Student Guide

Class #1 – Course Introduction; History of Money

Exercise: Introduce yourself. What do you hope to get out of this class?

Exercise: what could be some disadvantages to a bartering system?

Exercise: before telecommunications, how might people trade without shipping physical money like gold?

Exercise: What are some of the problems with commodity money?

A Brief History of Money and the Modern Monetary System

For most of human history, money did not exist. Early humans were nomadic, moving around and hunting/gathering for survival. Eventually, humans settled into tribes and small communities. People in these communities specialized in different disciplines. Some people farmed. Some people hunted. Some people made clothing. Some people created tools and built shelters.

Communities grew, eventually becoming villages and towns. People began bartering with one another. Bartering was the practice of trading goods people owned or services people provided for other people's goods or services. Bartering economies were simple – people could trade based on their areas of specialization and each bartering party benefited.

A bartering systems disadvantages include:

- Market availability: People may not find a market of buyers for their specific goods or services.
    - Example: a woodworker needs milk but cannot find a dairy farmer who needs wood products.
- Exchange rates: People may find widely variable exchange rates for their goods or services.
    - Example: if someone wanted to trade a Nintendo Switch for eggs, what is a fair exchange rate?

Money replaced bartering as a more efficient way to transact goods and services. Prices could be set based on a form of money. Village and town leaders established rules for the money in circulation. The earliest forms of money included buttons, commodities, and seashells. These forms of money were known as bearer money.

Villages and towns started trading with one another. Money had to become more portable and universally valued. Gold and other precious metals became widely adopted, eventually attaining universal perceived value.

Towns became states and states became nations. Governments minted coins in precious metals such as gold, silver, and copper. The minted coins had intrinsic value because of the universal perceived value of the precious metal.

Transportation innovations accelerated the speed of commerce. As commerce and trade moved faster, money had to move faster. Gold was a universally recognized form of money, but gold is heavy and difficult to transport in large quantities.

Governments began keeping ledgers, which represented claims on gold, instead of trading gold itself. Governments issued paper money, which also represented claims on gold.

In developing economies, commodity money was heavily utilized. The value of commodity money is derived from the good from which it is made. As an example, in the 1600s, tobacco was money in what is now the States of Virginia, Maryland, and North Carolina.

People needed to protect their money. Decentralized banking systems emerged where banks would safeguard gold in exchange for bank notes and interest payments to depositors. Bank notes were claims on gold held by the bank. However, banks could fail, causing depositors to lose their deposits.

The innovation of the telegraph in the 1800s made ledgers easier to maintain. Banks, businesses, and governments could quickly reconcile accounts over long distances. Electronic communications began the transition of money from bearer forms to electronic forms.

Governments began centralizing and regulating banking functions. In the United States, monetary policies are determined by the U.S. Federal Reserve. Central banks set monetary policies based on macroeconomic data such as employment and inflation.

Governments stopped linking their currencies to gold. The current monetary system throughout the world is based on fiat. Fiat money is currency that lacks intrinsic value, but which governments establish as legal tender.

Electronic money transfers and electronic payments have increasingly replaced bearer money like cash and coins.

Digital currencies, also known as cryptocurrencies, were developed as alternatives to fiat money. Most digital currencies are decentralized, meaning they are not backed by governments or central banks.

Central banks throughout the globe are exploring central bank digital currencies (CBDCs) as the next major evolution of fiat money. CBDCs are digital currencies which are centralized and backed by government. CBDCs would provide central banks with greater data and monitoring of the money supply and consumption patterns.

Key Takeaway

Money supports commerce and trade. As commerce and trade accelerated, money had to refine and transfer more quickly.