FAYAZ KABLI/REUTERS

Changing up: a Kashmiri money changer charges a small fee to swap damaged money for new notes.

ECONOMICS

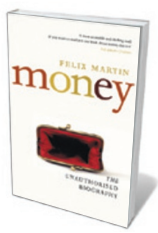
A tale of cash and credit

Martin Shubik navigates a study of the complex web of relationships that gives money meaning.

The macroeconomist Felix Martin covers a vast geographical and historical spread in his argument that we have it all wrong about money. *Money: The Unauthorised Biography* reveals that credit has a crucial role in society, but that many misunderstandings persist about the relationship of credit to gold or fiat money. The latest views on microeconomic theory get no airing here, yet such developments point to a scientific shift towards an information-processing and network analysis of money and credit markets in a dynamic evolving economy.

To a degree, Martin shows, the concept of money is all in the mind. Trust effectively oils the wheels, and a complex blend of expectations, law, customs and force creates money's 'store of value', such as its symbolic role representing gold. The key element is that transferable credit serves as money if the issuer (the government, banks, corporations or individuals) is perceived as creditworthy. The fundamental property of both money and credit in the dynamics of trade is the expectation that the recipient will be able to pass payments received on to others without loss.

Martin cites the example of the stone money of Yap, a Micronesian island in the western Pacific. The island's traditional monetary system is based on calcite discs (some of them 4 metres in diameter), nicely illustrating how geographical isolation and a tightly knit and networked society allow for the acceptance and enforcement of a credit system in which ownership rights are reassigned to a group of otherwise useless stones.



Money: The Unauthorised Biography
FELIX MARTIN
Bodley Head: 2013. 336 pp. £20

The author points to Ireland's banking system as another example of trust in a highly networked society. The country's economy survived reasonably well when strikes closed its banks for half a year in 1970. Among Ireland's relatively sedentary and homogeneous population, trade was carried out with cheques, aided in part by the informal credit-evaluation system provided by customers of pubs.

Martin then gives a swift overview of the evolution of trade throughout history, noting that the bureaucracy and the accounting and bookkeeping system developed by the ancient Mesopotamian civilization in the eighteenth century BC and earlier helped to simplify and standardize trade. Here he brings up the central problem of all monetary economies: who controls the system?

As we know from Aristotle, the Greeks saw money as facilitating individual exchange; conversely, the early Chinese viewed it as a key tool of the state. Martin sketches the growth of monetary sophistication in Europe, with regular trade fairs, bills of exchange and clearing houses providing the sinews for international trade and setting the stage for the emergence of central banks. He flags up the problem of debt, and explains the ways in which the public and politicians misunderstand the roles of money, credit and the uses and dangers of debt. He also notes the importance of financial inventions such as the automated teller machine (ATM), and the dangers of misconceiving the political and bureaucratic sophistication and support needed to preserve public confidence in new methods of finance.

Switching to the subject of the recent financial upheavals, Martin cites the views of economists Walter Bagehot and Hyman Minsky (as would I) in reference to crises in highly complex credit-based economies. Bagehot, the renowned one-time editor of *The Economist*, also authored the enduring masterpiece *Lombard Street: A Description of the Money Market* (1873). Minsky was an important twentieth-century US economist who worked on the subject of financial instability. In keeping with the advice of these figures, Martin notes the importance of central banks in making bold and decisive moves in times of crisis — but his analysis is much too brief. It is difficult to convey the degree of financial plumbing and public trust needed in an honest, lean and efficient bureaucracy to move from talk and promises to implementation.

The book's main weakness is its failure to cover many relevant developments in the microeconomic theory of pricing systems, decentralization, information and the development of trust. There is no reference to the vast literature on agency theory, a concept that concerns asymmetric information (A knows things that B does not know and can lie to him) and that makes credit assessment and bureaucratic behaviour so opaque. No reference is made to contract theory or mechanism design, devoted to designing and testing new structures that incorporate appropriate incentive systems in economic institutions such as commodity markets, clearing houses and web-banking services. Nor is there any appreciation of the considerable developments in game theory or work in the fields of econophysics and bioeconomics.

Martin does, however, understand that credit is central to running a modern economy and that it is a delicate flower that must be nurtured by both government and private financial institutions. He takes money seriously, but not the sea change in basic economic theory aimed at understanding the evolution and control of trust. ■

Martin Shubik *is the Seymour Knox Chair Professor of Mathematical Institutional Economics (emeritus) at Yale University, Connecticut. His books include* The Theory of Money and Financial Institutions.
e-mail: martin.shubik@yale.edu