

What is money, really?

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What is money? We use it every day, but most of what we are taught about money misrepresents what it actually is. In this Understanding Economics video, I explain why money is not a physical thing at all.

Banknotes, coins and the numbers in your bank account are representations of something else, which are promises to pay. Money records debts between people, banks and governments. What you think of as money in your bank account is, in accounting terms, just a promise made to you by your bank.

This is not a new idea. From tally sticks and coins to banknotes and modern electronic payments, money has always depended upon records of obligations. When payments take place today, nothing physical has to move between bank accounts. Accounting records simply change to show who owes what to whom.

Banks also create new money when they lend. When a bank provides a loan, it simultaneously records the borrower's debt and creates a deposit that can be spent. When that loan is repaid, those records are cancelled, and that means that the money the loan created then disappears.

Government money works through a similar process. Government spending creates money, while taxation removes it. The requirement to settle taxes in pounds also creates continuing demand for sterling throughout the UK economy.

But, in all this, money should never be confused with real wealth. Money cannot build houses, grow food, teach children or care for people. Those things require people, skills, knowledge and physical resources.

Money is an extraordinarily important economic tool, but it is ultimately a system for recording promises and organising economic activity. Understanding that distinction between money and real wealth is fundamental to understanding how our economy actually works.

<https://www.youtube.com/watch?v=Rs5flopDHI8?si=7si4UZxNmE17FGWQ>

This is the audio version:

https://www.podbean.com/player-v2/?i=8bu6i-1b7535a-pb&from=pb6admin&share=1&download=1&rtl=0&font=Arial&skin=f6f6f6&font-color=auto&logo_link=episode_page&btn-skin=c73a3a

This infographic supports this video:

Money

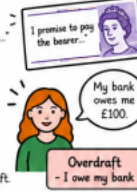
1 Money is not a thing

- When talking about money there is an important thing to understand: there is no actual thing called money.
- A £20 note is just polymer. The numbers in your bank account are just records.
- Neither has value simply because it physically exists.
- Money is just a record of a promise to pay. That's it.



2 Money is a promise

- Look at a Bank of England note. It says, "I promise to pay the bearer..."
- The note records a promise made by the Bank of England.
- Your bank account is similar. If it says you have £100, your bank owes you £100.
- What you call your money is also somebody else's promise to you.
- You can also make that promise, and you have if you have an overdraft.



3 Money has always worked this way

- Hundreds of years ago, England used 'tally sticks' to record debts owed to and by the government.
- The piece of wood was almost worthless. The promise it recorded was what mattered.
- Gold and silver coins also worked because the state accepted them in payment.
- The gold standard later linked notes to gold.
- That ended in 1971, but money carried on working. The promise mattered, not the gold.



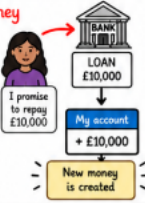
4 What happens when I pay you?

- Suppose I pay you £100. Nothing called 'money' moves from my bank account to yours.
- My bank changes its records to say it owes me £100 less.
- Your bank changes its records to say it owes you £100 more.
- The banks adjust their records between themselves. Paying means changing records of who owes what to whom.
- It's all about accounting.



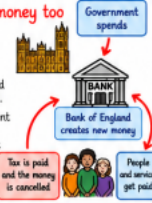
5 Banks create new money

- Money's also created by accounting.
- If a bank lends you £10,000 it does not lend £10,000 of somebody else's saved.
- You promise the bank that you will repay £10,000. That creates the loan.
- They then put £10,000 in your current account, recording its promise to you.
- That accounting creates new money. Repay the loan and those promises are cancelled. The money disappears.



6 Governments create money too

- When the UK government spends, it tells the Bank of England to make payments.
- Its account with the Bank of England is increased. New money is created.
- And when tax is paid, the government accepts its own money back and then cancels it. That's what tax is for.
- Tax does not, then, fund spending. Money creation does.



7 Why do pounds have value?

- The government creates pounds when it spends and then demands we use pounds to pay our taxes.
- That creates a permanent need for pounds. We accept and exchange them because we all need them to pay tax.
- And bank deposits work as money because the government promises to accept the money in them to settle our tax bills.
- There is no such promise for gold or cryptocurrencies. That is why they are assets, not money.



8 Money is not real wealth

- There are though real limits to what money can do.
- Money cannot build a house, teach a child, grow food or care for someone.
- People using skills, knowledge and real resources do those things.
- Money helps us organise economic activity, and reward those who take part in it.
- More money, though, does not automatically make us richer. Real wealth comes what we are capable of doing.



Summary

Money records promises about who owes what to whom. Those promises can be created and cancelled, but money itself is not wealth. What ultimately matters is whether we have the people, skills and resources to do what society needs.

Funding the future

Funding the Future
<https://www.taxresearch.org.uk/Blog/>

Richard Murphy's
Funding the Future blog
on political economy.

This is the transcript:

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Hello, I'm Richard Murphy, and this is Understanding Economics, the series of videos that I am making, which explains economics in the way that I see it. And I stress this is about economics in the way that I see it because I do not see economics in the same way as every economist does, and that is because I think that most economics has failed us. And so I am looking for a different explanation of the economy in which we all live that looks at the actual facts that we can observe in our society and explains them in a way that makes sense to me, and I hope makes sense to you.

This, then, is a series about re-understanding economics, and in this video I want to look at something which is about the hardest topic in economics to explain, and that is money.

Money is really difficult to understand, and that's because most of the things that you have ever been told about it and most of the things that you understand about it are probably wrong. I'm sorry to have to say that, but that's a fact.

The most important thing of all to understand about money is that there is no such thing as money, and by 'thing', I mean a physical substance.

A £20 note is just a piece of polymer. A physical paper note in another country is just a record of a debt owed to a person by the government that printed it.

Coins have the same effect.

And even the numbers in your bank accounts are just records. They are not a note of the physical existence of anything. There is no such physical thing as money. What we can see, which we think represents money, is no more than a representation. It is not the money itself because money is just a record of a promise to pay, and that is it.

And if you want evidence of this, look at a note printed by the Bank of England. It says on it, 'I promise to pay the bearer...' the sum of whatever the value of the note is. That's what tells us that this is a promise and it records a debt. You haven't been paid this money by the Bank of England. They promised to pay that money to you, and that is something quite distinctly different. And therefore the note is not money. The note records a promise to pay money.

And your bank account is similar. If it says you have £100 in your bank, your bank owes you £100. What you call your money is actually somebody else's promise to you.

And let's be clear, you can also make that promise and, in effect, create money, and you do so if you have an overdraft. You have promised to repay your bank the £100, or whatever it might be, that is in your overdraft.

Promises are what make money, and that's always been the case. Money has always worked in this way. Hundreds of years ago, England used tally sticks to record debts owed to and by the government. These were pieces of wood which had notches marked

on them, and they were split down the middle. This recorded a debt, and when the debt was repaid, the tally stick was burned. The slate was wiped clean. But until it was repaid, the half of the tally that remained with the person who owned the debt could be sold as if it was money. The half that recorded the liability recorded the fact that somebody had made a promise to pay and they had to do so.

And gold and silver coins also worked in the very same way. They recorded the fact that the state would accept them in payment for taxes. They recorded the debt that the government had created by spending money into the economy and the fact that it could be cleared by making payment back to the state by way of tax using the coins it had created.

And the gold standard later linked notes to gold, and that created money that we thought was backed by a physical product. It wasn't. It was actually still backed by the government's promise, and that promise was that it would accept the note to a specific value in payment of taxes. That ended in 1971 when the US came off the gold standard.

At that point, gold ceased to have any meaning inside the world's monetary systems. But although gold ceased to have value, money carried on working. In fact, a dollar note that was issued before the time that the gold standard was abandoned worked just as well after it was abandoned. What mattered was the promise, not the gold, and what stood behind the promise was the government. The physical representation of money has never been anything more than a record of debt. That's all money has ever been.

So what happens when you make a payment? Suppose I pay you £100. Nothing called money moves from my bank account to your bank account. My bank changes its records to say it owes me £100 less than it did before the transaction took place. Your bank changes its records to say it owes you £100 more. The banks adjust their records between themselves through the Bank of England, if necessary, to record the fact that this has taken place. But payment means changing records of who owes what to whom.

Money is all about accounting. The two are inextricably linked. Double entry bookkeeping is fundamental to the way in which money works. It is the way in which we record the existence of money, and it always has been, even before we recognised that double entry bookkeeping existed, because money is always a promise to pay. Somebody, one side of the entry, has promised to pay somebody else, the other side of the entry, and that's what the accounting records.

And money's also created by accounting, and this is incredibly important to understand. If a bank lends you £10,000, it does not lend £10,000 of somebody else's money that's been saved with the bank. In fact, it can't do that because it's promised to repay the £10,000 in question back to the person who deposited it with the bank. You instead promise that you will repay £10,000 to that bank, and that's what creates the loan. Because you've promised to pay £10,000, they promise to let you spend £10,000, and they record that by putting that money in your current account, and you could then go

off and buy whatever it is you want, a car, a kitchen, whatever.

That accounting creates new money. Repay the loan in that case, and those promises are cancelled. The money disappears, and this is incredibly important to understand. Creating a loan makes new money. Repaying a loan cancels that money. The slate is wiped clean. The money has gone.

And that's the case with regard to the government too. When the UK government spends, it tells the Bank of England to make payments. Its account with the Bank of England is increased; new money is created. And when tax is paid, the government accepts its own money back, and then it cancels it. That's what tax is for. Tax is a deliberately created debt to enable the government to cancel the money that it puts into circulation as a consequence of its spending. Tax does not then fund spending; money creation does.

So why do the pounds that we use have value? And why does the dollar have value? And why does the euro have value? And why do all the types of dollar we have all around the world have value, because I wasn't just referring to the US dollar when I made my comment?

The government creates pounds when it spends and then demands we use those very same pounds to pay our taxes. That creates a permanent need for pounds. We accept and exchange pounds because we all need them to pay our taxes. And bank deposits work as money because the government promises to accept the money in them to settle our tax bills.

There is no such promise for gold or for cryptocurrencies. They are assets. They are not money because there is no promise that represents a promise to pay that is stacked behind them. Only the government creates that promise and only the government can create money. Everything else is a fiction.

But let's be clear, money is not real wealth. That's one of the other common confusions people have. We talk about millionaires as if they're wealthy because they, in our imaginations, are sitting on a pile of notes or coins that comes to that sum of money. That is not true.

There are real limits to what money can do. Money cannot build a house. It cannot teach a child; it cannot grow food; it cannot care for someone. People use skills, knowledge, and real resources to do those things. They create value. That is what wealth is.

Money might help us to organise economic activity and reward those who take part in it, but more money does not automatically make us richer. Double the amount of money in every bank account in the UK tomorrow, and there would be no more houses, no more jobs, no more food on the shelves in the supermarket. There would just be

double the amount of money, but real wealth would be the same.

So money is not wealth. Money is a tool we use to facilitate the exchange of wealth, and wealth is the value that we create through our own efforts.

So what is money? It's a record of promises about who owes what and to whom. Those promises can be created and cancelled, but money itself is not wealth. What ultimately matters is whether we have the people, skills and resources to do what society needs, and money helps us marshal those resources so that we can create real value. Money is incredibly important, but it is not the be-all and end-all of life. It is not the be-all and end-all of the economy, and an obsession with it in any form of life is misplaced, and that includes in economics.

That's what I think. What do you think? There is a poll down below, and I will be very interested in your opinions. Please do also leave your comments, and do look at the playlist that we have put below this video because that explains how you can see more videos in this Understanding Economics series. And if you want more explanations about money, there are more on my Funding The Future blog, including a 'View On' article which we will link to, which explains money in more depth. It's a 5,000-word essay. It expands on the themes here, and I hope that will be of use.

Poll

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