

Money as a Social Technology

Keith Rankin, 10 July 2015

Two weeks ago I wrote about the way that most people who have money understand money ([Money 'As If' it was Magic](#), 27 June). And last week ([Creating a Future: The Adjacent Possible](#), 3 July) I wrote about why the intellectual leap to an understanding of money and wealth, as they actually are, is so difficult. The necessary concepts are not adjacent to the concepts that dominate today's finance-based belief system.

In addition to the predominant belief-system about money, there are a number of monetary reformers who know that money does not work as most of us assume it works. They know that money is not an appreciating commodity that, even when stored for decades, can assuredly be converted (spent) at any time into something else through an instant cargo-cult-like process called 'shopping'. Some of these reformers would like money to be like this, grounded in some perpetually scarce commodity. So they see the technologies of money – double-entry bookkeeping and fractional banking – as being problems rather than as historical solutions.

In the history of money, both credit-money and commodity-money have played their roles. (A great recent book to read is [Money: The Unauthorised Biography](#), by Felix Martin.) The intellectual conundrum came to a head in the United Kingdom in the 1690s, following the 'Glorious Revolution' of 1688. The Bank of England became in effect a central bank, through its acquisition of the Crown's debt. The newly fledged central bankers gained a good working understanding of money as a circulating promise without intrinsic value. Thus coins in circulation could be understood as promises of the sovereign, by virtue of his or her head being imprinted on them. And the new-fangled banknotes represented promises by the signatory banks, whose corporate signatures appeared on them.

The problem at this time, however, was that the intellectual rock stars of the time – John Locke and Isaac Newton – understood money as a commodity. Thus the value of a coin, they thought, was the amount of gold or silver or copper in that coin. They might have observed (but did not) that debased and clipped coins circulated quite happily as money, of equal value in exchange as the unclipped ones. What mattered, in practice, is that there was enough money *in circulation*. Even the counterfeiters who Newton hanged were actually (though not intentionally) doing society's economy a favour when these coins augmented the money supply when that money supply was inadequate.

Because the eminent men with the wrong understanding of money were regarded so highly, albeit for reasons outside of finance, their beliefs about money prevailed over the knowledge of the few emergent bankers who understood the social technology of money as a circulating medium. Today we are more than ever in the thrall of John Locke's mistake. We think of money 'as if' it were a magic yeast-infused organic resin. (Newton, the alchemist and natural philosopher, set his sights higher. He was in thrall of gold and God; refer to the 2009 book [Newton and the Counterfeiter](#), by Thomas Levenson.)

Money is a three-faceted Technology. The two most important developments that made it possible for the modern age to displace the medieval middle ages were developments in Europe around the fifteenth century: double-entry bookkeeping and fractional banking. For the former, the most accessible work is the 2012 book [Double Entry: How the Merchants of Venice Created Modern Finance](#), by Jane Gleeson-White. On the origins of modern banking, itself dependent on double-entry bookkeeping, Felix Martin (cited above) gives a good account.

Most economic textbooks give a short stylised account of how banks create money. While to students the process seems extremely dodgy, we must be grateful to the early accountants and goldsmiths who made it possible for us to create money without having to plunder the Americas. (Europeans still plundered the Americas, anyway, especially in the sixteenth century. Misunderstandings about money have been around since the time of King Midas, who wished even his food would turn to gold.)

Fractional Banking

We may think of a rich man in the year 1500 placing a bag of gold coins (that he regarded as his wealth) with a goldsmith for safekeeping. Now, as today, such rich men were a core part of the economic problem of their time. They held onto their money, rather than spending and circulating it.

Anyway, the goldsmith realises that the rich man was into accumulating money rather than spending it. So the goldsmith lends the bag of money to someone else who he knows will spend it. The borrower is content to be given a signed receipt for the gold (and to give the goldsmith an IOU that includes interest), and uses the goldsmith's receipt to pay for goods from some merchant.

There are now two owners of the one bag of gold; the rich man and the merchant. The actual gold continues to sit untouched in the goldsmith's safe, as the goldsmith's reserve. (The interest implicit in the borrower's IOU, plus the rich depositor's service fee represent the goldsmith's profit.) So the goldsmith issues further receipts (promises) on that gold (seen by the goldsmith as a 'lazy asset'), knowing that most likely none of the eventual holders of these receipts will ever want to withdraw this gold 'reserve'. (Perhaps 10 people now 'own' this gold.) Further, if some of the gold coins in the bag are withdrawn by either of these 10 people, then the goldsmith will be reasonably sure that the coins will end up in the safe of a fellow goldsmith. Further, through balancing swings and roundabouts, on any given day there is a good chance that gold withdrawn from a competitor goldsmith will end up in our goldsmith's safe.

Of course, the more receipts the goldsmith issues against one bag of gold, the more likely he is, on a bad day, to not have enough gold to honour his receipts. (Thus, the most important asset of an early goldsmith-banker was a very fast horse, which might take him far from the soon-to-be-maddened crowd!)

Banking works by having many more receipts in circulation than reserves to back those receipts. Thus, the supply of money is very 'elastic' in practice; we can always have as much or as little money as we need to facilitate our transacting needs.

Nevertheless, the problem that the rich man poses to society (or even the man or woman of modest middle-class means) remains. For the most part, rich men will not exercise their saved entitlements to goods and services; a statistical reality. This rich-man problem is the problem of the non-spender; the problem was resolved by the emergent banks issuing replica receipts (as debt) to actual spenders.

Japan, Revealing the Third Facet of Money as a Social Technology

The problem that we face today is too many rich men and too few credible private borrower-spenders. Japan was the first country in the developed world to go through (in the 1990s) a twenty-first century financial crisis. Japanese banks now rely on the Japanese government as borrower-in-chief. In fact what is happening is that the government of Japan has become a spending (rather than a lending) bank.

Japanese savers – of whom there are very many – effectively lodge their unspent money with their own government. They receive IOUs from the government, receiving minimal if any interest. Unlike the bank however, the government spends (ie circulates) the money that the savers do not wish to spend. The money, once spent, is received by more Japanese who don't themselves want to spend it, so their receipts are lodged once again with the government.

The process means that the government has issued IOUs to the Japanese bourgeoisie many times more than it can pay from its own financial reserves. But, because the number of Japanese who, at any one time wish to cash in their IOUs is very small, the government can issue IOUs worth many multiples of the government's own reserves.

Japanese public finance works on Ponzi principles, which sound dodgy. But everyone understands that, in order to remain afloat, the government must spend what the citizenry will not spend. For the Japanese creditors of their government, their precautionary savings are really just a form of insurance premium. So long as most creditors never cash in their IOUs, the few that do can always be paid out from government reserves.

This is the global future of public finance. Governments function as a spending and giving bank, rather than as a lending bank. It is fractional banking taken to the next level. It means that government debt can be many-hundred percent of GDP. And, so long as governments keep buying goods and services to the value of those that the citizenry are entitled to buy but choosing not to buy (or giving to persons or organisations who will spend their publicly-recycled money), then the saver citizens will continue selling and therefore earning, and never needing to draw on their accumulating savings. Further, the saver citizens know that, if too many wish to spend the savings they have lodged with their government, then the government simply raises taxes. So they don't spend their savings, except when 'rainy day' events occur in their private lives.

Fractional public finance is a simple extension of the fractional banking principle. It's a way of ensuring that all output is purchased, and it creates a level of social security that allows people to produce less yet still live comfortable debt-free private lives. They exchange private debt for public debt, and it's really only a bookkeeping exercise. (There is no moral imperative to 'pay back the debt'; that would be a disaster.) Further, the Japanese government need not spend in such ways that control the private lives of Japanese citizens. Rather it recycles its public debt money back to those non-bourgeois citizens (or community organisations formed around such citizens) who will spend what they receive. It is this non-bourgeois spending that further enriches the saver bourgeoisie, who redeposit their unspent earnings with their government. In reality the monetary reserves simply stays in the government coffers, as bookkeeping entries, while government IOUs, also bookkeeping entries, expand relative to reserves.

Twenty-First Century Public Finance

In these last few years I have been investigating trends in private and public sector financial balances. The largely unseen trend is for others to follow what Japan started in the 1990s. Many Japanese do not yet understand this at an intellectual level; but they do understand that it works. Further, few see anything happening in Japan today as a contributor to global financial uncertainty, despite Japan having a much higher per capita public debt than Greece does. It's to China and Europe that we look to with foreboding; and the Republican Party in the USA for that matter. These countries are following in Japan's footsteps, albeit like an unseen herd of clumsy elephants. In the Euro Area, as a whole, the governments owe almost the entire annual GDP of the Euro Area, to the people of the Euro Area. For the United States, government debt exceeds its annual GDP. For the most part, the creditors are the American people.

Public debt is the solution, not the problem. We can discover this the easy way or the hard way; most likely the latter. Public debt is the third component of the social technology of money. It works because to the in-need-of-placating rich it is much more acceptable than taxation; yet it works in practice 'as if' it was taxation.
