7 The taboo of inconvertibility

The concept of backing, in terms of precious metals or other commodities, long dominated monetary thinking and also influenced the notion of fiduciary money. It led people to identify the unit of money with the commodity it represented and define it in terms of the very thing that acted as its guarantee. This idea obscured the true nature of money and distorted its mechanisms. These distortions can plainly be perceived by comparing the interpretation of money from two separate points of view: from that of a commodity backing and that of the transaction (or ‘exchange’) function.

As regards the commodity guarantee, what counts for the holder of a title acquired in return for a supply of goods is the security of being able to make use of this title and thus receive something in kind, wherever and whenever he likes, in exchange for the goods he has supplied. As regards the transaction function, as was revealed in chapter 5, debt money is seen as the essential instrument for the conversion of production into consumption or investment. The search for some kind of security may help a monetary system to function smoothly and efficiently, but it cannot be regarded as the essence of such a system. If we want to understand the monetary mechanisms, we must first of all consider the exchange and conversion function, because it is fundamental. We must also resist the temptation to see, in the search for a guarantee or commodity backing, anything more than an ancillary operation, the means of which may, moreover, vary, and the role of which should be assessed only to the extent that it promotes the proper use of money in its conversion function.

The origin of money is not to be found in barter; its true role is much more of a fiduciary nature. In return for the article he had supplied, an animal skin or a flint axe, primitive man attempted to create a claim which he could use later somewhere else, and which could also, if necessary, be used for the purpose of obtaining another commodity, different in kind from the one he had sold. In order to do this, he needed
some sort of security, a guarantee both for the continued validity of the claim and the opportunity to make use of it at another time, in another place and for another thing. Men soon found the security they were looking for in the shape of precious metals, which fulfilled the necessary conditions thanks to their durability and their intrinsic value, which made them universally recognised and coveted assets.

But the identification of money with precious metals, however remote in the history of man, should not deceive us. If we look at things in chronological order, we can see that the search for a backing to money is posterior to the recognition of the existence of a claim, and is only one manifestation of one of the most powerful impulses which have at all times governed the actions of men — the search for security and the attempt to reduce risks.

The duality inherent in the function of metallic money, which was at once representative of a claim and the material security for this same claim, is reflected in the separation which persisted up to the eighteenth century of the metallic object which constituted the guarantee (Louis d’or, écu, etc.) from the exchange value of this same object expressed in units of account (pounds) on the faces of coins. It also explains how governments, whose fiat determined the connection between coin and unit of account, have been able, from time immemorial, to make abusive use of this privilege.

For centuries, kings took advantage of this inherent ambivalence in order to fill their own coffers, and at the same time supply the specie needed to keep the economy functioning smoothly. But, in fact, they were only partially successful; the shortage of specie, even more than the chronic deficits of public finances, was what hampered economic development from the Middle Ages to modern times. It was only in 1720 in France, at the time of the banking revolution of John Law, that the unit of account was first visibly marked on the currency units, first on the notes and then on the coins, and that the pound ceased to be a mere abstract unit of account.

The identification and assimilation of money and its guarantee very soon resulted in credit and the issue of the circulating medium being based primarily on the guarantee. The development of money and the introduction of the abstract unit of money, in the form of a claim on an institution, was not the result of a logical process of reasoning but was only the consequence of the risks which experience led lenders to take, vis-à-vis this same security.

The first banks, in the Middle Ages, kept all the specie that they received from their customers, in their coffers. Later, they learnt to lend