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CURRENT AFFAIRS

ANALYSIS
WHAT IS MONEY?

TRANSCRIPT OF A RECORDED DOCUMENTARY

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Gordon Kerr - Financial Consultant, Cobden and Partners

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Adam Fergusson - Author, "When Money Dies."
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STONER SAUNDERS: Money. It's the stuff of dreams; the cause of arguments; a source of both pleasure and anxiety. We hoard it, in case we don't die; or we spend it, knowing that we will. We invest it with all our affections and disaffections: there's dirty money, clean money, hush money, guilt money, blood money, funny money, bad money, pure money. The philosopher Georg Simmel could think of 'no more striking symbol of the completely dynamic character of the world than money.'

In a single generation, there's been a revolutionary expansion in the size and rate of financial transactions across the globe. But today, money is in crisis. Or at least, we're in crisis about money. We owe staggering amounts of it in both personal and government debt. In the last few years, we've become familiar with failing banks, bail-out funds, subprime mortgages, the credit-crunch, quantitative easing.

We know money is important. But do we understand it? Why do we trust it? What *is* money?

LANCHESTER The best way of thinking about it, I think, is to sort of see money as a collective act of the imagination, and it's a thing which we have invested our credence in, and it works because we do that. But when you try and press really hard on the question of its meaning and its actual value, it sort of gets away from you.

RUBIN: Money is extremely strangely enough Malleable as a system of mutality of trust and bluff and double bluff and so on.

GRICE: it's very difficult to argue that there is really any alternative to money because money is a signature of our species.

STONER SAUNDERS: OUTSIDE I'm at a hole in the wall, I'm just putting a piece of plastic in a slot and punching in a few digits. Ooh wonderful, it's given me five pieces of paper, instantly recognizable as having the value of ten pounds each. But what I really want is one piece of paper to the same value

Well, here it is, I went into a bank, waited in a long queue, and eventually exchanged my ten pound notes for a fifty pound note. The whole transaction took place reflexively, with the minimum of intellectual effort.

But now, as I stare at this piece of paper, it seems rather mysterious. How does something with no intrinsic value, so lightweight and ephemeral, become valuable? Is it real, or is a metaphor for something else? How do we all agree this is fifty pounds?

STONER SAUNDERS: I am outside Bank of England: at centre of complicated nexus of the thing we call money is the Bank of England. The building itself isn't particularly beautiful, but it is very impressive and imposing and designed to give be to give out a sense of power and authority and it is a place that used to be thronging with human life the buzz and hum of everyday transactions to do with money. People used to be able to access the bank and visit the cashiers and the tellers to exchange their dividends for money or gold now it is much less accessible but luckily I have got an appointment with a man who I am hoping who will explain to me just what this piece of paper is…

SALMON: I'm Chris Salmon , chief cashier at the bank of England which means I have responsibility for the whole range of the banking operations including the issue of bank notes

STONER SAUNDERS. Well talking of banknotes I've got um the new fifty pound note here and this I think is your signature Chris Salmon Chief Cashier?

SALMON: Yep. I stand identified. That is my signature

STONER SAUNDERS. Why do we need the cashiers signature on the bank note.

SALMON: That goes back to when the bank was founded in 1694 that was actually was to help finance the wars that were going on and in return we were given a banking licence and we accepted gold deposits and issued what was called then running bank notes and they were promissory notes which are what today's Bank of England notes are and we made a commitment a promise to honour the value on those bank notes and that basic principal remains today.

STONER SAUNDERS: Sorry this bank note, you saw me bring it in you know it is mine, do I own it?

SALMON: It's payable on demand to the bearer, so yes, its yours to do as you will.

STONER SAUNDERS: Can I burn it?

SALMON: You could burn it but wouldn't realise its value for it, that would be your choice..

STONER SAUNDERS: That would be my choice, could I burn a lot of it can I burn a million pounds?....

SALMON: Ah the bank note is for you to use as you wish to use it. I suspect people rarely burn a big pile of bank notes probably because it is not a very sensible thing to do.

STONER SAUNDERS: Right so I do own it until the point that I that I bring it into the Bank of England to redeem it for something else obvilously I am not going to do that because we know that is an.historical echo?

SALMON: The reason why the language is there is to send to send a signal that we take the responsibility to maintain the value these piece of paper that you have in your wallet or under your mattress at home to maintain there purchasing power that is one of our central core purposes and we take that very seriously.to build confidence and trust which is so important

STONER SAUNDERS: So my banknote says "I promise to pay the bearer on demand", but it doesn't quite mean that anymore. Economist Dylan Grice and financial consultant Gordon Kerr.

GRICE: It's meaningless what it says because you don't get paid in anything. You get redeemed in more paper. It's a legacy of the days when paper really was a receipt for something more tangible, something real such as gold.

KERR: It's a false statement and I think it should be removed from bank notes because I used to think that there was some merit and some truth behind that.

STONER SAUNDERS: So it's not worth the paper it's written on?

GRICE: Not worth the paper it's written on.

STONER SAUNDERS: Four fifths of our banknote transactions are for sums less than ten pounds. We may never tire of having these bits of paper but they do

Back to the physical life of a bank note what happens when banknotes expire?

SALMON: When bank notes are taking out of issue, they're destroyed and turned into bricketts which are chewed up bits of bank paper and infinitely small piece and then pasted on as agriculture compost.

STONER SAUNDERS: Oh great,

SALMON: They eventually end up on the farmers fields.

STONER SAUNDERS: **Can I go and buy a bag of Bank of England compost**

SALMON: No, they're sold for retail market they go through the wholesale channels.

STONER SAUNDERS: **So there may be some farmers in England that one might be able to say that money does grow on trees?**

SALMON: Er, more that trees grow on money?

STONER SAUNDERS: **That's a fine philosophical debate we could have there.**

STONER SAUNDERS: **Why do we have money at all, given we could just barter, as we once did? The barter economy is attractively simple: goods or services are swapped directly for other goods or services. But it's also impractical, relying as it does on a double coincidence of wants, as writer John Lanchester explains:**

LANCHESTER: If you've got a bicycle and I've got a prize-winning courgette, our two goods don't have much to do with each other unless you happen to want a courgette and I happen to want a bicycle. If you sell your bike and I sell my courgette, we can do anything with it and therefore is that sense in which money is all goods. You know money is all the things we can want at the same time in one form. That's an extraordinarily potent thing. if someone had just invented it, we'd be going, wow, that's an astounding thing to have come up with.

STONER SAUNDERS: **Money is the expression of the struggle for the affection or goods of a third party. Historically, it has taken many forms: leather, maize, dried fish in the Canadian maritime colonies, tobacco in the American colonies, wives in Ancient Egypt. In Iraq in 2007, when trust in paper money collapsed, contracts were written in values of sheep.**

To be successful, a medium of exchange has to be practical and it has to keep its value. For many societies over many centuries the most widely accepted form of money that satisfied these functions was gold.

Miri Rubin is professor of medieval history at Queen Mary College, London

RUBIN: Well, the intrinsic value is the bottom line. If you melted it down, you could always get that amount of money. It is your insurance that no body can take away from you. And then there is the added value that has to do with this is a good coin, I can go anywhere with it, by participating in systems of exchange, But, actually, by participating in systems of exchange that have been ratified by rulers or other authorities, you can get more out of it in a way,I can store it or I can exchange it anywhere it will be recognised because it has the stamp of the city of Venice or Florence. Politics and coinage are so like today, you know the authority of the sovereign be it a state and not a king now, how much that sovereign is trusted it is absolutely fundamental. for the faith in the currency itself.

STONER SAUNDERS: Once this notion of money as having intrinsic value plus the stamp of authority had taken hold, the issue of trust was irrevocably implicated.

RUBIN: When it turns away from silver and gold, which does already in the 13th century. The merchants of Europe, the great merchants of Europe, who are connected to the big commercial centres, Florence, London, Paris are able to trade, not totally, without metals, because they've invented another way which is, of course, the letter of exchange, the bill of exchange, this element of trust, this issue of bankers in different cities, finding that mutuality that means you don't have to schlep around, you know, bags of money, but rather you have your elegant letters written out.

STONER SAUNDERS: The bill of exchange was a form of memory, an efficient way to keep track of the myriad transactions that were taking place in an expanding economy. It also represented an anticipated command of goods and services in the future, a claim on someone else – or credit (from the Latin 'credere', to believe). The economist John Maynard Keynes called this 'a subtle device for linking the present to the future'. It's a small step from the bill of exchange to my £50 note, with the promise that it, too, has value. It's unarguably still a piece of paper, and it's no longer redeemable for gold. But it's more than that, it's also a great conjuring trick.

Philip Coggan from the Economist magazine

COGGAN**:** Money is a bit like the end of Peter Pan where we're all asked to clap if we believe in fairies, otherwise Tinker Bell will die. We show our faith in money every day by offering it in return for goods and services and getting it accepted, and that's all an act of faith.

STONER SAUNDERS. So it's just an illusion, so why on earth do we believe in it?

COGGAN: We believe in it because it works.

STONER SAUNDERS: Money seems to work because it exists as a zone of possible agreement. It doesn't have a mind of its own: somebody – a sovereign, government, or central bank – determines that it has a certain value, and we form a consensus around that, hence the term 'fiat currency,' again from the Latin "it shall be."

But the terms of that consensus have been altered dramatically by recent events. In a world of ever more extreme finance, money has been pressed into a series of reckless feats, with vertiginous results.

John Lanchester, author of *Whoops! Why Everybody Owes Everybody and No-One Can Pay*

LANCHESTER: : For various reasons lots of super smart people convinced themselves of one another of the oldest falsehoods in the world of money, which is this time it's different. People inside that systems were confident that they had magically engineered away risk, and that is never true.. And that is never true increased risk is just increased risk. And there was enormous amounts of money pumped all throughout the global financial system in the form of cheap credit and the basic assumption was that the tide would not go out, and if it did go out it would go out in one place and not somewhere else. And the thing that astonished the world of money and caused the credit crunch - it <u>was</u> the credit crunch - was the fact that basically the tide went out everywhere simultaneously.

STONER SAUNDERS: Ah, the credit crunch. The super smart people had deployed incredibly complex mathematical models to drive a bewildering array of financial instruments. They used these models to justify the buying up of dodgy debt – like subprime mortgages - and passing it on as a good investment. The economy was awash with cheap credit, and we thought our houses were worth fortunes. But when the crunch came, money stopped performing tricks. The magic stopped and our belief in banks, governments and money itself was shaken.

FERGUSSON/STONER SAUNDERS talking about banknotes

FERUSSON: Have a look at theis. That is 20 million million a million million.

STONER SAUNDERS: That a billion mark, the second biggest note

FERGUSSON: Yes, the second one was a 50 million million mark.

STONER SAUNDERS: Because they were printing so much

FERGUSSON: Yes because the mark was depreciated so fast they had to invent notes of bigger nominal value

STONER SAUNDERS: Adam Fergusson is the author of *When Money Dies*, about the nightmare of hyperinflation in 1920s Weimar Germany. First published in 1975, this book has suddenly found a new audience.

FERGUSSON:: When does money become worthless? Well it becomes worthless when people will no longer accept it. It's really as simple as that. By 1923 in Germany it was devaluing by the hour. If you were living in the towns all you could do was to do what you could by barter. If you had nothing to barter, you starved or you went out and stole. There was a terrific amount of crime all the time, there was revolution in the air because people were so unhappy and so uncertain along with the distress of rickets in children, suicide, social disruption in big was because medium for which they were able to purchase anything had disappeared.

STONER SAUNDERS: So law … a very complex advanced civil society essentially collapsed as result of this

FERGUSSON:: *(over)* Absolutely it collapsed. One of the bad things that turned out from all this experience of democracy, of a democratic government for the first time, the Weimar constitution rather a good one, but the experience of inflation so turned people against democracy or democratic government that it made it much easier in due course for Hitler to come to power a few years later in 1933.]

News clip on latest round of QE, £50 billion

STONER SAUNDERS: I'm a bit spooked by all this talk of just creating more money out of thin air. Looking again at my fifty pound note, I worry about the Bank of England's promise to uphold its value.

fx walking down corridor. **STONER SAUNDERS/FISHER** in MPC room

STONER SAUNDERS: Just entered a room here with Paul Fisher Executive Director of the Bank of England and it is rather grand it is beautiful chandelier high ceilings, lots of guilt.

FISHER: This is the meeting room where Monetary Policy Committee meet and make the decisions on assert purchases which lead to the creation of money.

STONER SAUNDERS: Right this is the quantitative of easing of movement of hundreds of billions of pounds at a time or over a short period of time. This is the genesis this is the place where that happens.

FISHER: It starts here we make that decision

STONER SAUNDERS: Paul Fisher is an executive director of the Bank of England and a member of it monetary policy committee, the council of nine men and they are all men whose collective wisdom we relay on to keep our money valuable. Fisher is in charge of implementing the policy of quantitative easing or QE. What's the total amount that's actually been released in the last couple of years?

FISHER: Total of QE?

STONER SAUNDERS: Yeah.

FISHER: By the time we get to May, we'll have done 325 billion.

STONER SAUNDERS: 325 billion, in over how many years has it been?

FISHER: Since the start of 2009. So that's somewhere over 20 per cent of GDP.

STONER SAUNDERS: Right, how do you get to that figure? Where does that money come from?

FISHER: Umm, well we create it. *(little laugh)*

STONER SAUNDERS: It's a controversial policy, though Fisher says it's reversible. The Bank of England, which has a monopoly on creating money, invents huge amounts of it simply by adding a figure to its balance sheet. Then, at the push of a computer button, it spends the new billions on treasury bonds or gilts – in other words, government debt. These, it buys these from financial institutions like pension funds, and it's hoped the money will then circulate and unblock the economy.

Dylon Grice is a global strategist at French bank Societe Generale

GRICE : There is an argument that says by fiddling around with the price of credit, with interest rates, by fiddling around with the supply of money, with quantitative easing, what you have is a central bank which you know they would say that they're independent of political interference, but it's very difficult to make that case now given that they're buying an awful lot of government bonds effectively with printed money. And there is an argument that would say well actually these public sector institutions are abusing the monopoly power for political gains, and I think that there is certainly a case to be made that that is true and that is happening. The thing is *(sighs)* inflation crises are not completely beyond the boundaries of a reasonable imagination, and I think if you're going to ask yourself do we trust the Bank of England, you have to ask yourself well actually do I trust anyone who's making promises? Now um…

STONER SAUNDERS: **Now it is very hard to fathom what the bank of England does? Now you need to have 3 degrees in Economic and a PhD in astrophysics etc**

GRICE: I think even some people would say even the Bank of England doesn't fully understand what the Bank of England does.

LANCHESTER: There is something really disconcerting about printing money or the government effectively you know making, inventing money by buying money from itself.

STONER SAUNDERS: John Lanchester

LANCHESTER: It's almost easier to understand if you just say that there are elves, you know there are elves who make money, and you know when the money elves get to work, they sort of magically come up with it *(presenter laughs)* and then there's more of it. I think that's probably more straightforward and makes just as much sense as you know explaining the mechanics of quantitative easing. It's elves.

STONER SAUNDERS: How do you expect people to have confidence in money and in your role at the bank if you can just create it? I mean no-one else, normal people can't just expand their balance sheets, can they, like that?

FISHER: Well this over the years has been the problem with fiat money systems: how do you have confidence

STONER SAUNDERS: So that's fiat money?

FISHER: *(over)* It's fiat money.

STONER SAUNDERS: That's money built around consensus?

FISHER: Yeah, so what gives people the confidence that it will retain its value. And that's been a challenge for governments over many years. Inflation target regime is way of trying to precommit to maintaining the value of the money. What we want is low and stable prices so by committing to that over a long period of time we try to build confidence that money will retain it's value, but nobody pretends we can fine tuen this. The errors that you can make on these calculations are very wide. We've been keeping a very close eye on those indicators about people's beliefs in the value of money and we're reasonably confident that people have had faith that the value of money will be protected in the long-run.

STONER SAUNDERS: It's a weird thing this trust business.

GRICE**:** There's a wonderful story about the Pacific island of Yap. Where they their money were these rocks. And the wealthiest family had this absolutely enormous, big rock, which never actually moved anywhere. It just kind of sat. There was one time they were trying to transport it between islands and it sank, the boat sank, so it went to the bottom. But this didn't actually affect anything because there was still ownership would still get passed among you know different people, different families the title rights to this lump of completely useless rock.

STONER SAUNDERS: It is a matter of absolute faith, isn't it, because you can't boat out and have a look at it and just check on it in all weathers to see if it's still there? You just take it as a given that it is?

GRICE: Yes, that's right.

STONER SAUNDERS: Well, although I can actually touch my fifty pound note, I'm not convinced it's the best form of money right now. I think I'm going to swap it for something else. Well I am in a West London Shopping centre and I am standing in front of an enormous gold machine which is seriously reinforced and it is next to a standard bank ATM. I have decided that is might be interesting for us to buy some gold. So I can buy a gold bar , a 1 gram gold bar for £58.00. Which actually to my disappointment is about the size of a sim card or a finger nail which is tiny, but then we can go up to a gold bar of two and half grammas' now that is a little bit bigger, almost a postage stamp but not quite and then I can get to a Kruger an and I can buy a tiny little one tenth of a Kruger an for an £152.00. Gordon Kerr you here and you know a lot about gold. Should I buy here?

KERR/STONER SAUNDERS at gold machine…Kerr: Gold beats paper money hands down.

KERR: Well I have just checked and the latest sterling prices is about one thousand one hundred and fifty pounds per ounce. So at £152.00 for one tenth of an ounce it represents, exactly a 30% mark up.

STONER SAUNDERS: Well I am glad that you have translate that for me, I'm not going to put my credit card in here now which I was about to do. Actually I was going to put some paper money in as I thought that to exchange paper for gold was really attractive proposition, but I think I'll probably withdraw from this particular transaction. But you like this stuff gold. Don't you?

KERR: Well I'll certainly think that when you consider the two fundamental functions of money. A) It is a store of value and B) It is a means of exchange. Certainly as store of value gold beats paper money hands down.

SCHENK: It would be hard to think of a whole economy with people running around with gold coins which are rather unwieldy, they tend to chip and lose their value. As a means of exchange it's not a very effective money.

STONER SAUNDERS: Catherine Schenk is professor of International Economic History at Glasgow University

SCHENK**:** But as a store of value, particularly at times of uncertainty, when you think there might be inflation or that paper currencies might suddenly inflate or disappear, or you don't have faith in your government, then you might put your investments in other kinds of assets and one of those assets might be gold.

STONER SAUNDERS: There's a growing debate about the role of gold in the economy, and it's not about buying a few coins and putting them under the mattress, but about returning to the gold standard. Advocates want to do away with elastic money that can be expanded or contracted at whim, and anchor it once again to something real and stable. The fact that the total amount of gold ever mined in the world would only fill a cube the size of a tennis court is no deterrent to Gordon Kerr of Consultancy Cobden partners.

KERR:: It's now inevitable that there'll be a return to the gold standard because, quite frankly, governments have shown themselves that they just cannot be trusted in the very important role of administering a paper money system. We're not talking about changing the way you use credit cards or debit cards or ATMs. All we're talking about doing is restricting/removing the power of central banks to create or print more money or to manipulate the price of money. What we're saying is that the Central Bank would have to have a store of gold and every pound note that was issued would be linked to some fraction of the value of gold.

STONER SAUNDERS: Gold doesn't generate any interest, and so it's inert. Yet its price goes up but also can come crashing down, so it won't stay still.

Money as a comedy of values has long drawn the satirical attention of artists. Marcel Duchamp once paid his dentist by drawing an ornate cheque, which he then filled in and signed. During Germany's hyper-inflationary period, the Munich artist Karl Valentin papered over a park bench with worthless 100,000 Deutsche Mark notes. The German word for bench is *Bank*; he called his piece "Deutsche Bank". These philosophical disruptions remind us that money is essentially the offering of one abstraction for another.

Wall Street clip: Gordon Gekko 'It's a zero sum game, somebody wins, somebody loses. Money itself isn't lost or made, it's simply transferred from one perception to another.'

STONER SAUNDERS: The steroidal Gordon Gekko, played by Michael Douglas in the 1987 film *Wall Street.* If money is perception, then is there nothing about it that we can take as fixed? Take credit and debt: apparently they're now the same thing.

John Lanchester

LANCHESTER: It's a trick of language, when I was a kid it used to be called debt and now it's called credit. I don't think you have to be all that old to remember when debt was just regarded as an uncomplicated bad thing. And now we call that credit. And that I think is a very profound cultural shift to do with this essentially rebranding.

COGGAN: History is a battle between creditors and debtors, and the nature of money is the battleground.

STONER SAUNDERS: Philip Coggan author of *Paper Promises: Money, Debt and the New World Order*

COGGAN:. Go back into novels of Dickens and you'll see that debtors were imprisoned, debtors were viewed as immoral, people who took on responsibilities which they then ducked. But I think in modern culture it tends to be the creditors who are seen as immoral, so we have campaigns against predatory lenders. We tend to blame the lender for forcing the borrower into debt rather than the borrower for taking on too much debt.

STONER SAUNDERS: So credit is debt and debt is credit. And the future, apparently, is the present, as it has been in the past.

Medievalist Miri Rubin

RUBIN: Edward III, who launched the wars in France to become the 100 years war had to be even more inventive in raising money against futures of taxes and futures of customs incomes and, ultimately, to become massively indebted to Italian bankers, so much so that the crown jewels were in the hands of Italian bankers

STONER SAUNDERS. So we had futures in the 13th century/14th?

RUBIN: Totally. 14th Century.

STONER SAUNDERS. So money was then as it is now a projection into the future?

RUBIN: Yup. And, as ever, those projections, it is always the sky is blue, all is well, everything comes out tops and, of course, it doesn't. And that's why you have various tragedies and desperate situations and emergencies and so on.

STONER SAUNDERS: As economies teeter, desperation and tragedy are present realities. And the present may last a very long time.

COGGAN: I think this is going to be the matter of political debate for the next ten or twenty years. We've essentially taken on, made more promises than we can afford to honour. So this is going to pit taxpayers against public sector workers, young against old, rich against poor, one country against another. Which promises are we going to break?

STONER SAUNDERS: I'm not even sure any longer if my fifty pound note is a metaphor for credit or debt. Government debt in the UK is one trillion pounds. The population is 62 million, which means that every single one of us owns a £16,100 pound parcel of the debt. I'm going to need a lot more fifties to pay that off.

Money is fantastically useful, but if we lose trust in it and those who control it, where do we turn?

Paul Fisher again, at the Bank of England

FISHER: In practice you could have absolutely anything as a form of payment, and if people are willing to accept it as a form of payment, it's got money like properties and ultimately you can't control what people are willing to do.

STONER SAUNDERS: At the Bank of England, would you mind then if I started printing my own money?

FISHER: Yes we would.

STONER SAUNDERS: Why? You just said there's nothing to stop me doing it.

FISHER: Yes. Well there's nothing to stop you using a medium of exchange. If you start printing money …

STONER SAUNDERS: It won't look like yours. It'll be different. No-one would confuse it.

FISHER: When you start printing money, you create some value for yourself. If you can issue a thousand pounds worth of I.O.Us to everybody, you've got £1,000 for nothing. And so we do restrict the ability of people to issue, create their own notes in that way.

STONER SAUNDERS: You're protecting us from ourselves?

FISHER: We're protecting you from charlatans.