What the Origins of Money Teaches Us About Spontaneous Order

Money has been around for most of human history. From Mesopotamia (or even earlier), all civilizations have employed some kind of medium of exchange to facilitate transactions regardless of their geographical locations, legal and economic systems, religious beliefs or political structures. Have you ever wondered why? In a brief essay entitled "On the Origins of Money," the nineteenth-century Austrian economist Carl Menger provides an answer to this question. Menger argues that money emerged spontaneously in different times and places to overcome the disadvantages of barter and facilitate the expansion of trade. Which disadvantages?

Imagine Sandy, a farmer in the Midwest, produces wheat, which she expects to exchange for barley. Two problems arise at this point. First, she needs to find a barley producer with whom to barter her products. This problem can be easily overcome if Sandy goes to a market where another farmer (let's call him Billy) sells barley. Since both proucts are harvested during the same time of the year, the exchange would easily take place.

But what if we are dealing with products with different life cycles? In this case, Sandy and Billy could only agree on exchanging their products if Sandy accepted the deferral of the payment until Billy's products have been harvested. This is what economists call deferred barter. Even though deferred barter solves some problems, it has an important limitation: it can only take place within small communities based on mutual trust due to the risks involved for one of the parties. What if Billy decides not to deliver the promised barley?

Thus, the use of deferred barter as a system of exchange prevents the expansion of trade beyond the limits of one’s community.

Barter has a second problem. Billy could refuse to trade barley for wheat. He might prefer exchanging his barley for any other commodity or good that better satisfies his needs. This represents another obstacle for the expansion of trade. How did societies overcome these problems?

They did so by using certain commodities as generally-accepted media of exchange, and more specifically precious metals. But why precious metals and not other commodities? According to Menger, gold or silver possess a high degree of saleableness, which he defined as “the greater or less facility with which they may be disposed of at prices corresponding to the general economic situation”. Today we call this property liquidity.

The relative high degree of saleableness of precious metals in relation to other commodities is fundamentally linked to their durability, divisibility, low transport and storing costs as well as the traditional demand for these goods in most places throughout history. The fact that precious metals are more saleable than other commodities implies that it is easier to exchange them for other goods: even though Sandy doesn’t need gold (she wants barley), she will accept it as payment because she knows she won’t have any problem to trade it for barley.

That’s why most civilizations adopted precious metals as money. Since then, money has gone through many changes, some of them spontaneous (e.g. the emergence of paper money) and some induced by the State (e.g. the replacement of commodity standards for central-bank fiat money).

In any case, money emerged as a result of what another Austrian economist, F. A. Hayek, called spontaneous order, that is, as an institution generated not by human design but by impersonal market forces. It wasn’t necessary for a central planner to overcome the limitations of barter. Economic agents through the market process figured out that precious metals could act as universal media of exchange, facilitating the expansion of trade and, thus, the establishment of commercial relationships among communities.

As a human institution that emerged spontaneously from the voluntary interaction of millions of individuals, money should teach us about the power of markets when it comes to providing solutions to economic problems; especially nowadays, when most people look to the government to solve their problems.

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