How money works

Gold rush

A good guide to the stuff in our pockets

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Money: The Unauthorised Biography. By Felix Martin. Bodley Head; 336 pages; £20. Buy from Amazon.co.uk

ONE story in this surprisingly entertaining book on the nature of money is about the Irish banking crisis. The country’s bank system ground to a complete stop, with branches closed, the clearing system suspended and customers unable to withdraw or deposit money. As cash ran out, people had to find a way of paying their regular bills, or even just stumpng up for a pint of stout in a pub. What actually happened was that businesses started accepting IOUs or cheques for everything, even though there was no telling when the cash would be forthcoming. It helped that a lot of Irish life is lived locally: builders, greengrocers, mechanics and barmen all turned out to be dab hands at personal credit profiling.

In short, Ireland developed a new class of money. Its currency was not backed by any central bank, but based solely on informal if surprisingly accurate credit scoring. And the currency was transferable: if certain people said the bond was good, then the bond was good.

This particular Irish banking crisis might seem vaguely familiar, but only vaguely. It took place more than 40 years ago, when the Irish financial sector came to a seven-month halt as a result of a national labour dispute. The point of the story is that it supports two of the author’s main contentions—first that money is not currency and that sovereign support for currency is not particularly important, and second that financial crises are endemic. No sooner has the last one been put to bed than the next is waking up.

For some people, money is merely something underwritten by...
the state and designed to enhance a basic barter economy. Felix Martin, an economist and fund manager, goes further.

Early societies, such as the Babylonians and the ancient Egyptians, were static, with a fixed hierarchy of social obligations. They had no need of money or currency. Money was the instrument through which later societies unshackled themselves from preordained social orders and became individualistic.

With money came speculation, bringing in turn those endemic financial crises. To ensure greater stability, Mr Martin would like to see the introduction of an ultra-simple version of "limited-purpose banking". Money must be "shorn of its specious promise" he says; let the state underwrite a tiny core of deposit-taking banks. Everything else—from interest-rate derivatives to collateralised debt obligations should carry on unregulated and uninsured. If you lose your dough, tough. You knew the risks. It is a solution that will attract anyone seeking a clean, clear, fair way of managing financial markets. Until they lose their money, of course.
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