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E Macroeconomics and Monetary Economics

The Making of National Money: Territorial Currencies in Historical Perspective. By Eric Helleiner. Ithaca and London: Cornell University Press, 2004. Pp. xii, 277. ISBN 0-8014-4049-1. JEL 2003-0896

One nation, one central bank, one money. This is the standard formula that holds for independent countries in the world today—with some notable exceptions of monetary unification across borders. The modern nation state is organized as a monetary union based on one money where the political and monetary boundaries coincide. The control of the national money supply is centralized to a single monetary authority, commonly the central bank. By law the national money is the sole legal tender. Monetary and political sovereignty goes hand in hand.

In short, this is the institutional framework for monetary policy-making that has emerged worldwide since the establishment of the *Riksbank* in Stockholm and the Bank of England in London at the end of the seventeenth century—forerunners of modern central banks. The rise of this model has been a gradual one, influenced by many developments, as told by Eric Helleiner in his book *The Making of National Money*.

The fundamental concept of his narrative is that of “territorial currency,” defined as a “territorially homogeneous and exclusive national” currency—to be brief, the money which the nation state has adopted as its monopoly money. There are episodes in history when the national currency and the territorial currency are not identical, but as a rule the reader can treat the two concepts as identical ones.

The first part of the book describes the rise of national currencies during the nineteenth century up to World War I. In Helleiner’s terminology two “key preconditions” were at play: the rise of the nation state and improvements in the production of coins and notes. The emerging nation state was able to regulate monetary and financial conditions within its borders in a way previously unknown. Coins, in particular those of low denominations, and notes of high and uniform quality, difficult to counterfeit, could be produced in the nineteenth century at falling costs due to technological breakthroughs.

Given these two preconditions, four additional driving forces behind national money are identified: the desire of policy-makers to reduce high domestic transaction costs due to heterogeneous currencies, to manage the domestic economy through monetary policy, to improve the fiscal position of the government through seigniorage and inflationary finance, and to foster and support the national identity by the use of one national money. A large number of episodes in monetary history are used as evidence for the workings of these determinants. The chapter dealing with the fourth determinant—the relationship between national identities and national monies—makes fascinating reading.

Helleiner examines the rise of national monies primarily from the perspective of the national policy-makers. By doing this, he downplays a major force behind the rise of unified domestic currencies in the nineteenth century, namely the process of monetization. With the growth of industry, rise of transportation and decline of agriculture in the nineteenth century, payments for goods and labor in barter and kind were rapidly replaced by payments in money. The simultaneous expansion of the financial system, in particular of commercial banking, was part of the growth of the money economy. As economies became monetized, the benefits from national monetary policy and from having one homogeneous national currency became stronger.

The second part of the volume deals with the spread of the national monetary model in the interwar period and after World War II. Now, representatives from central banks in the industrialized world, noticeably from the Federal Reserve System and the Bank of England, took an active part in the establishment of new central banks around the world.

In this part Helleiner also analyses the challenges to national monies, identifying four such threats: monetary unions, the use of a foreign currency replacing the national money—commonly analyzed as dollarization, domestic “local currencies” within national borders with restricted circulation, and “electronic” or “digital” money. Among these, the two first-mentioned items get the most attention.

The strength as well as the limitation of the volume is its breadth. The evolution of national monies in a large number of countries in the nineteenth and twentieth century is described,

adopting a mix of economic history, history, political science, geography, sociology, international relations, economics and numismatics. The extensive list of references reflects the broad approach adopted. Helleiner makes a convincing plea for an interdisciplinary and historical approach to the study of national money. His high ambition prevents him from going into depth with his many topics, however.

The author tends to view the optimal currency area theory as the standard tool of economics for the study of the evolution of monetary arrangements. As shown by recent work in monetary history by economists like Michael D. Bordo, Forrest Capie, Barry Eichengreen, Charles Goodhart and Hugh Rockoff, this is not the case. They adopt alternative approaches.

History shows that the rise of national monies has been accompanied by a wealth of statistics on coins, notes and other monetary assets. To my surprise, hardly any use of data on monetary developments is made in the text or in the illustrations. All figures but one depict various coins and notes. The exception is a drawing from 1836 of Boulton's new coining press.

To sum up, the author should be praised for his bold attempt to reveal grand themes in monetary history. His book makes an enjoyable complement to standard work on the history of money, central banking and monetary policy.

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The Shadow Economy: An International Survey.

By Friedrich Schneider and Dominik H. Enste. Cambridge; New York, and Melbourne: Cambridge University Press, 2002. Pp. xiii, 222. \$55.00. ISBN 0-521-81408-1.

JEL 2003-0890

Economists have begun to pay attention to phenomena which were largely ignored in earlier periods, such as the *dark side of economics* like the shadow economy. Friedrich Schneider and Dominik H. Enste, two experts in that field, provide with this book broad insight into the size and origins of the shadow economy.

The book is divided into nine chapters. It starts with a clear definition of the shadow economy and data on its size and development in 76 countries (developing, transition and OECD countries). The authors introduce several methods of measuring the extent of illicit work, pointing out

the pros and cons of the instruments. Thus, it is reasonable that the authors summarize and compare results obtained with different methods. This provides better insights into the general tendencies in the countries. The results show that the size of the shadow economy has increased in the last 30 years. In general, the huge number of analyzed countries is a good basis for future empirical investigations.

In a next step, the authors convincingly demonstrate the relevance of going beyond the traditional neoclassical focus to understand the multiple reasons for deviant behavior. Thus, they extend neoclassical economics, enriching theory with conceptions from other sciences, such as social psychology or sociology, but without abandoning the economic foundations.

The integrative model is applied to analyze causes and measures of economic policy. The authors stress that government failure is the main cause of illicit work. Besides the tax burden and regulation density, a defensive labor-market policy also leads to the exit option of migrating into the shadow economy. Using data from the OECD countries they show that there is a strong positive correlation between the size of a shadow economy and the tax burden and social security contribution. The tax burden seems to be an especially important variable, explaining more than 38 percent of the total variance of the size of the shadow economy in a bivariate analysis (p. 110). The results from a multivariate analysis with data from Austria indicate that an increase in the density of regulation and the direct and indirect tax rates leads to a rise in the shadow economy. Interestingly, an increase in the complexity of the taxation system is also positively correlated with a rise in shadow economy activities. This part of the book also stresses the relevance of tax morale as a cause of a shadow economy. Surveying empirical studies from the 80s with OECD data, the authors argue that tax morale has a strong statistical influence on the size of a shadow economy.

In the last part, the book focuses consistently on the consequences of the development of shadow economies for economic and social policy. The differentiation between allocation, distribution, stabilization and fiscal effects is very useful. It is important to mention that the authors not only treat the negative effects of shadow economic activities, but also the positive ones. For example,

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