ChatGPT

From Tally Sticks to Fiat: The Story of Money's Evolution

Long before coins or banknotes, societies kept debt and payments on clay tablets, temple ledgers or notched sticks – in effect, **credit money**. For example, medieval England's royal treasury used *tally sticks* (split hazel-wood rods) to record tax payments and debts. Each stick was notched with the amount, then split: the collector kept one half, the Exchequer the other. As one historian notes, these sticks "were an interest-free IOU (a promise to pay coin)… fully transferable and acceptable as a means to pay taxes. …As such they had currency as money" [1]. In other words, the state's tax liabilities themselves circulated like money. Similar practices were found in ancient temples and local communities – a priest or chief would write debts in an account book, effectively running an informal bank. What we call "money" began simply as a way to track who owed what.

By the late Middle Ages, expanding trade pushed Europeans to innovate. Carrying precious metals overseas was costly and risky, so merchant bankers (often Italians from Lombardy, or Jewish and Florentine financiers) created **bills of exchange**: written orders to pay a sum in a distant city. One merchant might deposit silver in Venice and receive a bill payable to another merchant in London. That second merchant could sell (or endorse) the bill to pay someone else in pounds. In effect, a bill of exchange combined an international remittance with a loan. It let traders settle foreign purchases without moving coin. These bills were *negotiable* – they could be sold or discounted at money markets – and they tied together currencies and credit across borders. For example, a Paris merchant sending silk to London could get paid in francs via a French bill drawn on a London banker. As trade grew, major banks in places like Venice, Genoa or Antwerp handled huge volumes of such bills, enabling long-distance commerce. In practice:

- A merchant in City A would sell goods or lend funds to a local banker and receive a **draft** drawn on a partner banker in City B.
- The merchant gave this bill to his creditor (who might live in City B), effectively transferring the right to claim payment in City B's currency.
- The banker in City B, upon presentation of the bill, paid the creditor in local coin.

This system functioned as an early foreign-exchange market. Even kings used it – for instance, the Medicis in France and Spain loaned to monarchs via these bills. But it required **trust**: if the issuer or guarantor was seen as unreliable, a bill might be refused or at a steep discount. Hence one sees in history that rulers who defaulted on debt (like Charles I of England or some medieval city-states) found financing cut off.

The real pivot came in 1688–1694 in England. The **Glorious Revolution** established parliamentary control of the purse. King William III needed massive funds to fight Louis XIV, but Parliament now insisted on supervising taxes and spending. Historians note that after 1688 "Parliament held the purse strings and repayment was guaranteed, so loans flowed and property rights became more secure" [2]. William's Nine Years' War (1688–97) cost about £5½ million a year at first, rising to £8½ million by war's end [3]. Parliament passed new excise and land taxes – though burdensome, they were *seen as legitimate* because MPs voted them. A Commons Commission even required each supply bill to specify precisely how revenues were spent [4]. In short, the state could now credibly promise to use tax income to repay debts. As a contemporary

account puts it, this “increased parliamentary control of revenue helped to ensure the success of the Bank of England… for investors in the Bank could be confident that their loans to the Government would be repaid by parliamentary taxation appropriated for that purpose” [5] .

In this climate of fiscal reform, England created the **Bank of England** in 1694. Facing William III’s deficits, the government offered a loan of £1.2 million from the public at 8% interest. In return, it granted a royal charter: *“The Governor and Company of the Bank of England”* was born. The response was astonishingly brisk – the entire sum was subscribed in just 11 days by over 1,200 individuals from nobles to shopkeepers [6] . These subscribers effectively became shareholders, lending to the Crown via the Bank. The Crown promised to use tax revenues (now controlled by Parliament) to pay interest. With this backing, Bank of England notes (promising gold on demand) and government bonds were now seen as secure. The new bank’s establishment meant Britain could finance wars by issuing government debt that foreign merchants and states trusted.

Two decades later, in 1717, England took another step that shaped modern money. Sir Isaac Newton – by then Warden (and soon Master) of the Royal Mint – recommended adjusting the gold-to-silver ratio of British currency. At the time one gold guinea coin was legally worth £1 (20 shillings) in silver, but market rates had diverged. Newton advised raising the guinea to **21 shillings** [7] . This slight tweak had massive consequences: silver became undervalued and flowed out of England, leaving gold coins dominant. In effect, Newton had *“transmuted silver into gold”* in the money supply [8] , and Britain slid onto a de facto gold standard for the next two centuries. From then on the pound was “as sure as the law of gravity,” fixed by a weight of gold. The decision even inspired awe: novelist Stefan Zweig later wrote that “the Austrian crown circulated in bright gold pieces, an assurance of its immutability. Everything had its norm, its definite measure and weight” [9] . Under a gold convertibility promise, anyone holding Bank of England notes or pounds sterling could demand real gold. This anchor gave creditors confidence: foreign merchants accepted sterling only because they knew it could be redeemed in gold.

Wars, Credit, and the Need for Hard Money

In the 18th and 19th centuries, wars repeatedly tested this system. Every major European conflict saw unprecedented spending on arms, navies, and subsidies – often demanding goods from abroad. England in the Nine Years’ War and the War of the Spanish Succession (1701–14) had to import vast quantities of naval stores, food, and subsidies for allies. Napoleon’s wars (1793–1815) were even more global: for example, Britain purchased Scandinavian timber for shipbuilding, Russian grain when continental supplies were cut off, and paid Portugal and Ottoman suppliers in gold. Likewise, France’s wars depleted its treasure – eventually Napoleon defaulted on some debts. In each case, governments sought loans from bankers and allied treasuries, often in exchange for hard currency. Foreign creditors demanded payment in gold (or silver) because fiat notes or war-time scrip were unreliable.

The **mechanics** of financing such wars often involved the international credit system built on bills of exchange and sovereign bonds. Governments issued bonds to investors at home and abroad, promising to pay interest from future taxes. They sometimes sold bills of exchange on major financial centers: a British agent might draw on Amsterdam, or a French one on Genoa, to raise specie. When taxes flowed, officials redeemed the promises in coin. For example, in the early 1800s the British Exchequer accepted land and window taxes as security for debt interest, assuring lenders that “public revenues” were dedicated to repayment.

In these centuries, **international trust** hinged on convertibility and credible governance. A merchant would lend to King George III because Parliament swore the loan would be repaid in gold from customs and excise taxes. By contrast, investors distrusted absolute monarchs or revolutionary regimes that altered contracts. As one 18th-century writer noted, in smaller states exchange rates fluctuated wildly unless a bank or sovereign guaranteed payment in good coin [10]. This was why major powers gradually pledged their paper money to gold: it signaled stability. The British, especially, insisted on "the gold clause": foreign holders of pounds could exchange them for bullion at the Bank of England.

In practice, **redeeming paper for gold** meant that if you held a banknote or Treasury note, you could go to the issuing bank and demand coin. Banks held vaults of bullion for this purpose. (Notably, during the 1793–1821 *Suspension Period*, Britain suspended convertibility; after inflation and crisis, convertibility was restored by Peel's Act in 1819.) Elsewhere, the single-peg gold standard was less consistent. For instance, France maintained bimetallic rules longer but later suffered inflation in wars. The key point was that *international* payments typically settled in specie: a creditor in Frankfurt or New York would only accept a country's notes if those notes were promised in gold.

This pattern continued through the world wars. In World War I, the Entente powers spent trillions on munitions, ammunition, and food. Unable to pay in their damaged local currencies, France and Britain bought massive shipments from the neutral United States and other suppliers – paying often in gold or US dollars (themselves convertible). The Federal Reserve notes that "a large inflow of European gold to pay for US exports increased the money supply. The Fed was powerless to offset the gold inflow" [11]. In effect, Allied belligerents sent gold to America to secure guns and supplies. After 1918, this shift left the US dollar as the new de facto reserve currency: America's money stayed tied to gold, while many European currencies had decoupled or inflated.

World War II saw a similar dynamic on an even greater scale. Britain, desperate for food and equipment, borrowed (often interest-free) from the US; under Lend-Lease and subsequent loans, the UK accumulated vast dollar debts. The Americans insisted on repayment in dollars convertible to gold, or in cash. In 1946 Britain even secretly shipped gold bars to Washington to secure final settlement of lend-lease. Overseas lenders – from New York to Moscow – simply would not accept liabilities unless they could be made good in tangible gold or gold-backed currency. For the US, financing half the war then guaranteeing civilian spending, the lesson was the value of a gold promise: many believed as J.P. Morgan had quipped in 1912, "Money is gold, and nothing else."

Bretton Woods and the Dollar-Gold Alliance

After WWII, policymakers tried to tame these problems with a new system. At the 1944 Bretton Woods conference, 44 nations agreed to revive fixed rates pegged to gold – but with the US dollar as the anchor. The Bretton Woods Agreement *"established a new international monetary system… in 1944, with gold as the basis for the U.S. dollar and fixed exchange rates."* [12]. In practice, every participating country defined its currency by a fixed value of dollars, and by extension a fixed value of gold. The US promised to redeem dollars for gold at $35 per ounce, and the International Monetary Fund and World Bank were set up to manage this order. Thus the postwar era *replicated* the old gold-parity idea – but under American hegemony. Trust was high: nations had to keep their currencies within 1% of the agreed parity, and any foreign central bank could in theory demand gold from the U.S. Treasury. This arrangement facilitated a global boom in trade and reconstruction. It also echoed the 18th-century confidence in Britain's gold convertibility – except now it was the dollar offering that promise.

However, by the 1960s strains appeared. The costs of Vietnam and domestic spending in the U.S. meant dollars in circulation far outpaced gold reserves. In August 1971 President Nixon finally broke the link. The dollar's *"direct convertibility to gold"* was *halted* – a moment dubbed the "Nixon Shock" [13]. As one account notes, after Nixon "devalued the U.S. dollar relative to gold… he declared a temporary suspension of the dollar's convertibility into gold. By 1973, the Bretton Woods system had collapsed" [14]. In effect, no government could now redeem its bills for bullion. With that, the world moved fully to **fiat money**: national currencies backed only by government decree and public confidence. Exchange rates floated freely.

Legacy: From Credit to Fiat

The journey from wooden sticks to electronic bank balances was driven by needs of trade, war and trust. Throughout history, the same themes recur: **credit expands the reach of money**, but only if *someone* guarantees it. Early temple ledgers and tally sticks show that governments and banks have long issued "money" as promises to pay. Bills of exchange and banks then linked distant markets, letting commerce flourish without heavy coin. When nation-states needed funding – especially for wars – they created public debt secured by taxes and pledges of convertibility. The Glorious Revolution and creation of the Bank of England were landmark events: by subordinating royal debt to Parliament and pledging tax revenues, investors believed in the pound as surely as they once believed in warmongering monarchs.

Gold played the role of **universal promise**. A 20th-century writer captured the faith that metal inspired: "the gold standard… remained there [for the next 200 years]… successful because… everyone knew where they stood" [8]. From Newton's London to postwar Bretton Woods New Hampshire, tying currency to a weight of gold was meant to instill discipline and trust. Once that link was broken – in 1971 and forever – governments had no commodity backing their notes, only tax receipts and policies. Today's fiat currencies are descendants of all these experiments. The paper bills and digital balances we use trace back to clay and sticks – always a promise of value. Our modern monetary system grew step by step: from temple scribes and tally sticks, to bills of exchange on merchant tables, to parliament's ledgers, to gold coins in vaults, and finally to the floating fiat that underpins our economy.

Sources: Historical records and analysis [1] [3] [5] [6] [7] [9] [13] [2] [12] [14] [11].

---

[1] A History Lost - The English Tally - The Gower Initiative for Modern Money Studies
https://gimms.org.uk/2019/03/08/history-english-tally/

[2] What really happened during the Glorious Revolution – and why it matters for current fiscal crises | CEPR
https://cepr.org/voxeu/columns/what-really-happened-during-glorious-revolution-and-why-it-matters-current-fiscal

[3] [4] [5] The Financial Revolution - UK Parliament
https://www.parliament.uk/about/living-heritage/evolutionofparliament/parliamentaryauthority/revolution/overview/financialrevolution/

[6] Why was the Bank of England founded? | Bank of England
https://www.bankofengland.co.uk/museum/online-collections/blog/why-was-the-bank-of-england-founded

[7] [8] [9] [13] A brief history of the international gold standard | World Finance
https://www.worldfinance.com/banking/a-brief-history-of-the-international-gold-standard

10 Chapter III, How Lombard Street Came to Exist - Econlib
https://www.econlib.org/book-chapters/chapter-chapter-iii-how-lombard-street-came-to-exist/

11 The Federal Reserve's Role During WWI | Federal Reserve History
https://www.federalreservehistory.org/essays/feds-role-during-wwi

12 14 Bretton Woods Agreement and the Institutions It Created
https://www.investopedia.com/terms/b/brettonwoodsagreement.asp