Doing Money

Elementary monetary theory from a sociological standpoint

Heiner Ganssmann

ROUTLEDGE

Routledge International Studies in Money and Banking

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Routledge
Taylor & Francis Group
LONDON AND NEW YORK

First published 2012
by Routledge
2 Park Square, Milton Park, Abingdon, Oxon OX14 4RN

Simultaneously published in the USA and Canada
by Routledge
711 Third Avenue, New York, NY 10017

Routledge is an imprint of the Taylor & Francis Group, an informa business

British Library Cataloguing in Publication Data
A catalogue record for this book is available from the British Library

Library of Congress Cataloging in Publication Data
Ganssmann, Heiner.
Doing money/by Heiner Ganssmann.
p. cm.
1. Money. 2. Capitalism. I. Title.
HG220.A2.G36 2011
332.401–dc22

2011009223

ISBN: 978-0-415-67738-7 (hbk)
ISBN: 978-0-203-80446-9 (ebk)

Typeset in Times
by Wearset Ltd, Boldon, Tyne and Wear

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Traditional neoclassical economic theory should be replaced by a theory with a role for money that reflects the importance of money in our lives. What mainstream neoclassical economists call 'money illusion' is no illusion. Rather, the illusionists are those who deny the importance of money, who divide the world in two, one with 'real', the other with 'nominal' magnitudes, and maintain that rational agents can always mentally reduce the latter to the former. Unfortunately for that theory, a monetary economy is one where agents have to have money – and therefore aim for its acquisition as such – to fulfill payment obligations, fixed in dates and amounts. No 'real' good will help in face of such obligations. A better theory of money must rely on some sociological building blocks. It starts with the recognition that money is a social fact, that social facts result from interactions and that interactions imply uncertainty. Given uncertainty, one can introduce money as a means of uncertainty absorption. The use of money 'crowds out' uncertainty and replaces it by the one certainty that governs economic life: the need and desire for money.

In the context of a fully developed capitalist economy, this need turns out to be overwhelming, so that more and more participants in such an economy are busy maximizing monetary returns. For the mainstream neoclassical theorist, such behavior indicates pervasive 'money illusion' and is deemed irrational. For a historical sociologist like Max Weber, on the contrary, money use induces the continuous rationalization of economic activities. Monetary calculation, driven by the unbounded desire to acquire money, thus is a condition of rationality. In this book, Ganssmann takes the side of Weber, but adds that money use also undermines this calculative rationality by stimulating speculation, with speculative opportunities being opened wide by the evolution of credit and financial institutions. The results are bubbles, the ensuing inevitable crashes. In this way, periodic crises turn out to be the 'costs' of uncertainty absorption through money.

This book puts in place the groundwork for an alternative theory of money in a sociological perspective, proceeding by way of a critique of existing theories.

Heiner Ganssmann was professor in the Department of Sociology of the Freie Universität Berlin until 2009, specializing in economic sociology, social policy and sociological theory.

To the memory of Keith Whitehouse, MD, who taught me 50 years ago that a used dollar bill was good for polishing glasses.

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Preface

Writing another book on money is risky, reading it perhaps even more so. For the writer, the risk is that the inescapable pattern of person Z reading *n* books to produce book number *n*+ 1 prevents the escape from established modes of thinking among monetary theorists. For the reader, a big disappointment may be waiting. Instead of learning something about the real thing all one gets is what X, Y and now also Z have to say about money. I have tried to escape the dilemma resulting for the writer, on the one hand, by trying to remain in touch with simple everyday practices of money use and, on the other hand, by reducing discussions of what particular previous authors had to say to a minimum. Since I believe that traditional neoclassical theory is the major obstacle on the way to understanding money, I have given short shrift to the thoughts of both heterodox economists and sociologists, although I am on their side mostly. However, even given that restriction, I have not succeeded in avoiding being Z writing about X, Y … Because what follows is a contribution to the *theory* of money, referring to other theories rather than money in the real world is unavoidable as long as a promising consensus on what an appropriate theory of money should look like has not emerged. In my case the reference is mostly to the broad body of traditional neoclassical thinking on money and is frequently critical. In contrast to other contributions from sociologists, for example, Nigel Dodd's *The Sociology of Money* (1994), I do not want to suggest that sociologists should aim for their own theory of money to compete with economic theories. Neither do I want to contribute to the ongoing sociological research on the 'social meaning' of money that is more or less complementing what economists have to say by pointing out the shortcomings of the excessive rationalism or individualism of economists. Rather, I believe that money is and should remain a subject of economics, but also that appropriate economic theories of money need sociological building blocks as foundations. My aim is to demonstrate that and to propose some such elementary building blocks.

Because thinking about social relations, their patterns and institutionalized forms is not a monopoly of sociologists, there are quite a few – mostly heterodox – economists who have been conscious of this need for sociological foundations (Lowe 1935), often without saying so or admitting that sociology could contribute anything worthwhile in their specific field of enquiry. To take an example, one of my systematic take-off points in sociology was Simmel's remark about the 'context in which the sociological character of money appears. The interaction between individuals is the starting point of all social formations' (Simmel [1907] 2004: 174). Roughly twenty years later, institutionalist economist J.R. Commons made the same point in his *Legal Foundations of Capitalism*: 'economic theory has consistently taken the point of view of individuals on the one hand and commodities on the other hand, instead of the point of view of transactions between individuals' (Commons 1924: 242). However, Simmel goes on: 'The interactions between the primary elements that produce the social unit are replaced by the fact that each of these elements establishes an independent relation to a higher or intermediate organ. Money belongs to this category of reified social functions' (Simmel [1907] 2004: 175). So the starting point for explanations of money are interactions, and the task is to show how money as a 'higher or intermediate organ' is inserted into these direct interactions so that they are replaced or mediated by relations between individuals and money.

In a nutshell, my argument in this book is: Given the starting point of interactions between individuals, one can show that uncertainty is an emergent property of such interactions. Given uncertainty, one can introduce money as a means of uncertainty absorption. The use of money 'crowds out' uncertainty and replaces it by the one certainty that governs economic life: the need or desire for money. In the context of a developed capitalist economy, this need turns out to be overwhelming, so that more and more participants in such a capitalist economy are busy maximizing monetary returns. For the mainstream neoclassical theorist, such behavior indicates pervasive 'money illusion' and is deemed irrational. For a historical sociologist like Max Weber, on the other hand, such behavior indicates that economic activities have become more and more rationalized. Monetary calculation driven by the unbounded desire to acquire money thus is a condition of rationality. I will side with Weber, but add that money use also undermines this calculative rationality by stimulating speculation, with speculative opportunities being opened widely by the evolution of credit and financial institutions. We have bubbles, the ensuing inevitable crashes and, in this way, periodic crises turn out to be the 'costs' of uncertainty absorption through money.

This argument is strictly opposed to the neoclassical mainstream, where basic assumptions rule that economic agents are both perfectly rational and extremely well informed – to the point of eliminating uncertainty in decision making. For a theory of money consistent with general equilibrium theory, the theoretical core of mainstream economics, these assumptions amount to insurmountable obstacles. No uncertainty, no money – except in the functions compatible with the neutrality of money, or, what is the same thing, with the absence of 'money illusion'. But neutral money, if it ever exists, can indeed be no more than the lubricant that makes the wheel of commerce turn more smoothly. It plays a kind of self-eliminating role as a means of exchange, and has no significance as a means of payment or as a store of value. As a means of accounting its acquisition cannot be a goal in itself for the maximizers of utility populating the model world of microeconomics. In such a framework, speculation can only do the beneficial work of the invisible hand and a crisis can only be the result of external shocks.

Seen from a different angle, neoclassical economics sticks to the biblical story. Maximizing monetary returns is the same thing as dancing around the golden calf. That kind of irrationality should have been exterminated when Moses had come down from the mountain. Unfortunately, however, the biblical story is a bit too simple and optimistic. Contemporary rationality, while certainly being bounded, pushes people to dance around the golden calf, although there is no gold anymore. But, as a well-known banker explained, as long as the music plays, you have to dance, and that is not – and certainly not always – irrational in the context of a monetary economy.

So it is time to replace the neoclassical tradition by a theory of the economy with a role for money that does correspond to the importance of money in our lives. What mainstream neoclassical economists call money illusion is no illusion (Marschak 1950). Rather, the illusionists are those who deny the importance of money, who divide the world in two, one with 'real', the other with 'nominal' magnitudes, and maintain that rational agents can always mentally reduce the latter to the former. Unfortunately for that theory, a monetary economy is one where agents have to *have* money – and therefore aim for its acquisition as such – to fulfill payment obligations, fixed in dates and amounts. No 'real' good will help in face of such obligations – unless it can quickly be transformed into money.

This argument might sound as if it was merely addressing an intra-economics dispute. But it is not. The contribution of sociology to the theory of money starts with the recognition that money is a social fact, that social facts result from interactions and that interactions imply uncertainty. That may sound trivial, but the implications are interesting and will, so I hope, stimulate fresh thinking about money.

Acknowledgments

To finish this book, as far as a book on money can ever be finished, took much longer than expected. I started work on it in 2006/2007 when I received the John G. Diefenbaker Award from the Canada Council of Arts. The grant allowed me to spend a year at the University of British Columbia in Vancouver as a guest scholar in the Institute for European Studies. I owe special thanks to its former and present directors, Sima Godfrey and Kurt Hübner, for their hospitality.

During that year I presented work in progress in lectures and seminars at the UBC Department of Sociology, at a workshop organized by Brenda Spotton-Visano at York University, at the Centre canadien d'études allemandes et européennes, Université de Montréal, in Harrison White's seminar at Columbia University, in the Economics Department faculty seminar at the New School for Social Research, and in a session organized by John Smithin at the Canadian Economics Association meeting in Halifax.

Back in Berlin, work on the book was slowed down by oversize teaching obligations and the turbulences accompanying retirement, but I had opportunities to present pieces of my argument in 2008 at the 38th World Congress of the International Institute of Sociology in Budapest, Hungary, at the 2008 interim conference of the Research Network of Economic Sociology of the European Sociological Association in Krakow, Poland, at a meeting of contributors to a special issue on economic sociology at the Max Planck Institute Cologne, at a NSF-DFG joint conference on 'Contextualizing Economic Behavior' in New York, and in 2009 at a workshop: 'Money – interdisciplinary perspectives', that I organized at the Freie Universität Berlin, and at the workshop 'On either side of the economic science of money' organized by Jean Cartelier in Paris; I also presented an appraisal of search theory models at the economics faculty seminar of the University of Kassel.

I am grateful for discussions and comments at all these events and additional comments and recommendations by anonymous reviewers, by Jens Beckert, Christoph Deutschmann and Riccardo Bellofiore. Linda Josefowicz and Hannah Zagel helped with the diagrams. Special thanks are due to Jean Cartelier and Ernst Michael Lange for a prolonged, most helpful mixture of criticism and encouragement from their respective viewpoints as economist and philosopher. Last but not least, friends and family have provided extremely patient moral support, most of all, my wife Uschi.

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Introduction

> Few writers seem able to avoid references to 'money' that are metaphorical: comments that seem on the surface to refer to money 'objects' but refer in truth to an unspecified complex of institutions associated with monetary economies.
>
> (Clower 1995: 525)

It is said about sculpture that you take a slab of marble, you chip away everything that is not the Venus of Milo and you end up with the Venus of Milo. Unfortunately, the theory of money cannot be built like that. There is endless controversy and confusion about money. Money has left bumps on many heads trying to understand it. But even if we could succeed in taking away all wrong-headed, inconsistent and fuzzy ideas, there would not be much left and we would still be far from an adequate theory of money.

Nonetheless I hope to contribute to such a theory. My argument differs from most existing contributions to monetary theory by combining four features: (1) The use of material and arguments from all relevant social sciences, but in a perspective shaped by the sociological tradition inspired by Marx, Weber, Simmel and Polanyi; (2) the focus on interaction, uncertainty and institution building in analyzing the social construction of money; (3) conceptual clarity and consistency; (4) the avoidance of inappropriate simplification.

First, I do not respect established disciplinary boundaries. While it is obvious that money should be primarily a concern for economics,[1] it is well known that mainstream economics has extreme difficulties to incorporate money into its core theory in a consistent way. I think that the reason behind these difficulties is the enduring refusal to fully acknowledge that uncertainty is a normal condition of social life. Therefore, it is promising to look beyond the boundaries of economics in proposing that the basic problem from which a theory of money should start is one that all social sciences share: How can we understand action coordination in social settings characterized by contingency[2] and therefore uncertainty?[3]

Second, as the title 'Doing money' is to suggest, money is not something that happens to us but something that we continuously produce and reproduce in specific social settings. The neoclassical mainstream has traditionally neglected