liquidation of the debt through repayment.

After a while, governments learn that they can sell their debt certificates to central banks. The governments then create central banks with a government monopoly to create money out of thin air to buy government bonds or whatever else they want, including gold. The first central bank was the Bank of England, created in 1694. It was a privately owned bank until after World War II. Most central banks are privately owned, but their directors are appointed by their governments.

From 1933 until 1974, the U.S. government granted to the Federal Reserve System the exclusive right to own gold. No other privately owned organization possessed this right. It was illegal for a U.S. citizen to own gold bullion or bullion gold coins during this period. President Roosevelt without authorization by Congress ordered Americans to turn over all of their gold to the Federal Reserve System (Executive Order 6102, April 5, 1933). The Federal Reserve System then created money out of nothing and bought all of the gold at \$20 an ounce in 1933. Then the President raised the price to \$35 an ounce on January 31, 1934, which Congress had authorized him to do the day before. The Federal Reserve System, the new owner of the gold, made 75% overnight on this declaration.

The problem with allowing the central bank to create money out of nothing is inflation. When it creates new money to buy government bonds, this money raises prices. It does not matter who does the counterfeiting; the results are the same: rising prices or prices that do not fall when otherwise they would have fallen. The government gets what it wants: money. The central bank gets what it wants: interest from the government on the bonds it bought from the government. But the value of the money drops. This hurts people on fixed incomes. It also creates conditions that lead, first, to economic prosperity - what economists call a **boom** - and then, when the free market reacts to the inflationary boom, produces a reaction, called a **bust**: rising unemployment and bankruptcies.

It is always wrong to seek to gain something for nothing. Only God has produced something (the universe) out of nothing (Gen. 1). While miracles can be considered a case of something for nothing, they exist only because of the ultimate payment: the sacrifice of Jesus Christ at Calvary. Governments pretend that they can get something - money - for nothing. They are wrong, both morally and technically. Someone wins when governments or their monopolistic private agents, central banks, inflate the currency, but only at the expense of someone else.

Conclusion

Money is the most marketable good. This means that it has the widest market. It is **liquid**, which means that it can be exchanged for other goods: (1) rapidly, (2) without advertising expenses, and (3) without offering a discount. In fact, you can often persuade a seller to accept a discount for cash. It is a medium of exchange. It is said to be a "store of value," but it is more accurate to say that it is a valuable thing to store. It does not have intrinsic value, but it has historic value. Because of this, it is widely believed to have future value. Because of this, it has present value.

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