

## The Five Pillars of Money

A successful monetary system must fulfill certain basic social requirements.

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I would like to share with you five ideas about money that may change your economic world. We economists don't usually share things such as these with people outside the club—they are from the first lecture I used to give at the university to PhD students being admitted to the inner circle. These notions are drawn from my own training at the hands of professors who learned their craft in the famous Money and Banking Workshop at the University of Chicago under the guidance of Nobel Laureate Milton Friedman.

The five pillars are: Money is a social institution. It is based on trust. It is a store of value. It separates sales from purchases. It is a contract.

Most economists would embrace most of these elements as part of their conceptual framework, even if they do not share Professor Friedman's views.

Not to worry, there will be no discussions of overlapping generations or money-in-the utility function (MIUF) models, or other specialized terms of an economist's craft. Instead, these ideas operate at the most basic level. They go to the essential conception of what money is and does in our society, and clearly they are not independent of each other. If a monetary system is

to function properly, it must address these five pillars of economic thinking in some way.

**Pillar One: Money is a social institution.** In the sense it is used here, the word "institution" refers to a structural arrangement at the center of some range of social relationships. That is to say, money is a product of social interaction, not intrinsic value.

**Money only has meaning in a world in which at least two people want to exchange things of value.**

While government can foster and support social institutions, it cannot sustain them if they do not serve the public or are inconsistent with public sensibilities. **No amount of government posturing can save a currency that has been over-issued, widely counterfeited, or otherwise debased.** The currencies of the Continental Congress and the Confederate States of America, victims of all of these ills, were both used eventually as wallpaper and kindling.

Money is a nexus of social activity that arises naturally as human beings relate to one another through economic exchange. In a world with only one person, there would be no money. Money only has meaning in a world in which at least two people

want to exchange things of value. No society, no exchange, no need for money. In a society, money emerges as a link between individuals.

Key leaders at the Federal Reserve understand and espouse this idea. Narayana Kocherlakota, president of the Federal Reserve Bank of Minneapolis, has argued that money is simply memory—societal memory. Money is a system of chits or markers, which people hold when society owes them future goods and services in exchange for goods and services that they have already surrendered to someone

else. Money is a social construct that formalizes the economic relationship of each person to society.

A direct implication is that monetary policy directly affects the fabric of society. It changes the way that people relate to one another. It changes relative wealth through distributional effects. And it affects every contract in the economy.

**Pillar Two: Money is based on trust.**

If Kocherlakota is correct, then the usefulness and acceptance of money in an economy relies on a trust between buyers and sellers that the value of money will remain constant through time: "I am willing to accept your \$5 for this thing or my labor that I'm selling now *only if*

