

Agreement is money: Beyond the chartalist reading of Adam Smith

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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, money takes place in that agreement on the valuation of mutual services in which exchange based on the desire of deserved credit and esteem consists. Money, thus, emerges in exchange, but, unlike the orthodox view, it emerges primarily as a measure of value. And unlike the heterodox point of view, government paper money is only a possible, tricky consequence of a long historical process and not its beginning.

Keywords: Adam Smith, chartalism, money, credit, agreement.

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 as measure of value out of the agreement on the valuation of reciprocal services that originally took place in exchange. These exchanges can be seen as based on self-love, understood as the desire to obtain deserved credit and esteem. The pursuit of deserved credit allows such initial exchanges to take place even in the absence of community enforcement. In these exchanges, the desire to merit esteem may lead to an agreement on the valuation of reciprocal services on the basis of a common measure agreed upon, i.e. original money as a measure of value.

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 (Schumpeter [1954] 2006, 276; Peacock 2013, 1-2; on a similar position, see also Graeber 2011, 21-41; Zelmanowitz 2016).¹ This thesis mainly draws on the criticisms of Smith by adherents to the so called chartalist theory of money. This line of monetary thought has its roots in the works of Georg Friedrich Knapp, who published the book *The state theory of money* in 1905, translated to English in 1924. His central argument is that money has no intrinsic value – “charta”, he stresses, in Latin means papyrus or register – and derives its value from its role as a means of payment of obligations imposed by the state (Knapp [1905] 1924, 25).² According to this view, money as essentially the unit of account in which debts and credits are denominated and enforced by the community or a state, notably through taxation.³ Consequently, chartalists have challenged the so-called orthodox view of money, based on the idea that money is created spontaneously in society as a means of 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.⁴

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 (see, for example, Innes 1913). 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

¹ A sophisticated synthesis of this so-called orthodox view of money can be found in Menger (1892). For an analysis of Menger’s theoretical contributions in the context of the early Austrian school, see Caldwell (2004, 23-25 and 75).

² Schumpeter (1954 [2006], 275) recognizes that the term chartalism originated in Knapp and defines theoretical chartalism as the denial of the proposition that it is logically essential for money to consist of or to be convertible into a metal. For the context of the debate in Smith’s time and beyond, see Schumpeter ([1954] 2006, 279) and Arnon (2011).

³ For a comparison of chartalism with other approaches to money within the Post-Keynesian tradition, see Rochon and Vernengo (2003).

⁴ See also Keynes (1930, 3-5), who explicitly refers to Knapp, for this critique of the orthodox view.

Chapter IV of Book One of the WN – where Smith seems to claim that money arose as medium of exchange out of the introduction of an easily adopted currency to facilitate trade (see Hollander 1911, Vickers 1975, Hanley and Paganelli 2014, Evensky 2015, Paganelli 2020) – is seen as flawed. And Smith is seen as adopting the orthodox view. However, other authors from the chartalist perspective, such as Wray (1998), Bell (2001) and Aggio and Rocha (2009), have also recently argued the opposite, seeking rather to see Smith as the pioneer of their heterodox view of money.⁵ They emphasize that, in line with the chartalist view, Smith considered the possibility that the value of money might depend on its ability to serve as payment of debts, especially to the state and with paper money (that has no intrinsic value).⁶

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 interpreters to read Smith as a precursor of the orthodox view.

In the WN, the explanation 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.⁷ But 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 spread of the means of exchange came about 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.

⁵ See also Laidler (1981) who, from another perspective not directly concerned with defending the chartalist school, takes a very similar view of Smith's monetary theory, arguing that for the latter the quantity of money is an endogenous variable.

⁶ See also Hollander (1911), who recognises the role of paper money in Smith, and Arnon (2011), who contrasts Smith's analysis of money as a pre-condition for the development of an exchange economy with his examination of credit and the banking system.

⁷ On this relation see also Hurtado and Paganelli (forthcoming), first presented at Nous 300 Smith Workshop, 19-22 June 2023.

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 real standard 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 (Hanley and Paganelli 2014, see also Hurtado and Paganelli, forthcoming). 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).

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 for Smith money could simply consist of a unit of account for mutual debts with paper money guaranteed by the government and used to pay taxes. Unlike the chartalists, however, Smith sees this not as the beginning of history, but as a possible, tricky consequence of a long process. This historical process begins with the first exchanges based on the original money and then evolves 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 increased need for a government to enforce property rights (see WN V.i.b.1-3).

This means that, for Smith, exchanges take place before the emergence of the need for a government to enforce the effectiveness of such agreements. 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.

In the exchange based on the desire for deserved esteem, the agreement finally reached indicates that both parties to the exchange agree on the valuation of their mutual services. In other words, they agree on a measure that allows the reciprocal services to have an exchange value. From these agreements, therefore, emerges the common measure, which is none other than the original money. Mutual services thus have a real price in terms of that original money which, according to Smith, is real wealth: the ability to acquire an equivalent amount of other people's labour.

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 this 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. We then show that, for Smith, government paper money is only one possible consequence – with all the problems it entails – of a long historical process, and not its beginning, as the chartalists claim. It is a historical process that begins with agreements that do not need to be enforced by law because they are generally respected out of a desire for deserved credit. Finally, we argue that it is in these initial exchanges – which give rise to the division of labour and all its consequences – that the original money is generated. This money can be the common measure of value on which exchangers agree to value each other's services, motivated by the desire to receive from others the esteem they feel they deserve.

1. The mistake Smith did not make

Smith's discussion of money in Chapter IV of Book I of WN could be seen as an example of the orthodox view on money. If Schumpeter ([1954] 2006, 276) sees Smith as a "theoretical metallist" when discussing monetary theories, more recent authors restate this view from different perspectives. It is the case of Graeber (2011, 21-41), who criticizes Smith's ideas on money from the point of view of anthropology. For him, the arguments presented in Chapter IV constitute the "fable of barter", according to which money emerges in a barter economy out of the non-coincidence of wants. For Graeber (Ibidem, 28) this "fable" became the "founding myth of our system of economic relations", even though, for him, there is no anthropological evidence that it ever happened. For Peacock (2013, 1-2), Smith's approach in Chapter IV is a "conjectural history" that has passed into the collective unconsciousness of the economics profession as the orthodox view. Peacock then rejects this view, claiming that there is little historical evidence to support it (Ibidem, 22). Arguing from a philosophical standpoint, Zelmanovitz (2016, 12-14) subscribes to this picture of an orthodox Smith, by placing him in a line of "catallactic" monetary thinking that, in his interpretation, includes also the late Spanish Scholastics, Turgot, Galiani, Hume, Ricardo, Menger, Mises and all modern marginalists. This portrait of Smith, that we challenge in this section, is not new. In a very critical tone, Alfred Mitchell-Innes, an early adherent to the chartalist theory of money, 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). Innes's discussion condenses arguments presented by this interpretative line that associates Smith to monetary orthodoxy and, hence, provides us with a privileged vantage point from which to explore it (alongside Knapp, he is an important theoretical reference for interpreters such as Graeber 2011, 40; Zelmanovitz 2016, 46; Peacock 2017).

The “error” was to assume that in primitive conditions people lived by barter and then, as life became more complex, barter was no longer a suitable method of exchanging goods. Therefore, a generally accepted commodity became the 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 mistake lay in assuming that money arose as medium of exchange out of the difficulties of barter and not, on the contrary, that it was exchange that was made possible by money as measure of value. That is, to imagine that money arises directly as a means of exchange is to disregard the fact that exchanges first need money as a commonly agreed measure 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” (Paganelli 2020, 29; see also Campbell and Skinner 1976). Although such an account of the evolution of money may appear “naïve” and “may not be historically accurate” (Ibidem, 29), this seems to be the one offered by Smith in Chapter IV (see also Hollander 1911, Vickers 1975, Peacock 2013, Evensky 2015, Hanley and Paganelli 2014).

However, as we intend to show, Smith never made the error attributed to him. Rather, in this chapter, Smith is only explaining how a medium of exchange – such as gold or silver – came to be universally accepted. Although it appears to be the opposite, not only does Smith not claim that money arises directly as a medium of exchange (without already being a measure of value), but he does not even claim that money as a medium of exchange arises because of the difficulties of barter (as it will be seen in the next section). The difficulties of barter only explain the spread of instruments of exchange. In this Chapter IV, Smith seems to state that money emerges as medium of exchange out of difficulties of barter implied by the establishment of 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 completely 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 rejoined (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” (WN I.iv.7-9), indicating first the fineness of the metals and then the weight (but this in turn led to new abuses, such as seigniorage, which Smith attributes to the avarice and injustice of the rulers, see WN I.iv.10).

Although the example of the butcher may be a pure supposition, Smith nevertheless still seems to imply that money emerges after trade as instrument of exchange, as in the orthodox view: 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. 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 money as a medium of exchange arises out of the difficulties of exchange due to the division of labour. All he is saying in this Chapter IV is that, as the division of labour develops, the inconvenience that others may not need precisely what we have to offer them becomes more and more pressing. For this reason, “every prudent man” will consider using what can already be seen as an available instrument of exchange, that is, a commodity that presumably only few people would refuse to accept (WN I.iv.2). Smith, therefore, is only explaining what causes the instruments of exchange to be used more and more as the division of labour extends. For him it is a question of prudence, which he considers to be a moral virtue (see TMS VI.i). In the absence of such a prudent attitude, one could risk not being able to exchange one’s goods with others for lack of goods that others are willing to accept, putting one’s own economic activity at risk. This prudent attitude becomes increasingly relevant the more the division of labour is extended, especially in the advanced society where it is thoroughly established. But here, in fact, Smith says nothing about the origin of instruments of exchange.

The title of this Chapter IV may be confusing: “Of the Origin and Use of Money”. Smith seems to be talking about how money emerges as an instrument of exchange out of 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 (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 (before being 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, such as gold, became money as a universal means of trade.

2. From measure of value to medium of exchange

Having explained in Chapter IV of Book One of the WN how gold became a universal medium of exchange, Smith argues in the next chapter that it is not gold but labour that is the real measure of value. As this section shows, Smith implies that labour is the original money as a measure of value. For him, this is the original money that is present since the earliest exchanges in so-called primitive societies, even when no instruments of exchange are in use. Money is initially a measure of value and only for this reason can it also take on the function of an instrument of exchange. This becomes clear when these chapters are read in conjunction with what Smith wrote on the subject in his *Lectures on Jurisprudence* (LJ), where the order of explanation is reversed. Here, Smith first explains money as a measure of value and, then, as a consequence, money as a medium of exchange.

In Chapter IV of Book One of the WN, Smith does not explicitly account for the origin of the instruments of exchange, but only of their increasing necessity due to the division of labour. In the LJ, instead, we find an explicit account of the origin of the instruments of exchange. According to Smith they derive from the fact that they “were before considered as the measure of value” (LJ B 238, see on the contrary Campbell and Skinner 1976, 21).⁸ For him, therefore, the instrument of exchange as such does not emerge from the difficulties of barter, as often stated (see, for example, Hollander 1911, Vickers 1975, Graeber 2011, 21-41, Peacock 2013, Evensky 2015, Hanley and Paganelli 2014, Paganelli 2020, 29). The instrument of exchange is primarily a consequence of being a measure of exchange value, and not the other way round. 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.

In the LJ, 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). In explaining money as a measure of value, Smith explains that when there are only a few kinds of goods (as in a society with little or no division of labour), each kind of good can play the role of a “common measure of the value of the rest” (LJ A vi.97). Their “relative values” are easy to remember (LJ A vi.98). Money as a common

⁸ It is striking that the editors of the Glasgow edition in their introduction to the WN instead argue that it is in these LJ passages ‘that Smith defined money as merely the instrument of exchange’ (Campbell and Skinner 1976, 21).

measure thus indicates the proportion of value between goods, i.e. allows them to be valued relatively to each other.

But when people start to deal with many goods, one of them must be regarded as the common standard 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). 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 A vi.101, see also LJ B 235-6): “In Gre(e)ce cattle were the *most generally used commodity*, and this was for some time *the measure*. In Homer every thing is valued as worth so many oxen; the arms of Glaucus were worth 100 oxen and those of Diomedes worth 9” (LJ A vi.98, emphasis added). This is the same example Smith gives in Chapter IV of Book I of WN, where he not only says that oxen were the common instrument of exchange, but also that “in old times things were frequently *valued* according to the number of cattle which had been given in exchange for them. The armour of Diomedes, says Homer, cost only nine oxen; but that of Glaucus cost an hundred oxen” (WN I.iv.3, emphasis added; see also WN IV.i.2). Smith, thus, suggests that it is because a most familiar, most generally used commodity is often adopted as a common standard of value that also is commonly used as medium of exchange.⁹

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 equal quantities should have equal values” (LJ A vi.99).¹⁰ 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 common standard, and thus also the common medium of exchange. As Smith tells his students in LJ: “I had begun to shew you how the metals 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).

⁹ Smith also refers to other instruments of exchange used by the various societies, such as shells, tobacco, sugar (see WN I.iv.3). Like the scholars of his time, Smith was interested in natural history and the stories of missionaries and travellers (such as Lafitau, Charlevoix, Kolben) who reported on the customs of distant or hitherto unknown peoples. Smith discusses this at length in the LJ and the WN. Exchanges, contracts, property relationships are analysed using numerous examples from these sources. In the LJ (B 220), Smith also speaks of exchange in terms of reciprocal “presents” (see also Young 1997, pp. 58–62), as would twentieth-century anthropologists such as Marcel Mauss in his famous *Essai sur le don* (1924). In the WN, however, Smith prefers to speak directly of exchange rather than reciprocal gifts (which for him are based on forms of benevolence); on this difference, see Bee (2021, 134-5) and Bee (2024). A detailed study of the difference between twentieth-century anthropology and Smith’s thought is, of course, beyond the scope of this paper.

¹⁰ However, as will be seen later in this section, Smith then questions also the ability of gold and silver coins to be accurate measures of value (as opposed to proportions of labour quantities).

According to these *Lectures*, the instruments of exchange do not arise from the difficulty of bartering, but from the fact that they are first taken as a common standard.¹¹ Money as a measure of value is present from the earliest exchanges that take place in society without a division of labour. As explained in the LJ (A vi.44; B 219), but also in Chapter II of Book One of the WN, these exchanges gradually give rise to the division of labour and the consequent increasing need for means of exchange. Money, as a measure of value, precedes the fact that a large number of commodities – mainly due to the establishment of the division of labour – makes it necessary to establish a common standard that can also take on the role of an instrument of exchange; a role that becomes all the more necessary as the number of commodities increases due to the development of the division of labour. From this necessity the technical problem of the adequacy of the medium of exchange arises, linked, for example, to its divisibility, as well as the well-known historical problem of the relationship between units of account and means of exchange.¹²

The process described in the LJ begins with each commodity serving as a measure of the value of the others, until one assumes the role of common standard and, then, the function as a medium of exchange. In Chapter V of the first book of the WN, Smith offers an explanation of the origin of this process (after describing its development in Chapter IV): we measure the value of commodities against each other because it is easier (presumably when the commodities are already numerous enough due to the establishment of the division of labour). This procedure is simpler than the original one: to assess the exchangeable value of a commodity not as a function of “the quantity of some other commodity”, but as a function of “of the labour which it can purchase” (WN I.v.5). 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” for the quantities of labour and that this measure is usually found in trade, through “higgling and bargaining” (WN I.v.4). Because of the difficulty of valuing in such “abstract” terms, “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). Rather, it is estimated in terms of quantities of commodities, so that one commodity can then play the role of the common standard, as explained in the LJ.

At this point of Chapter V, however, Smith states that when this exchange commodity that serves as reference becomes the gold and silver money, as he has already explained in Chapter IV, it is with the latter that the exchange value of each commodity is “frequently estimated” (WN 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

¹¹ The view that money is first and foremost a standard for comparison (and not an instrument of exchange) is particularly important for theorists of money from fields of knowledge other than economics. Georg Simmel, for example, emphasized the purely symbolic character of money, underlining that one of the greatest advances of mankind is to establish a proportion between two quantities, not by direct comparison, “but in terms of the fact that each of them relates to a third quantity”. See Simmel (2004, 144).

¹² This ratio varied considerably from the Greeks via Charlemagne to the gold standard introduced in the late 17th and early 18th centuries. See Bloch (1954), Fantacci (2005), Amato (2008). See also the historical examples suggested by Smith in WN (I.v.24-26).

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).

In this same chapter, however, 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” (Ibid., emphasis added).¹³

Bearing in mind that in the LJ Smith says that money as a measure of value is prior to money as a medium of exchange, we can better understand what he is saying in Chapter V of the first book of the WN: labour is the original purchase-money, that is, money with its first function as measure of value.¹⁴ The money as measure of value that takes place from the earliest exchanges (even before commodities are the measure of each other) is the proportion between quantities of labour, that is, the proportion of the other’s labour that can be obtained in exchange for ours. Moreover, Chapter VI begins with the two hunters in “primitive” society, before the division of labour, exchanging on the basis of this proportion (see WN I.v.1-2).

If this explanation is in reverse order to that of the LJ (first the measure of value and then the medium of exchange), it may have something to do with Smith’s polemical aim: Mercantilism. In the LJ, immediately after the explanation of the evolution of money, he moves on to criticize the mercantile system, for which wealth coincides with “money”, understood as gold or silver coins. However, in the WN, the critique of the idea that metallic money coincides with wealth does not follow the account of the evolution of money explained in Chapter IV, as it does in the LJ.¹⁵ In the WN, this critique is found only from the fourth book of the WN, which Smith reserves precisely for the critique of the mercantile system.¹⁶

Having in mind the critique of Mercantilism and the explanation of the evolution of money in the LJ, however, one can understand why in the WN, after explaining the origin of gold and silver as universal instruments of exchange, Smith then questions them as a real measure of value, proposing in their place in Chapter V labour as the “original purchase-money” (WN I.v.2). In Chapter V Smith is sharpening his theoretical weapons for the attack on Mercantilism that he

¹³ It would be beyond the scope of this article to discuss the command labour theory of value in Smith. On this topic and the theory of value in Smith see, among others, Aspromourgos (2009), Bowley (1973), Naldi (2013), Bee and Sternick (2023), Hurtado and Paganelli (forthcoming).

¹⁴ Paganelli (2023, 35), on the other hand, discussing chapter V of Book I of WN, states that, according to Smith, we may incorrectly “think that money is the measure of value, even if it is labor, and only labor, that is the real and unique measurement of exchangeable value. Smith identifies the problem of using money as a measure of value in that the value of gold and silver money varies and varies a great deal”. And she concludes: “Reading between the lines, Smith seems to be giving us one more reason for being skeptical of considering money as a measure of value or as anything more than what it is: a medium of exchange” (Ibidem, 38).

¹⁵ See the footnote n. 1 of the editors of the Glasgow edition regarding the order of speech (WN p. 37).

¹⁶ In Books III and IV of WN, Smith connected his distinction between money and wealth to a theory of international trade based on the beneficial effects on the division of labour internal to each nation (and not on bullion accumulation). On this point, see Tribe (2015, 128).

will launch at in the fourth book of the WN, where he states that it is a mistake to think that gold and silver coins are the real wealth. If in the WN Smith preferred to discuss the real measure of value only after discussing the development of the means of exchange, it is probably also because he 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.

This argumentative order of the WN is reversed in the LJ (following the logic of what comes first: the measure of value), probably for the simple reason that the idea that it is the proportion of quantities of labour that are the real measure of value is not found in the LJ of 1762-63 and is only hinted at in one sentence in his last *Lectures* of 1766¹⁷: “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 *Early 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 mercantile 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).¹⁸ 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. What was new for him, however, was to say that the first function of money, that of a measure of value, was originally performed by the proportion of the quantity of labour. This allowed Smith to continue his discourse by distinguishing between real wealth (in terms of the real measure of value) and nominal wealth (i.e. in terms of money as a medium of exchange). With this distinction, Smith wanted to emphasise the distinction between “wealth” represented by gold and silver coins, as in the mercantile system, and what he considers to be the real wealth expressed by the proportion between quantities of labour.

Although the proportion between quantities of labour is an “abstract notion”, for Smith it constitutes the real measure of value, as opposed to a “plain palpable object” like the quantity of a particular commodity, as gold or silver coins (WN I.v.5). If money had remained at its initial function as a measure of value (in terms of the proportion between quantities of labour), there would have been no problem for Smith in expressing real wealth in terms of “money”. Money would only be the original purchase-money, i.e. the proportion between the quantities of labour agreed upon in higgling and bargaining. The “real wealth and prosperity of the world”, says Smith, is “the real value of the annual produce of the land and labour of mankind”, i.e. “the real quantity of labour which it could purchase or command”, which “would, no doubt, be very different” from

¹⁷ The year in which he will leave the University of Glasgow to travel to Europe and write the WN.

¹⁸ The paragraph continues: “except general history of the coins of France, England, and Scotland; the different changes they have undergone; their causes and effects. And except some observations upon what may be called the money prices of commodities” (Ed 33).

“its nominal value”, i.e. “the quantity of gold and silver by which this annual produce could be expressed or represented” (WN I.xi.n.21).

The value of gold or silver varies over time and does not necessarily represent the real wealth.¹⁹ Only labour, “never varying in its own value”, can be “the ultimate and real standard” by which the value of commodities can be judged and compared at any time and in any place; it is their “real price” (WN I.v.7). “Money” – as a universal medium of exchange like gold and silver coins – “is their nominal price only” (Ibid.).

The danger that arises when people identify gold or silver coins with real wealth – as the mercantilists do for Smith – is that they desire them for their own sake and want to accumulate them, whereas the instrument of exchange only needs to pass from hand to hand because its purpose is to circulate real wealth. Since for Smith money as an instrument of exchange is not wealth but what allows wealth to circulate, 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 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, led to its widespread use as an instrument of exchange, giving it that second function which – when combined with the first – makes it easily associated with wealth.²⁰ The beginning of the fourth book and thus of the critique of the mercantile system 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).

Smith’s account of the evolution of money is marked at least by three conjectural historical moments.²¹ The first is that of exchange based on the original purchase-money, the real measure of value, i.e. exchange of quantities of labour. This is described at the beginning of 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). Money, therefore, emerges first and foremost as a measure of value. While the first moment takes place in a society with no division of labour, the second and third see an increasing role for the latter.²² The second moment is that of a greater ease in exchange given by valuing in terms of the quantities of a commodity rather than in terms of the “abstract” notion of quantities of labour, as Smith says in the WN (I.v.5), or by keeping in mind the proportion with only one commodity, and not with all commodities among each other, as he says in the LJ (B 235). Smith seems to imply that it is the frequent use of a commodity as a

¹⁹ On the discrepancy between nominal and real wealth, see also Smith’s reasoning in the fourth book of the WN (IV.iii.c.17). See also Paganelli (2023, 32), who states that: “Generally, money is considered the measurement of value. That is, for example, how Aristotle defines money, as the unit of account used to compare values. The problem is that when this idea of money as a unit of account is directly linked with the idea of money as a medium of exchange, the unit of account may become unstable. If the medium of exchange is a precious metal like gold or silver, and if the value of the gold or silver changes, then the unit of measurement of value risks changing as well”.

²⁰ This also entails the problem of the instability of the value measure, which is linked to changes in the value of the exchange instrument, as for gold following the discovery of American mines, see WN (I.v.7), see also Paganelli (2020, 32-33).

²¹ On the idea of conjectural history in Smith, see Stewart ([1793] 1980).

²² On so-called primitive societies as societies without division of labour, see Bee and Sternick (2023).

common standard to measure value that also makes it an instrument of exchange, rather than the difficulty caused by the non-coincidence of wants. This difficulty represents the third moment, that of the spread of the use of exchange instruments until the establishment of a universal medium of exchange, such as gold and silver, which may, then, receive the government's stamp to attest their weight and purity.

3. Deserved credit and government paper money

In the fourth book of WN, Smith argues that money – as the universal instrument of commerce, i.e. gold or silver coins – is not real wealth. Money as an instrument of exchange should only enable wealth to circulate, which is why it should not be stored, not even for fear of its lack (see Tribe 2015, 129). 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 chartalist assertions as in Innes (1913) and Peacock (2013, 1-2) – Smith also considers the possibility of exchange based on credit, even before there is a government to enforce credit contracts. As we shall see, for Smith it is possible for people to perceive and trust each other's creditworthiness – that is, each other's real willingness to keep a promise – and therefore to trade on the basis of concrete debts and credits in an advanced society as well as in primitive society, that is, before money became widespread as a medium of exchange (and thus also before metallic currency) and before a government was set up to enforce credits or give value to paper money. This means that the opposing “pictures” of him – as an orthodox and as a prodrome of chartalism – are both flawed.

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 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, differently from in Book I, Smith does not stop there in Book IV 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 an advanced society, where, he argues, unlike Innes, probity is considered a virtue (see LJ B 326-327).²³ 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 (LJ A ii.40; see also Pesciarelli 1986). 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).

²³ On the link between commercial societies and the rewarding of ‘bourgeois virtues’ such as sincerity or honesty, see McCloskey (2006), Herzog (2013). On the link between commercial societies and frankness and openness, see also Schliesser (2003), Bee and Paganelli (2019). See also Paganelli (forthcoming).

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, as 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, see also WN V.i.b.2). 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 approval and credit deserved.²⁴ That is, it is to gain the approval and credit of others that we know we deserve, because at the same time we are praiseworthy and creditworthy in the eyes of our impartial spectator (see TMS VII.iv.24).²⁵

According to Smith, it would be mortifying to succeed in gaining the approval of others without at the same time being aware of deserving it, as would gaining the credit from others without at the same time being aware of deserving it: “we cannot always be satisfied merely with being believed, unless we are at the same time conscious that we are really worthy of belief”, i.e. unless we do not get the credit that, in our impartial judgment, we feel we deserve. (TMS VII.iv.24). Although it appears to Smith as perhaps the strongest motive for action, of course, not everyone always follows this desire of gaining the approval and credit deserved. But, for Smith, the problem is not serious when the values exchanged are one or two days’ work; only as goods of higher and higher value are exchanged, clearer and more community-protected relationships appear increasingly necessary (see LJ A ii.49; WN V.i.b.2). When the goods exchanged are of

²⁴ The desire to obtain deserved credit is, for Smith, a desire distinct from the desire to obtain the credit of others at any cost, and from the desire to be credit-worthy regardless of the judgement of others (see TMS VII.iv.24). It is a related desire to obtain deserved approval, as distinct from the vain desire to obtain the approval of others at any cost, and from the virtuous and wise desire to obtain the approval of oneself (one’s impartial spectator) regardless of the judgement of others. In both cases it is not a matter of gaining only the credit or the approval of what Smith calls the “man without”, i.e. the external spectator, or only the credit or the approval of what he calls the “man within”, i.e. one’s own impartial spectator (TMS III.2.32), but of gaining the credit or the approval of both (see TMS VII.ii.4.8-10, TMS VI.i.3 and TMS VII.iv.24; see Bee 2021, see also Hanley 2009). As Smith argues in WN (V.i.b.2), people tend not to be naturally driven by passions such as envy, malice or resentment. However, when there are wide economic differences, the avarice and ambition of the rich and the hatred of work and the pleasure of enjoying the present can drive one to no longer respect the property of the other and the institution of civil government becomes increasingly necessary (Ibid.).

²⁵ 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).

little value, it is not extremely important for the maintenance of society if a few do not honour mutual debts and credits because they do not act, as instead most do, out of a desire for deserved credit, i.e. out of the desire to be deservedly regarded as capable of keeping promises and therefore creditworthy. When the goods being traded are the most valuable due to increasing wealth in society, even the few who do not honour their debts can cause such a significant damage, that society needs to protect itself against them. The existence of an authority that regulates credit is, for Smith, the possible outcome of a historical process in which wealth increases through the extension of the market and the development of the division of labour, not the beginning of this process, as in the chartalist view.

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, provided that it is “well regulated” (WN IV.i.15).²⁶ But this, for Smith, is an outcome and not the beginning of the process. Immediately after discussing the possibility of credit in the eventual absence of metallic 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 as Wray (1998) and Bell (2001), so as to legitimize their own chartalist approach by describing Smith as a pioneer. According to them, Smith supposedly solved the paradox of metallism: although paper money has no value, it is undeniable that it continues to circulate in the economies. In their view, the solution is provided by Smith’s argument, presented in Chapter II of Book II, that a prince might “give a certain value” to a specific sort of paper money, in that he enacts that taxes should be paid in this paper money (WN II.ii.104). Wray (1998, 20) states that, for Smith, “paper money could actually circulate above par even under a gold standard if it was legally required by the state”. Furthermore, Bell (2001, 154), claims that for Smith, “the value of this money [i.e., inconvertible state or bank money] depends on its usefulness in settling tax or other liabilities to the state”. In their reading of WN, Book II, Chapter II, they bypass the fact that Smith was suspicious of legal tender and believed that, for the good performance of a free banking system, paper money in circulation should not exceed the value of the gold and silver they are supposed to replace (see Paganelli 2023).

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 (see Laidler 1981, 195). Smith’s analysis in this chapter, which led chartalists to see him as their predecessor, 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

²⁶ On Smith and paper credit money, see also Paganelli (2006), Hanley and Paganelli (2014). For a critical account see Fitzgibbons (1995).

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 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).

The second argument used by chartalists is related to bank notes. 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).

When mentioning these two lines of argument, chartalists bypass the fact that, when Smith recognizes that paper could function as an instrument of commerce and lower the costs of maintaining capital, he was not advocating inconvertible paper money. In that respect, Wray (1998, 23) suggests that, for Smith, “the key, then, is not redeemability (...); rather it is the acceptance of the paper money in payment of taxes”; while Bell (2001, 155) states that, for Smith, “*Whatever* the prince announces he will accept in payment of taxes will immediately be imbued

with value” (*italics in the original*). In other words, the fiat money issued by a modern state that chartalists have in mind was not the paper money mentioned by Smith in this context. Later in the chapter, Smith is clear: “The whole paper money of every kind which can easily circulate in any country never can exceed the value of the gold and silver, of which it supplies the place” (WN II.ii.48). So, for Smith, what in fact guaranteed that the “money business” of a country is carried out through issuing banks was confidence – not on a central authority, as chartalists envisage, but on the fact that bankers would be able to redeem their notes in due time.

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. 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 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” (WN II.ii.104). 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 “sell for somewhat more in the market than the quantity of gold or silver for which it was issued” (WN II.ii.104). Here, again, chartalists read Smith selectively. Referring to this passage on the prince, Wray (1998, 23) concludes that, for Smith, “all that mattered was that the state accepted these banknotes in payment of taxes, in which case they could circulate at par, or even at a premium”. Bell (2001, 157), in turn, states that: “In sum, Smith, Knapp, Keynes and Minsky recognized the state’s power to demand certain payments from its constituents (taxes, fines, etc.) as well as the power to determine both the unit in which these liabilities are denominated and the means by which they may be discharged”. However, Smith’s recognition that paper money could bear a premium as a prince accepted it in payment for taxes was accompanied by his reference to “government paper” with legal tender in the North American colonies as “an act of violent injustice” (WN II.ii.100).²⁷ And while for these chartalists the state is the only agent capable of assigning a value to money, this is clearly not the case for Smith.

The idea that money derives its value solely from its role as a means of payment of obligations imposed by the state is central for chartalists since Knapp (1905] 1924). Therefore, chartalist interpreters such as Wray (1998) and Bell (2001) have selected the previous arguments to sustain their picture of a “heterodox Smith”. As we have showed, the three lines of argument

²⁷ In this case, money took the form of “government paper whose payment was not exigible until several years after it was issued” and that the colony rendered “a legal tender of payment for the full value for which it was issued” even “though the colony governments paid no interest to the holders of this paper” (Ibid.) See also Paganelli (2023).

used to show that Smith was a forerunner of chartalism are based on bypassing the fact that, for Smith, paper money should not exceed the value of the gold and silver whose place it supplies, as this ensured the good operation of the banking system. Smith indeed feared that over issuance of paper money could lead to serious crises and defended a prudential regulatory framework for the credit system, even though he recognized it as a violation of “natural liberty” (WN II.ii.94). For example, he advocated the prohibition of the issuance of notes with small denominations (he also considered the adoption of a usury law; on these regulatory aspects, see Rockoff 2011 and 2013; Diatkine 2021, 218-228). Smith also recognized that a free banking system could be destabilized by form of state interventions, such as the abolishment of convertibility, the introduction of legal tender, government borrowing and the influence of interest groups on legislation (see Paganelli 2003).²⁸ However, as we have showed, adherents to the chartalist view have bypassed these issues to read monetary heterodoxy into Smith. Although Smith gives a conjectural account of how we have historically come to have government-regulated forms of currency as a means of payment, he does not appear to be a defender of them. Nor does he advocate the idea that money arises from the institution of the state. This is not to say, as already discussed, that for him it arises from the difficulties of barter. Rather, for Smith, money arises from agreed valuations, which tend to be respected because of the desire to obtain deserved credit from others.

4. Money as agreed valuations on deserved esteem

According to Smith, in the initial state of society, 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. This could also be done through government paper money, with all the problems that this entails; but, in any case, for Smith this can only happen after a long historical process and not at its beginning, as Knapp ([1905] 1924) argued. The original purchase-money that for Smith is exchanged in the original exchanges is not guaranteed by any government nor is its value established by it. Rather, as this section shows, this “money” – understood as measure of value – 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).

²⁸ For the consistency between Smith’s position on the usury law and his defense of a free banking system, see Paganelli (2003).

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 in exchange on the value of each person’s labour as a proportion of the other person’s labour, a common measure of value is agreed upon. The proportion between quantities 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.²⁹ 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 (on Smith’s self-love understood as moderate self-interest, see among other Fleischacker 1999, see also Young 1986 and 1997, Fontaine 1997, Walraevens 2010). But since, according to Smith, people in such a society exchange, it is possible to understand self-love as the pursuit of self-approval that is validated by the approval of others, i.e. as the pursuit of deserved approval (see TMS VII.4.8-9, see also Bee 2021; on the different kinds of Smith’s self-love, see also Hanley 2009 and Heath 2013).³⁰ 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 that we know we deserve, because at the same time we are praiseworthy and credit-worthy in the eyes of our impartial spectator (see TMS VI.i.3, see also TMS VII.iv.24). The “desire of becoming the proper objects” of the respect of our equals, “of *deserving and obtaining* this credit and rank among our equals, is, perhaps, the strongest of all our desires” (TMS VI.i.3, emphasis added).

What people desire most is neither the approval of others alone nor self-approval alone but a blending of the two: the approval of others, which is considered to be deserved, since it chimes with the approval of our impartial spectator. Smith observes that self-love as self-approval

²⁹ For a discussion of society without division of labour in Smith and thus of the possibility of a society that is not based on mutual necessity due to the supposed inability to provide for one’s own needs, see Bee and Sternick (2023).

³⁰ The connection between self-love and approval has already been pointed out in discussions of Smith’s intellectual context, but mostly in connection with vanity as the desire for other’s approval at any cost (see Hirschman 1977; Winch 1978; Skinner 1992; Lewis 2000; Kalyvas and Katznelson 2001; Force 2003; Dupuy 2006; Diatkine 2010; Luban 2012). From this perspective, exchange would simply be a means to impose on others, in the sense of persuading others to give us what we want by simulating an interest in what they want. Their agreement to our proposal would in itself fulfil our desire for the approval of others (see Force 2003), and for the pleasure of having persuaded the others (see Young 1997; Dellemotte 2005; Walraevens 2010). Here, instead, the “pleasure of exchange” is understood as the pleasure of having persuaded the others that we really deserve their approval, and thus as the pleasure of having obtained their deserved esteem (see also Bee 2021).

makes people “happy and contented”, but he adds that “it greatly confirms this happiness and contentment” when we find that other people, viewing our own character and conduct “with those very eyes with which we, in imagination only, were endeavouring to view them, see them precisely in the same light in which we ourselves had seen them. Their approbation necessarily confirms our own self-approbation” (TMS III.2.3). Smith argues that this desire of obtaining from others the approval we think we deserve is a kind self-love and probably the most common (see TMS VII.ii.4.9-10).³¹

We can therefore apply it to the self-love to which Smith refers in the WN to explain the motive for exchange, when he says that when we exchange we are addressing the other’s self-love (see WN I.ii; on the exchange base on this kind of self-love see Bee 2021; on exchange and other’s approval in Smith see also Sugden 2002). In such a case, addressing the other person’s self-love means making an exchange proposal that shows an appreciation that can be in accordance with the other person’s self-approval, i.e. that confirms it and thus satisfied the other’s desire for deserved approval. Showing that we are willing to give something of ourselves in exchange for what others have done (like the butcher does with the brewer or the baker) can show them how much we appreciate at least what we are asking for in return. If the other person finds something in this appreciation that does not diminish their own self-appreciation, but on the contrary confirms it, then they may accept the exchange proposal because their desire for deserved approval has been fulfilled (provided they are among equals, truly free to trade and not forced to accept a price, as in the case of a monopoly, for example).³²

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.³³ 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).

³¹ According to Smith only the wisest are at all times able to find satisfaction in their self-approbation alone, without any recognition from others (TMS VII.ii.4.10). At the same time, only the poorest in spirit are most of the time deaf to their impartial spectator and in constant need of the vain approbation of others (see TMS VII.ii.4.10; see also Young 1997, 47; Fleischacker 2004, 104–120; Rasmussen 2008, 118).

³² On the exchange not based on material interest, but on the pleasure of persuading the other, see Young (1997), Dellemotte (2005), Walraevens (2010). On the exchange based on the pleasure of persuading the other of our real merits and not only for its own sake, see Bee (2021). On the exchange among peers, see Paganelli (2023), who argues that “to appeal to the self-love of the butcher [...] is not just an effective way of getting our dinner. It is also a moral claim of equality among human beings”; therefore, “every time we buy our dinner” we also exchange “respect and dignity”. On the equality among traders in Smith, see also Young (1997), Rothschild (2001), Fleischacker (2004), Darwall (2004 and 2006). On the equality among traders in Smith not only as a condition of exchange, but also as the result of exchange agreements, see Bee (2024).

³³ Here we limit ourselves to a discussion of primitive society, since we are dealing with the original measure of wealth (which for Smith is labour). For a demonstration that exchange based on the third form of self-love, i.e. the desire for deserved approval, can also take place in an advanced society, see Bee (2021).

When, in exchange, one seeks to obtain from the other the deserved valuation of one's own merit, the agreement finally reached gives rise to that common measure which allows the reciprocal services to have an exchange value. They have a real price in terms of that original money in which, according to Smith, real wealth consists. That is, they have the capacity, recognised by both parties in exchange, to acquire an equal amount of the labour of others. If there were no agreement on the valuation of mutual services, which money as a common measure of value consists of, exchange would not take place. Exchange is made possible by money as the common measure of value agreed upon in the agreement in which the exchange consists.

Before the measure of value is historically identified in a commodity that assumes the role of common standard, the measure of value arises from such agreements based on the mutual recognition of deserved esteem. Agreements that generally do not need to be enforced by law because of the associated desire for deserved credit. These agreements ultimately generate the original money, from which the whole historical process described by Smith then proceeds to the instruments of exchange and their dissemination.

If these instruments of exchange still bear some relation, however inaccurate, to the original money (i.e. to agreed proportions of quantities of labour), then they essentially convey deserved esteem. When we exchange our money for other people's services, we are implicitly proposing or accepting an equivalence between the deserved recognition we have received for the services we have rendered to others (revealed by that amount of money) and the recognition we are giving to others for their services.³⁴ All of this is true, of course, if these are truly consensual arrangements and thus establish relationships between equals.

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 from the difficulties of barter 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 exchangeable 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, it is not that money is 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 general use, as in the case of gold and silver.

³⁴ On this point and how this type of original exchange can take place in an advanced society even in impersonal exchange with money, see Bee (2021).

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 with all the problems it entails. 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 possible outcome of a process that presupposes the development of the division of labour beginning from exchanges in which money is primarily a measure of value.

If Smith is not an advocate of the heterodox view, he is not an advocate of the orthodox view either. For Smith, money takes place with exchange, but it does not arise as a medium of exchange out of the difficulties of barter arising from the development of the division of labour. Money, for Smith, arises originally as that unit of measure which already takes place in the exchanges of a society without division of labour, means of exchange and government.

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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