

Czego uczy nas historia gospodarcza?

12 ROZMÓW NA TRUDNE CZASY

Money, monetary systems and their functioning past and present.

Discussed by Prof. Paweł Grata and Prof. Wojciech Morawski

Paweł Grata: Good morning. Welcome to the latest conversation in the series "What does economic history teach us? 12 Conversations for tough times", part of a project under the same title funded by the Ministry of Science and Higher Education as part of The Social Responsibility of Science programme. The topic of today's discussion will be money, monetary systems and their functioning in the past and today. My guest is Professor Wojciech Morawski, an economist from the Warsaw School of Economics, head of the Department of Economic and Social History. Good morning, Professor.

Wojciech Morawski: Good morning, and welcome.

Professor, I would like to talk about money. About something that really interests us all, concerns us, spins us around and often controls our lives. But also about how this money was created, what it is made of and what role it plays today, based on historical experience. What is the monetary system? This is where we need to start, to explain the basic concept.

For a long time, people have felt the need for some measure of value that is neutral to other goods and is a convenient means of exchange. There are certain commodities that lend themselves to this. These goods must have certain characteristics. Firstly, they should not break down, they should be durable. So, for example, it cannot be bread that goes stale. Secondly, they should be easily divisible into smaller pieces so that you can give out the rest. The ideal commodity of this kind, when things go wrong, is spirits. Spirits then enter the role of money and from various wartime circumstances we know this phenomenon. A bit of tobacco too. These are the commodities that have this function. Money in the form of a metal disc, which we associate with today's coins, appeared in the 7th century BC in Greek culture, but not in Greece, but in present-day Turkey, where there was a state called Lydia. The ruler of this Lydia was Croesus and he began to mint money from such a natural alloy of silver and gold. Then it became popular, for centuries money was bullion money, so that we understand what that means. If I hold in my hand a silver 5 French franc from 1842, that meant, at least in theory, that I was holding a piece of silver

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that was worth 5 francs. If this silver had not been in the form of a coin, but had been an irregular lump, it would have cost 5 francs, because that is how much silver costs 5 francs. That is, bullion money represented value not conventionally somehow, but as literally as possible. It's worth 5 francs. Of course, even such money was spoilt, that is, it was subject to all sorts of inflationary processes. For a long time, it consisted of rulers spoiling money. The rulers withdrew the money from circulation, minted it anew and either added a little copper in place of the silver or made the money a little smaller. And in this way, they cheated, because they took a million out of circulation and put a million and a hundred thousand back into circulation. This, of course, had to be accepted from the ruler at face value, and if it was then worth less, the ruler didn't care. He didn't care until he received taxes in such corrupted money. That's when he started to care again. But it worked like that for many years. And generally, the theory that people had was that if there was something wrong with the money, then it was being corrupted. The rulers are spoiling it. This corruption sometimes went to extremes. In the 13th century, such money appeared in Europe, which was called *bracteates*, or leaves in Latin. These were such thin sheets of metal that only one side could be bent, because if you bent one side, you could still see the other side. Of course, after every such bending, some reform came along that introduced more decent money back in and everyone breathed a sigh of relief. But that's how it rocked for centuries. Something new in this area started in the 16th century. The Spaniards gained a colony in South America and it turned out that there were huge reserves of silver there. They started importing this silver to Europe and began minting such large, decent money, thalers. That's when the name thaler appeared, from which today's dollar is derived. And these thalers were very decent money, they certainly weren't spoiled, and yet they caused inflation. At that time, the idea dawned on people that perhaps money would lose value not because there was something wrong with it, but because there was simply too much of it. The quantitative theory of money was born at this point. It was Copernicus who had something to do with this, because he was pondering the monetary system at this very time. Another breakthrough in this area took place in the 17th century and in our immediate vicinity. After those wars, which we know as the "Deluge", both Poland and Sweden were broke, badly ruined financially by the war effort. We got out of it in the traditional way, that is, the king leased the mint to Andrzej Tymf, and he started minting such money, which formally was Polish gold. The Polish zloty before the partitions had 30 groszy and on the tymfs it was written that it was 30 Polish groszy, but in fact there were 13 groszy for 13, that is silver for 13 groszy. We were spoiling as we had for centuries. The Swedes came up with something much more original. They had little silver, little gold, but a lot of copper. They came up with the idea of including copper as a third bullion in the bullion money system. The problem was just

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to get it right. It wasn't about the appearance of a perfunctory kind of contractual money, copper money, such as we also have in our purses today, five-penny notes and lower. The idea was to incorporate copper into the bullion money system, i.e. the stock of bullion in a coin is to correspond to its nominal value. And since copper was, however, much cheaper than both other bullions, I will show you what the Swedes got out of it. They started to get this kind of money out of it. It's called platment, that's the natural size of this sheet. it's about two centimetres thick and weighs 20 kilograms. And it's 10 thalers, there's a stamp here in a few places that says it's 10 thalers. In theory, the idea of including copper in the bullion system was great, because there was a lot of copper, you could expand the system. In practice, however, it was immediately unusable, because if we told ourselves at the outset what conditions money had to fulfil, there was one more thing we expected from it: that it should be easy to carry around. Money that weighs a tonne and stands in front of the entrance to my house, what am I supposed to do with it next? And the platitudes began to pose such a problem. It was 10 thalers, imagine being paid 120 for some reason, and you were cooked, there were no cars. The Swedes constructed these toboggans, they pulled these platments behind them on the toboggans, there are engravings of that. But it was a kind of madness. That forced another invention soon afterwards. The Swedes set up a Swedish state bank, the Sverige Riksbank, and this bank started accepting these platments from them and issuing them with receipts that they really had it. With these receipts you could go to the bank at any time and collect your copper. But because these receipts were bearer, the Swedes started paying themselves with these receipts and not bothering to go and get the copper. This is why Sweden became the home of paper money, at any rate within European culture, because the Chinese had older experience in this area. It was Marco Polo who described Chinese paper money, and he went into great detail about it. And this is where the next thought immediately occurred to me. There was a separate lecture on banking systems. Banks actually operate and make money by under-covering their liabilities. Banks assume that, after all, all customers will not come to collect their liabilities at the same time. Therefore, you can create a little more credit than you have cash. If they don't all come at once, we can manage. If they come, then it will be a disaster, but that is unlikely. And with this invention we are talking about, it immediately started to be the same. That is to say, the thought arose that, after all, they won't all come for their platments at the same time. And that means that the coverage doesn't have to be 100 per cent. If we have one million platments, we can spend the notes, print three million, and it will work. And that's how the circulating money system looked in the following centuries, until the Great Depression of the 1930s. It was still said that there was gold currency, but that did not mean that people had gold money in their pockets. People had more or less

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the same thing in their pockets as we do, which is banknotes, coins, they didn't have cards of course, because those were still not those times, except that those banknotes at the central bank could be exchanged for bullion. And what's more, there was a statutory link between the bullion stock at the central bank and the size of the monetary circulation. And the central bank could print more by how much, but not more than what the law said. Usually it was this coverage around 30%.

Did this Swedish experiment, which was successful, find imitators?

It found one immediately. When the English saw that it worked so well, they started to do the same thing, only no longer with copper, but with gold. At the end of the 17th century, the Bank of England was established. The Bank of England started to have the same fun with gold. And then others followed the same path.

But not everyone seems to have succeeded.

The advantage of this monetary system was that it was much more robust than our monetary system today. It was much more resilient to inflation. The disadvantage was that ultimately the size of the monetary circulation depended on a force majeure, i.e. the bullion stock. And this could not be artificially multiplied. Alchemists tried, but it turned out not to be possible. This could mean that in certain situations the monetary circulation was too narrow for the needs of the economy and the economy was being suffocated by deflation. There were, therefore, various ideas at the price of how to widen and loosen this without giving up this main advantage. One such idea was the bimetallic system, that is, to include both gold and silver in circulation as issue cover. This was cool because more money could be made. It wasn't cool because in order to set up such a system, you had to agree on some kind of rigid ratio of the value of silver to gold. And that relationship fluctuated according to supply and demand and didn't correspond to our rigid one. And there were terrible problems with that. In general, bimetallism failed. At the end of the nineteenth century, the situation was outlined that if any countries wanted to play in the top league and be taken seriously, they had a gold currency. All of Europe switched to gold currency in the 1900s. Russia did it, in 1900 quite late the Americans did it. When Japan wanted to signal that it was a premier superpower, it too made a gold yen. Silver, on the other hand, was used by Asian countries and these countries were getting poorer relative to Europe. British India, French Indochina, there were silver currencies everywhere, and silver was cheapening relative to gold. As silver cheapened, these nations became poorer relative to Europeans. It was such a monetary manifestation of colonialism. This all changed during the Great Depression. Deflation was the main problem during the Great Depression. The economy was being suffocated by too narrow

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a monetary circuit. An idea such as state interventionism, i.e., an active economic role for the state, emerged. What followed? An unbalanced budget, which we will discuss separately in a moment. This meant that gold could not be a cover for money issue. There must be some other system, and gold must be excluded from that. In general, the principle adopted was that this cover for the issue is the sovereign debt. The more the state is in debt, the more money can be issued and, in a sense, by issuing money we cover the budget deficit. There was a danger that this would turn into a huge inflation, so somehow, we had to put the brakes on it after all. I think that when we talk about the budget, we will talk about these brakes. In any case, we entered the post-war period with such a system that individual countries were no longer required to convert to gold, but the Americans, who after the Second World War had more than half of the gold in their hands, it was all gathered in one place, in a military base like Fort Knox, a little bit as part of such propaganda, showing off, declared that they were exchanging dollars for gold. Not to everyone, just to the central banks. In any case, the Americans have made a promise that they are exchanging for gold. And what's more, they exchange for gold at a fixed rate like before the war, that is, \$35 per ounce. This at some point turned against the Americans, because people realised that gold was unnaturally cheap. And what's more, it was the Americans who, for prestige reasons, got themselves into such a situation that they had to defend the low price of gold. But the Americans will not be able to do this indefinitely. One day they will break and then gold will get very expensive. you should take the opportunity to buy into that gold while the Americans are still holding out. And in the 1960s there was talk of something like bleeding the dollar, that is, that gold was fleeing Fort Knox. The Americans were quite powerless against it. They should have devalued the dollar, but they had previously let slip the saying that the dollar was as good as gold. If we have always said that the dollar is as good as gold, then we can't devalue it because people will stop believing it. This went on until 1971, when Richard Nixon finally decided to suspend. That's what we used to say suspend back then. It was propaganda of success . It was rather known that it was forever, this convertibility. That was when the monetary system actually broke with gold. This was finally cemented in 1976, at the Monetary Fund conference in Kingston, Jamaica, where gold was demonetised. Since 1976, it has not been allowed. No official parity in gold is simply allowed to be set. The monetary system is to have nothing to do with gold. Gold, of course, is still in the world, it has its value, it has its market price, but that price has no more to do with the currency system than the price of oil, gas and a few other things. It is simply a commodity, such a unique quite commodity. By the way, just to give you an idea of the volumes we are talking about, I found an estimate somewhere that all the gold mined and used up to now by humanity is

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a cube of 33 metres. A sizable chunk and it weighs a lot, but nevertheless so conceivable for us.

What impact did the gold demonetisation process have on exchange rates? money was based on gold, then exchange rates were quite rigid. Here gold cost the same everywhere, depending on the value of the currency. By contrast, later on, when that gold went away.

So that's the breakthrough I was talking about, that breakthrough in the early 1970s was to move to a floating exchange rate system. It was recognised that rigid exchange rates were something that got in the way. and that in the name of freedom, either we had rigid exchange rates or we had, for example, the freedom to move capital around the world. It is better to have this freedom of capital movement. It is impossible to have both of these things at the same time. In general, the 1970s, as this system unravelled, were years of quite high inflation. Then there was an attempt to somehow bring it under control. There was a policy in the 1980s. There was a turnaround in the macroeconomic policies of individual countries. That is, monetarism emerged. Monetarism was the belief that inflation was the greatest evil. And first and foremost, the government's job is to fight for macroeconomic stability, as it used to say, which means that we fight inflation first and foremost. At the expense of other things. If it has to be at the cost of increasing unemployment, then tough. We would rather not have inflation than have high unemployment. That was the mindset. This way of thinking spread gradually. The stabilisation reforms in the post-communist countries were based on just such assumptions. The Balcerowicz Plan, or other such plans, were based on monetarist assumptions. This way of thinking triumphed in the 1990s, when it seemed to be the only right one, and was put to quite a severe test in 2008. In 2008 came such a crisis of monetarism. It turned out that this policy can be dangerous, it can generate financial crises and it does not safeguard against them. And, in fact, some competing great economic doctrine should have emerged at that point to replace monetarism. It has not emerged yet. It has not emerged, I think, mainly because a new problem has appeared on the whole economic policy scene that was ignored by everyone before, namely the ecological barrier. For example, boosting the economy at the expense of expanding industry at all costs encounters a barrier in the form of environmental destruction, and one simply cannot go too far in this direction. This new doctrine should somehow take this into account, but so far no one has come up with it yet. Whoever comes up with it will surely get the Nobel Prize .

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The only question is whether he will live to see it There is no new doctrine, but the essence of money is changing. It is no longer just paper money, bullion money, which is long gone, but there are various new forms of money. There is a certain expansion of forms of payment.

This has all been controlled by central banks. From what we have said, and from what Professor Leszczyńska has probably also said, it follows that banks have the ability to multiply money. This means that for a long time now, people have known that money is not just these coins and notes. Money is also what banks are able to add to it, because banks operate on the principle of incomplete coverage, that is, if they have a million, they make three out of it, because they have their ways of doing that. Well, and the central banks have steered it a little bit, that is, the central banks have learnt to slow down or to drive this inflation, to somehow influence the behaviour of the commercial banks. From this point of view, 1966 was a turning point, when a trial of strength took place in the United States between the central bank, the Federal Reserve, and the commercial banks. The Federal Reserve decided that inflation had to be fought because it was too high, and American banks then discovered something like the euro-dollar market, that is, they moved their dollar-denominated business to Western Europe. It turned out that US banks thus escaped the power of any central bank. Because let's imagine, a US bank opened a branch in Amsterdam and started doing business in dollars on a large scale. The Dutch central bank looked at this and came to the conclusion that it was responsible for the condition of the guilder, which is what the Dutch currency used to be called. And since what is happening is in dollars, we won't go into that. The US Federal Reserve would have loved to deal with it, but its authority ended at the US border. That's when this kind of extraterritorial banking emerged, which virtually no one controls. Then the problem of tax havens and so on began. I mean it was such a step towards globalisation. This finance became so international that no national authorities could control it alone. And then there was also a technical issue, that is, the moment it became electronic and not analogue, so to speak, well that makes it all the more difficult to control. In fact, no one in the world controls global finance. They are autonomous to themselves to a large extent. And this, of course, boosts the economy, it is an important part of our modern prosperity, but it is also a source of danger, because things can happen there which, like in 2008, happened in this sphere. In any case, many things have changed, because it used to be that if a bank went bankrupt, there would be a queue in front of the bank, and the bank would say at some point that we have run out of cash and we are going bankrupt. Today this is hard to imagine. Today it would probably involve turning off the ATMs,

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whereby they wouldn't tell us that this is a financial problem. They would tell us that it is a technical problem and we are working on it and tomorrow everything will be fine.

What is the future for money ? And for monetary systems ?

I do not believe in such predictions that we are moving towards a single global currency. That would not make sense. The security of the currency system should be somewhat aligned with the wealth of the society. Poorer societies want easier access to credit at the expense of possibly lower security standards. The richer a society is, the more it values the security of the system . From this point of view, the Euro was already a risky idea , because it combined the German society, a wealthy one, with the Greek society, a much poorer one, and an equal level of security had to be included for these two. And it turned out, , that this is already causing tensions. The world is even more diverse than Europe, so this is unlikely to work on a global scale.

But will money survive or will it be replaced?

It will survive, of course, but what is it supposed to be replaced by?

Cryptocurrencies?

No, I find it difficult to take it seriously. It's speculative in nature. Someone will get really dinged on it, because it's like any speculation, but in my opinion it's not more.

That is, the monetary system created by the evolution we have been talking about should be in place for decades to come.

At least... Yes, it will change, but the essence will remain.

It is changing, it is changing, but it will continue to be the bloodstream of economic life.

That's right.