

## The Invention of Fiat Money / Dror Goldberg

The currency we all use today is legal tender for taxes and debts. It has no intrinsic value, it is not convertible and it is not tyrannically imposed on all transactions. This money – fiat money – was born in Massachusetts in 1690. Historians have claimed that it was a simple wartime substitution of fiat money for specie, as has happened many times since then, but this view is anachronistic. Later governments learned from Massachusetts that fiat money is a good wartime emergency, but for Massachusetts this was not an obvious idea. I show that the colony reached it by accident while it was stuck between a rock and a hard place: It had to issue money but was restricted by a peculiar combination of political constraints.

Massachusetts had to issue money to pacify mutinous troops who returned defeated from war. However, formally issuing money, and backing it with land (as was then standard), would have been fatal for the long-run independence of the colony. Massachusetts had lost its charter in 1684, partly because it minted its own coins (a violation of the royal coinage prerogative). Moreover, all the colony's land was temporarily considered to be the king's land from 1687-1691. In 1690, when Massachusetts had to issue money, its agents were lobbying for a new charter in London. It could not afford to upset the king by violating his coinage prerogative again and backing money with *his* land. The solution was to issue IOUs, as any English subject was allowed to do, not back it with land, and not force it on trade. Like any IOU issuer the colony could offset its credits with it, namely making it legal tender for taxes. It was also made effectively legal tender for debts in an elaborate, dishonest way. The outcome was fiat money.