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AGREEMENT IS MONEY:
BEYOND THE CHARTALIST READING OF ADAM SMITH

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SUMÁRIO

RESUMO

Este artigo mostra que Adam Smith não é o precursor nem da visão ortodoxa, nem da heterodoxa da moeda, como tem sido duplamente argumentado. Segundo ele, a moeda não surgiu nem como um meio de troca introduzido para superar as dificuldades do escambo, como na visão ortodoxa, nem como uma unidade de conta estabelecida pelo Estado, como na visão heterodoxa. Pelo contrário, como mostra este artigo, para Smith a moeda surge do acordo sobre a avaliação de serviços mútuos que ocorre originalmente na troca. A moeda, portanto, surge espontaneamente na troca, mas, ao contrário da visão ortodoxa, surge principalmente como uma medida de valor. Ao mesmo tempo, se o Estado pode intervir para garantir a universalidade de um meio de pagamento para liquidar créditos e débitos, para Smith isso é apenas o fruto do processo histórico e não o seu início, como na visão heterodoxa.

Palavras-chave: Adam Smith; cartalismo; moeda; acordo; autoestima.

ABSTRACT

This article shows that Adam Smith is the precursor of neither the orthodox nor the heterodox view of money, as has been doubly argued. According to him, money arose neither as a medium of exchange introduced to overcome the difficulties of barter, as in the orthodox view, nor as a unit of account established by the state, as in the heterodox view. On the contrary, as this article shows, for him money arises from that agreement on the valuation of mutual services that originally takes place in exchange. Money, thus, emerges spontaneously in exchange, but, contrary to the orthodox view, it emerges primarily as a measure of value. At the same time, if the state can intervene to guarantee the universality of a means of payment to settle claims and debts, for Smith this is only the fruit of the historical process and not its beginning, as in the heterodox view.

Keywords: Adam Smith; chartalism; money; agreement; self-esteem.

JEL Classification: B10, B12, B31, D46, E40, Z13

1. INTRODUCTION

Adam Smith is often regarded as the father of modern economic thought. As far as modern monetary theory is concerned, he is even regarded as the pioneer of two opposing schools of thought: the orthodox and the heterodox. The purpose of this article is first to show that, on the contrary, Smith is the forerunner of neither the former nor the latter. In other words, we will show that for him money arose neither in the market as a medium of exchange introduced to overcome the difficulties of barter, as in the orthodox view, nor as a unit of account established by the state with which people can perform credit transactions, as in the heterodox view. Introducing the historical dimension of his thought, we then show that, for Smith, money initially emerges from the agreement on the valuation of reciprocal services that originally took place in exchange.

In contemporary literature, the theory of money set out in the Wealth of Nations (WN) has been read as the first expression of the 'orthodox' view of money. This thesis explicitly draws on the criticisms of Smith by chartalists such as Georg Friedrich Knapp ([1905] 1924) and Alfred Mitchell-Innes (1913). Chartalists point out that money has no intrinsic value ('charta' in Latin means papyrus or register) and derives its value from the state. According to them, money is essentially the unit of account in which debts and credits are denominated and enforced by the community or a state, notably through taxation. Consequently, chartalists tend to challenge the so-called orthodox view of money, based on the idea that money is created spontaneously in society as a means of market exchange, evolving from the difficulties of barter, that is, as a commodity which is generally accepted as an instrument of exchange because of its intrinsic value.

The main assertion of chartalists against the idea that money emerges from the difficulties of barter is that money is, previously, a unit of account. The idea is that it is impossible to barter without a prior act of comparison between the things to be exchanged by some measure of value. Therefore, the logical sequence that seems implicit in Chapter IV of Book One of the WN – where Smith seems to claim that money arose from the introduction of an easily adopted currency to facilitate trade – is seen as flawed. And Smith is seen as adopting the orthodox view.

However, authors from the same strand of chartalism have also recently argued the opposite, seeking rather to see Smith as the pioneer of their heterodox view of money. They have emphasized that, in line with the chartalist view, Smith considered the possibility that the value of money might depend on the ability to pay debts, especially to the state and with paper money (that has no intrinsic value).

This dual interpretation was possible because the proponents of the opposing readings focused on two different chapters of the WN, each ignoring the other. The former chose to target and criticise Chapter IV of Book One of the WN, in which Smith discusses the origin of money as a universal medium of exchange, while the latter focused on Chapter II of Book Two of the WN, in which Smith discusses money as a particular branch of the general stock of society. However, as we will show, there is nothing contradictory for Smith in these two chapters of the WN. To be convinced, we must take into account the historical dimension of his monetary thought, which is more explicit in the Lectures on Jurisprudence (LJ) than in the WN. Taking this aspect into account also allows us to arrive at an interpretation of money in Smith that departs from the two partial readings that try to place it within the orthodox or heterodox view.

As we argue in this article, for Smith, money is not initially an instrument of exchange and therefore a measure of value, as usually argued, but primarily a measure of value and therefore an instrument of exchange. This is clearly stated in the LJ. However, the argument for this explanation is reversed in the WN. This reversal has not been noticed in the literature and may have caused the confusion that later led to read Smith as a precursor of the orthodox view.

In the WN, the explanation of the emergence of money as a measure of value comes after the explanation of the diffusion of money as a medium of exchange and not before, as in the LJ. This explanation is found in Chapter V of Book One of the WN, which is usually considered separate from Chapter IV and only related to the labour-based measure of value and not to the origin of money. Chapter IV is used by Smith only to explain the origin of money as a universal medium of exchange, i.e. how instruments of exchange such as gold or silver became generally accepted. This happened because, as Smith explains in Chapters II and III, as exchange takes place and trade develops, the division of labour also arises and develops. In Chapter IV, Smith argues that as the division of labour develops, the need for readily accepted means of exchange increases.

Chapter V, on the other hand, argues that real money, and therefore real wealth, does not consist in the universal medium of exchange, such as gold or silver, but in the real measure of value: labour. Labour is therefore the real measure of value and the original money as a unit of account that made possible the original exchanges – from which the division of labour then emerged – even in the absence of instruments of exchange (as in the famous example of the two hunters with which Chapter VI begins). Hence, according to Smith, it was out of the exchanges that took place with this original money as a measure of value that money as an instrument of exchange subsequently emerged and spread, as the division of labour developed, until it became universally accepted.

This historical account of the origin of money is central to Smith's critique of Mercantilism. This is clear from the very first lines of the chapter devoted to it in the WN (Chapter I of Book IV), which begins precisely with a critique of the mercantilist idea that wealth coincides with money, or gold and silver. Here Smith explains that this confusion arises because money has a dual function, not only as a measure of value but also as an instrument of exchange (see WN IV.i.1). Since we can easily obtain almost anything with a universal medium of exchange, it is what everyone wants to obtain (reversing the means with the end). Thus, rather than being an orthodox defender of the idea that money arises as an instrument of exchange, Smith argues that the mistaken association of wealth with the universal medium of exchange arises precisely from the fact that money also fulfils this function.

This critique of Mercantilism also finds echoes in Chapter II of Book Two of the WN, which was the focus of those chartalists who saw Smith as the precursor of some of their ideas. They point out that Smith suggests that money can simply consist of accounting for mutual debts with paper money guaranteed by the state through taxation. Unlike the chartalists, however, Smith sees this not as the beginning of history, but as the end of a long process. This historical process begins with the first exchanges based on the original money and then develops with the development of the division of labour. The development of the division of labour brings with it the increase of wealth and its unequal distribution, and thus the need for a government to enforce property rights (see WN V...).

This means that for Smith, exchanges take place before the need for a government to enforce the effectiveness of such agreements arises. It is exchange in primitive society that gives rise to the division of labour and thus the process that generates the need for government. Contrary to the chartalist view, for him there is no need for government or community to ensure the effectiveness of the debt and credit agreements by which the first exchanges take place. These exchanges can be based on mutual trust, as Aristotle, quoted in the LJ (A ii.46), also implies. It is in these initial exchanges – based on the desire to gain deserved credit and appreciation from others – that the original money emerges as a measure of value.

First, we argue that in Chapter IV of the first book of the WN Smith does not say that money as an instrument of exchange derives from the difficulties of barter, as is usually argued. This kind of money, for Smith, only becomes increasingly necessary as the division of labour develops. Next, we show that the origin of money as an instrument of exchange is explained in the Lectures of Jurisprudence (LJ) starting with money as a measure of value. We also claim that it is found, with specific variations, in Chapter V of Book One of the WN and that this is connected to the critique of Mercantilism, set out in Book IV, as well as in Chapter II of Book Two of the WN. Finally, we show what this original money – with which the first exchanges giving rise to the division of labour and all its consequences – may consist of. This money may be the common measure of value on which exchangers agree to value each other's services, motivated by the desire to obtain from others the esteem and credit they feel they deserve.

2. THE ORIGIN OF THE UNIVERSAL INSTRUMENT OF COMMERCE

Smith's discussion of money in Chapter IV of Book I of WN can be seen as an example of the orthodox view on money that has passed into the collective unconsciousness of the economics profession , constituting the founding myth of modern economic science . This portrait of Smith is not new. In a very critical tone, Alfred Mitchell-Innes denounced Smith's views on money as an "error" that was perpetuated by many other economists and became part of the "fundamental theories on which the modern science of political economy is based" (Innes 1913, 377). The "error" consisted in assuming that under primitive conditions people lived by barter and then, as life became more complex, barter no longer sufficed as a method of exchanging commodities. Therefore, one commodity generally accepted in exchange became medium of exchange and was called "money". Different commodities performed this function, but, in the end, metals emerged as the only means of exchange, for their inherent qualities (Innes 1913, 377-8). In essence, the error lay in assuming that money arose from exchange and not, on the contrary, that it was exchange that was made possible by money. That is, to imagine that money arises as a means of exchange is to disregard the fact that exchanges first need money as a unit of account in order to enable exchange partners to compare the goods to be exchanged. From this point of view, the arguments presented in this Chapter IV, may indeed lead one to consider Smith as an orthodox in monetary matters. It is here that we can find the idea that one would move "from barter to money because barter becomes inconvenient as commerce develops", which would mean that Smith defines "money only with regard to its function of medium of exchange, and he disregards its function as a unit of account" . Although such an account of the evolution of money may appear "naïve" and "may not be historically accurate", this seems to be the one offered by Smith in Chapter IV. However, as we intend to show, Smith never made the error attributed to him.

In this Chapter IV, Smith seems to state that money emerges from the exchange difficulties involved in the division of labour. At the beginning of the chapter, he describes a situation in which "the butcher has more meat in his shop than he himself can consume, and the brewer and the baker would each of them be willing to purchase a part of it" (WN I.iv.2). None of them has anything to give in return for the products of others than their own. They have no medium of exchange. However, the butcher is already provided with all the bread and beer which he has immediate occasion for" (Ibid.). Thus, the exchange between them cannot take place. "In order to avoid the inconveniency of such situations", Smith continues, "every prudent man in every period of society, after the first establishment of the division of labour", would consider having, "besides the peculiar produce of his own industry" a certain quantity of a commodity or other, which few partners in exchange would be likely to refuse (Ibid.).

The example of the butcher with no instruments of exchange seems rather to be a pure supposition – "we shall suppose", says Smith – aimed at showing an "inconvenience" that is more visible in a society where the division of labour has been thoroughly established (Ibid.). If there were no instruments of exchange at all, for Smith there probably could not even be the butcher in "his shop" (Ibid.), with a trade distinct from that of the brewer and baker; a distinction of trades that Smith uses as an example of the division of labour in "civilized society" as early as the previous Chapter II (WN I.ii.2). In line with what he says in the following Chapter III, the division of labour is limited by the extension of trade, which in turn is enabled by the instruments of exchange. When the division of labour has been thoroughly established, some instruments of exchange should already be in place. As Smith argues in Chapter IV, instruments of exchange have existed since "the rude ages of society": at first, this function was performed by cattle and by other goods such as salt, shells, dried cod, tobacco, sugar, hides and nails; eventually, however, metals were preferred to all other commodities, since they could be kept at little loss, were not perishable and could be easily divided and rejointed (WN I.iv.3-4). Different metals were used for this purpose, but in the end it was gold and silver that predominated "among all rich and commercial nations" (WN I.iv.5). Finally, in order to avoid abuses, countries began to "affix a public stamp on certain quantities of such particular metals", indicating first the fineness of the metals and then the weight. (WN I.iv. 7-9).

Although the example of the butcher may be a pure supposition, Smith nevertheless seems to imply that money comes after trade. If the butcher may have already purchased enough bread and beer before the "inconveniency" of not having an instrument of trade emerges, this means that the butcher may have already engaged in various exchanges with the brewer and the baker before considering the need for such an instrument. Moreover, exchange must necessarily precede money if it is true that money is a consequence of the division of labour, given that the division of labour for Smith is a consequence of exchange (see WN I.ii). The fact that money emerges first and foremost as an instrument of trade would then also imply that money as a measure of value is a consequence of it, and thus that exchanges would be possible even in the absence of a measure that allows the comparison of exchanged goods.

However, Smith does not say that the money arises from the division of labour and thus after exchange. All he is saying in this Chapter IV is that as the division of labour develops, it is a matter of prudence to use an instrument of exchange (so as not to find oneself in the inconvenience of being in the situation of not being able to exchange with others who do not need one's goods). A prudence that then becomes a necessity in advanced society, where the division of labour has been fully established. But here, in fact, Smith says nothing about the origin of instrument of exchange as such.

The title of this Chapter IV may be confusing: "Of the Origin and Use of Money". Smith seems to be talking about how money as an instrument of exchange emerges from the difficulties of barter due to the division of labour. However, he is only talking about how "in all civilised nations" money as the "universal instrument of commerce" emerges from increasingly necessary instruments of exchange, which are perfected up to the coined precious metal bars (WN I.iv.11). Throughout the chapter, Smith is careful not to use the word "money" until the end of the process leading to such instrument of commerce. Therefore, when he talks about the origin of money in the title, he is referring to "money" in the form it has in advanced society. He does not refer to the origin of the instruments of exchange, about which he says nothing.

In sum, in this Chapter IV Smith does not make the error often attributed to him. Smith is not saying that out of the difficulties of barter comes money, understood as an instrument of exchange (and not as a measure of value). Smith only argues in this chapter that with the development of the division of labour, prudence meant that instruments of exchange were increasingly used until some became money as the universal means of trade.

3. THE ORIGINAL PURCHASE-MONEY

In the WN, Smith does not give an account of the origin of the use of instruments of exchange, but only of their increasing necessity due to the division of labour and then their refinement. It is in his Lectures on Jurisprudence (LJ) that we find an account of the origin of these trade instruments. According to Smith they derive from fact that they "were before considered as the measure of value" (LJ B 238). For him, therefore, the instrument of exchange does not derive from the difficulties of barter: it is a consequence of being a measure of value, and not the other way round.

Smith observes that money "serves two severall purposes": "It is first the measure of value", then "it is also the instrument of commerce, or medium of exchange and permutation" (LJ A vi.101, emphasis added). He argues that when people start to deal with many goods, one of them must be regarded as the measure of value: "Suppose there were only three commodities, sheep, corn, and oxen, we can easily remember them comparatively. But if we have a hundred different commodities, there are ninety nine values of each arising from a comparison with each of the rest. As these cannot easily be remembered, men naturally fall upon one of them to be a common standard with which they compare all the rest" (LJ B 235).

This suggests that Smith understands this common standard as a proportion: one chooses a good whose proportion with other goods is taken as a reference point, so that one does not have to keep in mind all the proportions between goods each time. The good chosen for this purpose would then be the "most familiar" (LJ 368, see also LJ 499). For example, in the pastoral age, such as Homer's, it was the oxen (LJ 367). This is the same example Smith gives in Chapter IV of Book I of WN, where he not only says that oxen were an instrument of exchange, but also that "things were frequently valued according to the number of cattle which had been given in exchange for them" (WN I.iv.3, emphasis added).

Subsequently, Smith explains in his LJ, gold and silver emerged as "a more certain and accurate measure of value than cattle could be, of which equall quantities should have equall values" (LJ A vi.99). This is again consistent with the explanation, given in the WN, about the emergence of metals such as gold and silver as money: "If, on the contrary, instead of sheep or oxen, he had metals to give in exchange for it, he could easily proportion the quantity of the metal to the precise quantity of the commodity which he had immediate occasion for" (WN I.iv.4). The fact that these metals allow for a more accurate proportioning of the quantities exchanged makes them a widely used measure of value, and thus also the general medium of exchange. As Smith tells his students in LJ: "I had begun to shew you how the metalls gold and silver came to be the measure of value, for it was from thence that they came to be the instrument of commerce" (LJ A vi.101, emphasis added). According to these Lectures, the instruments of exchange – such as money made of minted gold and silver bars – do not derive from the difficulty of bartering, but from the fact that they are first taken as a measure of value or, in other words, as a unit of account.

In his account of the evolution of money in the LJ, Smith does not appear so naïve as to overlook the function of money as a measure of value. It is therefore difficult to imagine that he had become naïve by the time he wrote the WN. Here, Smith gives only the account of the diffusion and refinement of the instruments of exchange, without giving the preliminary explanation of their origin as a measure of value, which is instead found in the LJ. To understand why in the WN he subtracts the explanation that precedes this account, it is important to consider what follows the account given in Chapter IV.

In the LJ, after giving the explanation on the evolution of money, Smith moves on to criticize the mercantilist system, for which wealth coincides with money. For Smith, however, money is what allows wealth to circulate. Therefore, there is no point in seeking and accumulating gold and silver coinage per se. As he says in the LJ, echoing the same metaphor in the WN (II.ii), money is like a highway: grain does not grow on it, but that is precisely why it enables it to be brought to market (see LJ B 245, WN II.ii.86). The critique of the idea that money coincides with wealth, however, does not follow the account of the evolution of money, as it does in the LJ. In the WN, this critique is found only from the fourth book of the WN, which Smith reserves precisely for the critique of other theories, in particular the mercantilist one.

What follows the account given in Chapter IV of the first book of WN is something that rather supersedes the preliminary explanation on the measure of value given in the LJ. In Chapter V of the first book of the WN, Smith develops an idea that is not found in the LJ of 1762-63 and is only hinted at in one sentence in his last Lectures of 1766 : “We have shewn what rendered money the measure of value, but it is to be observed that labour, not money, is the true measure of value” (LJ 503).

This idea is also not found in the Early Draft of part of The Wealth of Nations (ED), which seems to have been drafted shortly before April 1763. In this draft Smith follows the speech pattern adopted in the LJ and plans to deal with money in Chapter IV (as indeed he will in the WN). Here he announces that he wants to deal first with money as a measure of value and then with it as an instrument of exchange, following this up with his criticism of the mercantilist system. The title of this Chapter IV is: “Of money, it’s (sic) nature, origin, and history, considered first as the measure of value, and secondly as the instrument of commerce”. On the first point, about money as a measure of value, he writes: “I have little to say that is very new or particular” (ED 33). It is therefore possible to assume that Smith avoided writing the preliminary explanation of the origin of the instruments of exchange as measure of value given in the LJ, because it was so un-novel that he could imagine that his readers would take it for granted. Moreover, he probably felt that it would be confusing to state that money was an instrument of exchange born as a measure of value and then say that it was not the real measure of value.

The latter problem arose because Smith wanted to emphasise the distinction between nominal wealth given by the universal medium of exchange, i.e. gold and silver coins, and real wealth given by the real measure of value, i.e. labour. Although gold and silver coins must necessarily also be a measure of value, the fact that they are also the universal medium of exchange naturally gives rise to the “popular notion” that wealth consists in them (WN IV.1.i). The original “money” could have remained only a measure of value, as in primitive exchanges. But the division of labour, which developed precisely as a result of such exchanges, made it practically necessary for it to be disseminated as an instrument of exchange, making it take on that dual function that makes it easily associated with wealth tout court. The beginning of the fourth book and thus of the critique of Mercantilism begins like this: “That wealth consists in money, or in gold and silver, is a popular notion which naturally arises from the double function of money, as the instrument of commerce, and as the measure of value” (WN IV.i.1).

In order to emphasise the distinction between real and nominal wealth, i.e. between gold and silver coins and labour, in the first book Smith first gives an account of the evolution of exchange instruments up to gold and silver coins (WN I.iv), and then clarifies that these do not, however, constitute real wealth (WN I.v). As is well known, this distinction would later allow Smith to distinguish between real and nominal price (WN I.vi) and thus to deal with price formation (WN I.vii).

In Chapter V of the first book of the WN, Smith explains that the coins one obtains with one’s labour only have value because they “contain the value of a certain quantity of labour which we exchange for what is supposed at the time to contain the value of an equal quantity” (WN I.v.2). “Labour”, Smith continues, “was the first price, the original purchase-money that was paid for all things. It was not by gold or by silver, but by labour, that all the wealth of the world was originally purchased; and its value, to those who possess it and who want to exchange it for some new productions, is precisely equal to the quantity of labour which it can enable them to purchase or command" (WN I.v.2, emphasis added).

At this point, Smith says that there has been a shift from this real measure to the use of commodities to carry out trade: "But though labour be the real measure of the exchangeable value of all commodities, it is not that by which their value is commonly estimated" (WN I.v.4). This is because of the difficulty one can have in measuring the proportion between the two different quantities of labour exchanged for each other. This difficulty stems from the fact that there is no such thing as an "accurate measure" and that it is usually found in trade, through "higgling and bargaining" (Ibid.).

Smith, therefore, does not here explicitly put forward the idea suggested in the LJ that it is difficult to keep in mind so many proportions between goods, when trade intensifies, to the point of having to assume a commodity to represent the various proportions (which then assumes the role of the first instrument of exchange). He only says that it is easier to exchange in terms of ratios between goods and not in terms of ratios between quantities of labour (although, as he just said, this is the real measure involved in such exchanges). Exchanges therefore take place by assessing exchange value in terms of a quantity of a commodity rather than in terms of the quantity of labour it actually can purchase. At this point, Smith states that when this exchange commodity becomes the gold and silver money, as he has already explained in Chapter IV above, it is with the latter that the exchange value of each commodity is "frequently estimated" (I.v.6). It is in this way that Smith can finally tell the story of the butcher, the baker and the brewer in the terms in which it really happens and no longer in a hypothetical way, as in the previous chapter: "The butcher seldom carries his beef or his mutton to the baker, or the brewer, in order to exchange them for bread or for beer, but he carries them to the market, where he exchanges them for money, and afterwards exchanges that money for bread and for beer" (WN I.v.6).

Smith's account of the evolution of money, therefore, is marked by three historical moments. The first is that of exchange based on the original purchase-money, the real measure of value, i.e. exchange of quantities of labour; as is also shown at the beginning of the following Chapter VI, where Smith gives the well-known example of hunters exchanging deer for beavers on the basis of such quantities (see WN.I.vi.1). The second is that of a greater ease in exchange given by valuing the quantities of a commodity rather than the "abstract" notion of labour quantities, although the proportion between these quantities constitutes the real value of wealth. The third is that of the spread of this use of a commodity as a medium of exchange due to the development of the division of labour, until the emergence of gold and silver money. Although the proportions between quantities of labour are too abstract, they constitute the real measure of value, as opposed to the seemingly concrete thing that is gold or silver money, which instead constitutes only a nominal, i.e. abstract, wealth.

If money had remained at its initial function as a measure of value (in terms of the quantity of labour), i.e. as an original purchase-money, there would have been no problem for Smith in identifying "money" with wealth. Since, however, money also takes on the function of an instrument of exchange, the risk of identifying wealth with it is that people will want to seek it for itself and accumulate it; when, on the other hand, the instrument of exchange only needs to pass from hand to hand, because its purpose is to make wealth circulate.

4. TRUSTING THE FIDELITY

The account of the evolution of instruments of exchange from the measure of value appears reversed in the WN compared to the LJ. In the WN, the account of the spread of such instruments of exchange due to the division of labour is not followed by the critique of the mercantilist idea that wealth is money, as in the LJ, but by the new explanation of their origin from the real purchase-money, which is labour. Rather, the critique of Mercantilism is found in the book devoted to it, namely the fourth of WN. In this book, Smith argues that money is not the real wealth, but what enables its circulation, which is why it should not be stored, not even for fear of its lack. For this reason, he again considers the situation in which sellers and buyers find themselves without money, just like the butcher, the brewer and the baker in Chapter IV of Book I. This time, however, Smith considers it as if it could really happen. It becomes clearer from this new example that the situation described in Chapter IV was purely hypothetical and that – contrary to some chartalists' assertions – Smith also considers the possibility of an exchange based on credit.

Innes directly criticizes Smith's example of the butcher, the brewer and the baker described in Chapter IV of Book I of WN, stating that money is primarily a unit for establishing contracts of credit and debt. In his words: "Adam Smith's position depends on the truth of the proposition that, if the baker or the brewer wants meat from the butcher, but has (the latter being sufficiently provided with-bread and beer) nothing to offer in exchange, no exchange can be made between them" (1913, 391). His point is that in this case exchange can take place even in the absence of a medium of exchange, through "the exchange of a commodity for a credit" (Ibid.). Smith's argument would also be refuted by an empirical discussion of the importance of the instruments of credit in history: "What we have to prove is not a strange general agreement to accept gold and silver; but a general sense of the sanctity of an obligation. In other words, the present theory is based on the antiquity of the law of debt" (Ibid.). Innes mentions many cases of ancient legal codes in which there was a "law of debt": an example is the code of Hammurabi, who compiled the laws of Babylonia around 2000 B.C.

Innes's claim is that: "Assuming the baker and the brewer to be honest men, and honesty is no modem virtue, the butcher could take from them an acknowledgment that they had bought from him so much meat, and all we have to assume is that the community would recognize the obligation of the baker and the brewer to redeem these acknowledgments in bread or beer at the relative values current in the village market, whenever they might be presented to them, and we at once have a good and sufficient currency" (Ibid.). According to Innes, therefore, it would be enough for the community to enforce mutual credits and debts, in the absence of honesty between exchangers. A similar position is taken by another chartalist and critic of the orthodox view, Georg Knapp ([1905] 1924, 11): "If payment has not been made on the spot, there are certain permanent obligations to pay, that is, debts. The State, as the maintainer of law, adopts a definite attitude to this phenomenon, which is not technical but juristic".

When Smith considers again in Chapter I of Book IV of WN the situation of sellers and buyers without money, he says that even if gold and silver should be lacking in a country, there are more expedients to replace them than there are to replace almost any other good: "If the materials of manufacture are wanted, industry must stop. If provisions are wanted, the people must starve. But if money is wanted, barter will supply its place, though with a good deal of inconveniency". In the absence of gold or silver coins, therefore, the butcher, the brewer and the baker could still barter with each other. Yet, if the situation is the one exposed by Smith in Chapter IV of Book I of WN, where the butcher is already provided with all the beer and the bread needed, the brewer and the baker should not be able to exchange with the butcher. Innes, thus, would be right. However, Smith does not stop there this time and writes that there is another, less inconvenient expedient: “Buying and selling upon credit, and the different dealers compensating their credits with one another, once a month or once a year, will supply it with less inconveniency” (WN IV.i.15).

We have here the demonstration that the example given in Chapter IV of Book I of WN was only a pure supposition, unrealistic, and that, instead, Smith also considers the possibility of trading on credit. This is not only possible in a commercial society, where, he argues, unlike Innes, honesty is considered a virtue (see WN…).1 It is also possible in the other earlier societies. For example, when Smith writes in Chapter II of Book I of WN about exchange in primitive society giving rise to the division of labour, he is not only talking about people exchanging arrows for cattle (nor, as in Chapter VI, only about hunters exchanging one beaver for two deer), but also about someone excelling in “making the frames and covers” of little huts. In this case, we would hardly have an instant barter.

This is even clearer when Smith recalls exchanges in the “first period of society” based on promises, which do not need to be reinforced by the community (LJ A ii.46). What Innes calls “sanctity of an obligation” is discussed by Smith in his LJ as the obligations examined in the natural law. Before discussing exchange and money, in these Lectures Smith addresses the topic of “personal rights”, following the model of the discourse of Pufendorf, Carmichael and Hutcheson (see LJ A ii.40)2. According to Smith’s Lectures, a personal right is “the right one has to demand the performance of some sort of service from an other” (Ibid.). Here Smith discusses all the different ways in which we may or may not regard someone’s promise as a real obligation – i.e. as something that gives rise to a “reasonable expectation” – because of the “uncertainty of language” (LJ A ii.46).

Smith argues that in the early periods of society, conflicts were handled by the entire community gathered in assembly. Since this procedure was quite troublesome for most people, since they had to absent themselves from their occupations for this purpose, these public courts were hardly ever convened for minor disputes. Since exchanges at the time could not involve considerable values, they were not subject to collective judgement (see LJ A ii.45-47). In this regard, Smith quotes Aristotle, who speaks of various Greek states in which “the validity of contracts was not acknowledged” (LJ A ii.47). Only later, with the increase of differences in private property, did contracts begin to become valid for the community, particularly under “ecclesiasticall law” (LJ A ii.49). This is not to say that contracts did not take place in the absence of such validity; Smith argues that in “uncivilized nations” oaths are common for this purpose, due to the uncertainty of language (LJ A ii.54). Rather, they took place without necessarily being regulated by the community through corrective justice. In this way, “the multitude of judicial proceedings”, was avoided (LJ A ii.47). This was also because, Smith says following Aristotle, they held that “the one who enters into a contract trusts to the fidelity of the person and is supposed to have trust in him” (LJ A ii.47-48, emphasis added). This is more understandable if one takes into account that in the TMS (VI.i.3) Smith argues that perhaps the strongest desire of every person is to obtain the

[1] See also McCloskey (2006), Herzog (2013).
[2] See also Pesciarelli (1986).

esteem and credit deserved. That is, it is to gain the approval and credit of others, knowing that one is praiseworthy and creditworthy in the eyes of any impartial spectator (see VII.iv.24).3

For Smith, therefore, in addition to being based on the real measure of value, initial exchanges could be based on credit, not enforced by the law of the community. It was the development of the division of labour that changed relations, making instruments of exchange and laws for enforcing contracts increasingly necessary. An advanced society, in which government is established, can introduce a currency such as paper money, based on government credit.4 But this, for Smith, is the end and not the beginning of the process. Immediately after discussing the possibility of credit in the eventual absence of money, Smith writes: "A well regulated paper money will supply it, not only without any inconveniency, but, in some cases, with some advantages" (WN IV.i.15).

Here Smith is taking up what was already discussed in Chapter II of Book II of the WN. This chapter was later mobilized by chartalist monetary theorists such to legitimize their own chartalist approach by describing Smith as a pioneer. According to this perspective, Smith supposedly solved the paradox of metallism: although paper money has no value, it is undeniable that it continues to circulate in the economies. The solution was provided by Smith's argument, presented in Chapter II of Book II, that a prince might give value to paper money of a certain kind, in that he enacts that taxes should be paid in this paper money. In this formulation, Smith implied that the value of money depends not on any inherent property or function, but on its usefulness to in settling debts or other liabilities to the state, which is consistent with the chartalist view.5 A very similar chartalist interpretation implies that Smith developed a theory of money based on credit. In this reading, not only did Smith acknowledge that paper money derives its value from the possibility of using it to pay taxes, but he also formulated a theory of money based on the law of reflux. So, just as bank money (notes or deposits) is refluxed when notes and cheques are presented for clearing, payment of taxes is a form of reflux that removes paper money from circulation (ensuring the maintenance of its value).6

Indeed, in this chapter Smith is interested in the possibility of reducing the costs of maintaining national capital or, on other words, in converting the species embodied in the money stock into circulating capital.7 This analysis, which enables interpretations of Smith as a forerunner of chartalism, can be divided in three main lines of argument. The first one is related to the costs of maintaining money. Smith differentiates three types of stocks: the one intended for consumption, fixed capital and circulating capital. Money is part of the circulating capital and "the only part of the circulating capital of a society of which the maintenance can occasion any diminution of their net revenue" (WN II.ii.11). In that aspect, money (understood here as commodity-money) is very similar to fixed capital, in that both "require a certain expence, first to erect them, and afterwards to support them, both which expences, though they make a part of the gross, are deductions from the neat revenue of the society". Smith explains that "valuable materials, gold and silver" and "very curious labour" is deviated away from their use in the

[3] On the Smithian concept of the impartial spectator, see Raphael (2007). On the relationship between distance and impartiality in Smith, see Paganelli (2010). On internal debate and self-questioning, see Brown (2016, 242–245). On the relationship between Smith's thought and Shaftesbury's idea of soliloquy, see Weinstein (2013, 44–49).
[4] On Smith and paper credit money, see also Paganelli (2006), Hanley and Paganelli (2014). For a critical account see Fitzgibbons (1995).
[5] See Bell (2001, 154).
[6] See Wray (1998, 19-23).
[7] See Laidler (1981, 195).

subsistence, conveniences, and amusements of individuals in order to support metallic money – "that great but expensive instrument of commerce" (WN II.ii.11). The reduction of the stock of metallic money in circulation represents, thus, a saving in the expense of supporting society's capital and leads to larger productive possibilities. Smith concludes, then, that "the substitution of paper in the room of gold and silver money, replaces a very expensive instrument of commerce with one much less costly, and sometimes equally convenient" (WN II.ii.14). Even though this substitution of metallic money was partial (since paper money would have backing in this context), there is a clear recognition that, to be an instrument of commerce, money does not necessarily need to be a commodity, with an intrinsic exchange value.

The second argument is related to bank notes as a form of paper money. After recognizing that bank notes are the best known and best adapted form of paper money, Smith states that when the people of a country have "confidence in the fortune, probity, and prudence of a particular banker", so that they believe that this banker will be able to pay his promissory notes at any time upon demand, "those notes come to have the same currency as gold and silver money, from the confidence that such money can at any time be had for them" (WN II.ii.28). Smith, then, elaborates on the functioning of a fractional reserve system based on the confidence the public places in the banker: "Though he has generally in circulation, therefore, notes to the extent of a hundred thousand pounds, twenty pounds in gold and silver may, frequently be a sufficient provision for answering occasional demands" (WN II.ii.29). For Smith, an important advantage of this system is that it liberates commodity money to be used abroad, as paper money fills the internal channel of circulation.

Moreover, Smith praised an invention of Scottish banks, which went beyond the usual practice of issuing notes by discounting bills of exchange. They granted "cash accounts" (i.e., credit, to the extent of a certain sum) to "any individual who could procure two persons of undoubted credit and good landed estate to become surety for him" (WN II.ii.44). The result of the generalization of these cash accounts was that all payments of the society could be carried out in bank notes. If the merchants have cash accounts in the bank, they may pay in promissory notes to manufacturers for goods. Manufacturers use such notes to pay the farmers for materials and provisions, and farmers pay away the notes to their landlords for their rent. The landlords use them to buy conveniences and luxuries from the merchants, who again return the notes to the bank to balance their cash accounts (or to repay what they borrowed). Therefore, Smith concludes: "almost the whole money business of the country is transacted by means of them [issuing banks]" (WN II.ii.45). In this case, we have a monetary economy whose functioning is completely based on confidence, where money is a unit in which credit contracts are denominated.

The third argument regards the role of the government. It is important to note that the Scottish banks Smith praised (and even the Bank of England in this context) were all private institutions that should, in his perspective, operate freely, in a self-regulated banking system.8 However, at the end of the chapter, when discussing monetary policy in the colonies, Smith seems to have recognized the role of taxation in ascribing value to (paper) money: "The paper of each colony being received in the payment of the provincial taxes, for the full value for which it has been issued, it necessarily derived from this use some additional value". This additional value would vary according to the difference between the

[8] Apart from notes of small denominations, see Arnon (2011, 44).

amount of paper issued by a colony and the quantity that could be employed in the payment of the taxes charged in that colony (WN II.ii.103).

Smith then makes a more general statement: "A prince, who should enact that a certain proportion of his taxes should be paid in a paper money of a certain kind, might thereby give a certain value to this paper money". If the bank issuing this paper is careful to manage its emissions to keep the quantity of paper in circulation somewhat below the amount that could be used to pay the taxes charged by the prince, the demand for such paper could make it bear a premium. This premium meant for Smith that the paper note would be exchanged in the market for more than the quantity of silver currency for which it was issued (WN II.ii.104).

5. AGREED VALUATION

According to Smith, in the initial state of society, in which the instruments of exchange have not yet become necessary, exchanges can take place on the basis of promises, even without the need for their reinforcement by the community. Similarly, should gold and silver money be lacking in a community, reciprocal credits and debits could replace them, also facilitated by government guaranteed paper money. For Smith, the creation of money by the government, however, is the end of a historical process and not its beginning, as Knapp ([1905] 1924) argued. The original purchase-money that according to Smith is exchanged in the original exchanges is not guaranteed by any government nor is its value established by it. Rather, this "money", as a unit of account, is generated by the agreements on the value of reciprocal services in which exchanges based on the desire to obtain deserved credit and esteem consist of.

At the beginning of Chapter IV of the first book of the WN, Smith states that "when the division of labour has been once thoroughly established" everyone "lives by exchanging, or becomes in some measure a merchant" (WN I.iv.1). With the introduction of the division of labour, instruments of exchange became increasingly necessary. However, before this happened, exchanges took place on the basis of the original purchase-money, which is the amount of other people's labour obtainable in exchange for one's "good offices". As Smith writes in Chapter V in this regard, although it is not easy to evaluate each other's merits in terms of the hardship and ingenuity spent in one's own work, it is always possible to come to an agreement through "higgling and bargaining" (WN I.v.4).

In the primitive society – in which, for Smith, there is neither division of labour nor government – the original purchase-money, as a measure of value, can be established in the exchanges themselves. These agreements establish the value of what each person offers in exchange for the amount of other people's labour that can be obtained with it. In this way, both exchangers can see their merits recognised by the other, thus satisfying the strong desire to receive the deserved appreciation. By agreeing on the value of each other's work, a common measure of value is agreed upon. The quantity of labour as a measure of value arises from such agreements as the original purchase-money.

This also explains how exchange is possible for Smith in the society where there is no division of labour. In such a society, exchanging apparently gives no advantage, since all the people already do everything for themselves and do also the same things. But, as Smith writes in Chapter II of the first book of the WN, in such a society people exchange, and exchange often. They "frequently" exchange before they realise that “at last” they can obtain more out of it than if they continued to do everything themselves (WN I.ii.4).

As he says in this chapter, exchanges are based on self-love (WN I.ii.2). But if by this is meant individual self-interest, however moderate it may be, it would make no sense to exchange in the absence of any obvious advantage. But since, according to Smith, people in such a society exchange, it is possible to understand self-love as the pursuit of self-esteem, which is validated by the esteem of others. Here, too, it is a matter of what for Smith is perhaps “the strongest” desire of any person, i.e. to gain the approval and credit of others, knowing oneself to be praiseworthy and creditworthy in the eyes of any impartial spectator (see TMS VI.i.3, see also TMS VII.iv.24). In the TMS (VII.ii.4.9), he argues that this desire is a kind self-love and probably the most general (see…). We can therefore apply it to the self-love to which Smith talks refers in the WN (I.ii) to explain the motive for exchange.

One way to show how much one appreciates the work of another is to show how much one is willing to give in return. If the other agrees, this means that the other also considers such appreciation appropriate, i.e. in accordance with one’s own self-appreciation (which means with the approval of one’s impartial spectator). Accepting the other’s exchange proposal also means agreeing with the other’s self-appreciation. Finding the equivalence that makes this mutual appreciation possible means finding a common measure of each other’s merits, i.e. a measure to assess by mutual agreement the “hardship” and “ingenuity” that the exchangers put into their good offices (WN I.v.4, see also WN I.vi.2-3). This agreed valuation gives rise to the common measure of which the original purchase-money consists.. As Smith writes in the TMS, though there should be no mutual love and affection among the different members of the society, it may subsist by the “exchange of good offices according to an agreed valuation” (TMS II.ii.3.2, emphasis added).

For Smith, money does not arise from convention, as argued by John Locke, with whom he disagrees on this point (see LJ A vi.106). Nor does it arise from the institution of a government, as in the heterodox view, but in exchange. However, this does not mean that money arises as a pure instrument of exchange, without any relation to the measure of value, as in the orthodox view. On the contrary, the only money that arises in exchange is the original purchase-money – i.e. quantity of labour as measure of value – with which, according to Smith, all the wealth of the world was originally purchased (see WN I.v.2). From this money then arises money as an instrument of exchange, leading to gold or silver coins, i.e. that not real and much coveted wealth. For Smith, money is not a measure of value because it is an instrument of exchange. On the contrary, it can be an instrument of exchange because of that measure of value that is established in exchange – even in the absence of instruments of exchange – by an agreed valuation.

The original purchase-money, which underlies every other form of money, is the fruit of that kind of agreement in which exchange consists. This agreement can also take the form of a credit and a debit without this promise necessarily being reinforced by the community or the state. As a result of frequent agreements of this kind, the division of labour with all its consequences can emerge, including the spread of instruments of exchange and their universalisation such as gold and silver.

CONCLUSION

According to the chartalist critique, Smith regards money exclusively as an instrument of exchange that arises from trades that otherwise could not take place, not even through credits and debits. As we have shown, this criticism is not reflected in Smith's texts. Not only does he regard money as something that arises originally as a measure of value, but it is also for this reason that it can be an instrument of exchange. Furthermore, he considers that exchanges based on credits and debits are always possible, which can also give rise to paper money based on government credibility. At the same time, however, this does not make him a prodrome of chartalism. While for chartalists the state monetizes the economy by establishing the medium of payment in which taxes must be discharged, for Smith exchanges based on the original money can take place without a government or community to enforce it as a measure of value and then as an instrument of exchange. What chartalists see as the primal source of money – the state's capacity to transform a piece of paper in money by means of taxation – is, for Smith, a possibility at the end of a process that presupposes the development of the division of labour beginning from exchanges in which money is primarily a measure of value.

In the absence of such a government, according to Smith it is always possible to exchange on the basis of credits and debits, due to the fact that people tend to be driven by the desire to obtain from others the esteem and credit they feel they deserve. A desire that for Smith is perhaps the first human motive. A motive that drives people to exchange even in the absence of the advantages provided by the division of labour and instruments of exchange, and that leads them to agree on a common measure of their respective merits. This measure is none other than the original money with which, according to Smith, all the real wealth of the world was originally purchased.

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