SIDELINE

As Good as Gold

The Evolution of Money

In early societies, a wide assortment of items—for example, cloth, seashells, and cattle—served as money. The following article outlines how money has evolved since then.

Coinage

About 7000 years ago, precious metals, such as silver and gold, began to be used as money. Because of their high intrinsic value and durability, they gradually became the dominant type of money in many parts of the world.

The first coins were invented during the 7th century BCE in the ancient kingdom of Lydia (in what is now Turkey). Early coins differed from previous types of metal money in that they bore stamps or symbols indicating the weight and purity of the metal from which they were made.

Early coins were supposed to be full-bodied so that their face value matched their worth as pieces of metal. However, because users tended to accept coins at face value, cheaters could make a profit by employing practices known as clipping and hollowing. Clipping was conducted by shaving metal from the edges of a coin, while hollowing involved trimming a coin's two faces. Slivers of metal collected in this way could be sold to make new coins. Governments could make matters worse. Political rulers sometimes engaged in a practice known as debasement, reducing the value of metal in the coins they issued. Until this dishonest behaviour became common knowledge, their coinage was accepted at face value. For a while, rulers were, therefore, able to buy products worth more than the metal used to make their coins.

Because many coins were worth less than their face value, people tended to hoard full-bodied coins, while passing on other coins to buy goods and services. This behaviour is described by one of the earliest laws in economics. Gresham's Law is named after its originator—Sir Thomas Gresham, England's Chancellor of the Exchequer during the reign of Queen Elizabeth I. According to Gresham's Law, "cheap money" always replaces "dear money" in circulation because full-bodied money is saved.

Paper Money

The next development of money involved the use of paper. Unlike previous types of commodity money, paper money has no intrinsic value and is more convenient and cheaper to produce than coins. Paper money first appeared during the 7th century CE in China, and in succeeding centuries, its use spread to other parts of Asia. In the 13th century, for example, the Italian traveller Marco Polo recorded with wonderment the use of paper currency in the empire of the Mongol ruler Kublai Khan. In medieval Europe, the introduction of paper money was closely tied to the development of banking. Over time, the paper receipts issued by banks began to circulate as a means of payment. Depositers found it convenient to settle transactions by exchanging banks' receipts rather than withdrawing and redepositing coins. These receipts—which were endorsed by each holder as they passed from hand to hand—were an early form of the bank cheque.

By the 17th century, the certificates of deposit issued by banks were generally accepted as money—first in the United Kingdom and the Netherlands, and then in other parts of Europe. Bank deposits still make up the bulk of the money supply in most nations, including Canada.

Like bank deposit money, government-issued paper currency dates back to the 17th century. An early use of paper currency occurred in Canada during the colonial period. Starting in 1685, a shortage of coins forced colonial administrators in New France (now Quebec) to issue card money. Playing cards endorsed by colonial officials were assigned different denominations and then used in the colony as a means of exchange.

For a time, this card money was a success, and its use spread to some of the British colonies in North America. But the system finally broke down when colonial officials issued too many cards in order to pay for government purchases. This caused a cycle of inflation. As playing card money became less valuable, the prices of products in terms of this money increased.

The temptation for governments to distribute too much currency led to the adoption by many countries of a gold standard. Under this system, which prevailed in Europe and North America during the 19th and early 20th centuries, a unit of paper currency could be exchanged for a coin containing a given amount of gold. For example, the Canadian dollar could be converted into 23.22 grains of gold. This option ensured there were constraints on the amount of paper currency that could be issued.

While minimizing the risk of inflation, the gold standard did not allow governments to vary the money supply as a tool of stabilization policy. During the Great Depression, when stimulating economic activity was a prime concern, the gold standard was allowed to lapse in Canada as well as most other countries. Since then, Canadian paper currency has not been convertible into any other form but possesses a set value by law. The same applies to Canada's coins, whose face value does not depend on their metallic worth.

1. "Any commodity can act as money as long as all participants in an economy agree to use it." Discuss.
2. Explain the advantages and disadvantages of the following types of money:
   a. Coinage
   b. Bank deposits
   c. Paper currency