What is money? A brief historical perspective

Money is anything (an object, or a written or electronic record) that is generally accepted as a **means of exchange** and a **way to settle payments**. In a barter economy goods can be exchanged for other goods, and goods can be used to settle debt, but it goes without saying that money greatly simplifies economic transactions and makes prices more transparent. Soon enough, societies realized the advantage of money over barter and started to create money.

Throughout history, societies have used different things as money, either commodities with some intrinsic value (salt, peppercorn, rice, barley, sea shells, cigarettes, precious stone or, most commonly, precious metals) or fiat money (that is, objects with no intrinsic value such banknotes, or promissory notes).

In many economies where *commodity money* was used, virtually anyone could create money. Anyone who could produce or find a certain quantity of the commodity money (be it salt, rice, a particular shell, or a precious stone, or some precious metal) could use it to purchase goods, or pay off debt, or simply save it for future needs. Once transacted for the first time, the additional units of money would add to the stock of money existing in the economy and they would start circulating within the economy supporting more and more transactions. What made certain commodities so special so as to become money? What properties should these commodities possess so that anyone would accept them as a medium of exchange, recognize them as a unit of account, and keep them as a store of value?

To fulfill these functions, a certain commodity had to possess an intrinsic value (which often meant that it had to be scarce), exist in fairly homogenous pieces (so that it would be easy to count it, and use it to measure the value of goods), and be durable (so that it would not deteriorate any time that it was changing hands). Because of these intrinsic characteristics, money soon started to function as a **store of value**, and a **unit of account**. Of course, commodity money also presented some disadvantages: first, it was difficult to convert into other money used in other communities; second, if for any reason the available quantity of this commodity changed (for example, it would stop being scarce, or it became even scarcer) then the economy would suffer (we will see this later on in this section).

The first turning point in the history of money was the introduction of **metal coins**. Gold and silver coins were first used around 600 BC and soon societies realized that these presented advantages over other commodities, among which durability, malleability, and the fact that it was difficult to produce them (we will get back on this point later in this module). Over time, one disadvantage of coins was their supply really depended on the availability of mines: once one was exhausted, there would not be enough metal to support more economic transactions.

The second turning point in the history of money was the creation of **fiat money**. At different times in different places people started to transact goods and services using "documents" that certified the existence of claims on someone. These "documents" took different forms in different parts of the world, for example: clay tablets in Mesopotamia, banknotes in China, transferable certificates of deposit in Italy... The last in this list is a stark example of how these documents would constitute money. When someone deposited coins in a bank, the bank would issue documents which anyone could present at the bank in exchange for a certain quantity of coins. As these documents would only *identify the bank* from which coins could be claimed and *not the original owner of the coins*, these documents could effectively be transferred. As far as the issuer of these documents was known and trusted (either by reputation of because of the law), the person who first deposited the coins could (and actually would) use these documents to make payments; the receiver would then use these documents to make other payments, so on and so forth. Soon these documents would be recognized as an acceptable means of exchange, as a unit of account, and as a store of value. Soon, these documents would become part of the stock of money of the economy. Some elements made these "documents" so special so as to be accepted as money: they allowed one to identify, clearly and unequivocally, the issuer, they were difficult to forge (that is, either by nature--for example, few people knew how to write--or by law--forging the official seal was heavily punished), they were transferable, the issuer was trusted as honoring obligations, and the value of these "documents" was backed up by coins made of gold, silver, or other precious metals.

Soon enough people realized that for large payments (for example, between merchants) it was not even necessary to issue these documents, it was just enough to keep good track of who owed to whom, and how much. One disadvantage of this system was that metal coins were still necessary as a collateral for paper money