

# **MONEY AND MONETARY POLICY IN CANADA**

## **MODULE 2: MONEY: A HISTORICAL LOOK**

**“Money and Monetary Policy In Canada” by Gary Rabbior**  
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## 2.1 TYPES OF MONEY: COMMODITY, SPECIE, FIAT

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### Our Money Is Pretty Worthless Today—Except in What It Can Buy!

Today, our money has little, if any, value in and of itself. Our bank notes really only have value in terms of what we can acquire with them. The metal in our coins isn't worth very much either. There isn't 10 cents' worth of silver in our 10-cent piece or 5 cents' worth of nickel in our 5-cent piece. The coins are worth more for what they can acquire (their purchasing power) than their metal value (their intrinsic value). This is probably just as well, or people might set about melting down the coins for their value.

This hasn't always been the case. At one time, money did have value in and of itself. Let's introduce some terminology to help us understand the differences in the types of money that have existed from the past to today.

#### **Economic**

##### **Insight:**

#### **Commodity**

*Money – when an object is used as money – e.g. beads, cattle, tools*

#### **Economic**

##### **Insight: Specie**

*Money – when a precious metal is used to make money – gold, silver, bronze*

#### **Economic**

##### **Insight: Fiat**

*Money – has no value in and of itself – it represents value in terms of what it can buy*

### Commodity Money

An object used as money has intrinsic value, that is, have value in and of itself, not just because it can be exchanged for goods or services. Over the course of history, a variety of objects have served as money. When an object is used as money, it is referred to as commodity money. If we decided to use hockey pucks as money, the hockey pucks would be a form of commodity money. (Pause and think for a moment about whether hockey pucks could serve as money, according to the criteria we identified in Module 1 for something to serve as money.)

### Specie Money

When money isn't an object but, rather, is made from one of the precious metals such as silver or gold, it is called specie. A silver dollar that contains about a dollar's worth of silver is specie.

### Fiat Money

Anything that is used as money, even though it only represents value without having value in and of itself, it is called fiat money. Our \$10 bank note can acquire \$10 worth of goods and

services. But the piece of polymer that serves as that \$10 note is not worth \$10. Instead, it represents \$10 worth of purchasing power. It is fiat money.

**Economic  
Insight: Fiat  
Money relies on  
people's faith in  
its value**

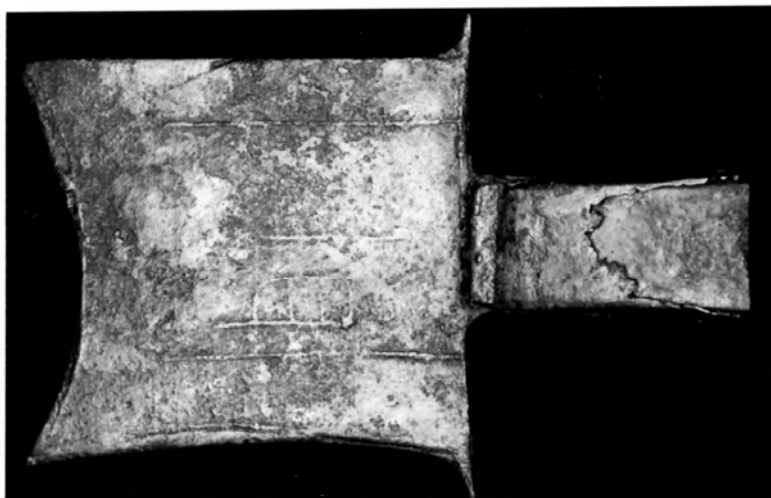
### **Trust and the Willingness to Accept Money**

The distinction between commodity money, specie and fiat money is important. In the early days of money, people were skeptical about accepting an object that only represented value and wasn't valuable in and of itself. Think about how willing you might have been a few thousand years ago to accept as payment a piece of polymer with a picture and a 10 on it.

A willingness to accept something that represents value requires a significant amount of trust, something that early users of money didn't have. As we learn about the history and evolution of money, we will see that events took place that increased people's willingness to accept fiat money. And it is a good thing they did, or our economy today might be in some trouble.

### **Money: Its Origins**

Cattle were the first commodity to be used as money, more than 6,000 years ago, when all forms of livestock first became domesticated. Since it was considered important that money be worth something in and of itself, such as cattle, the Chinese chose tools as a form of money. Because tools had intrinsic value, they became valuable as a form of money, serving as both a medium of exchange and a store of value. The tools, like the cattle, were a form of commodity



*Hollow Handle Spade, Chou Dynasty, 580-476BC, China. National Currency Collection, Bank of Canada; photography James Zagon, Ottawa.*

money. The Chinese later switched to metal coins but, true to their past, they designed the coins in the shape of tools. Hence, “spade money” in China looked like a little shovel or spade. Cowries (the shells of a mollusc found in the Pacific and Indian oceans) were also used as money in China and other nations.

While beads, shells, cattle and many other commodities have served as money in various societies in the past, it was much more common to use specie, that is, some form of metal such as gold or silver.

## **2.2 MONEY AND WORLD TRADE, POWER AND TECHNOLOGY**

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### **Early International Use of Money**

Long ago, the Greeks used primarily silver coins as their form of money. The Greek coins were among the first forms of specie to be used for trading between different countries. Until that time, countries produced and used their own money—and money wasn't used to exchange goods and services internationally. But the conquests of Alexander the Great between 334 BC and 324 BC changed things, and the use of Greek coinage began to spread to other countries.

The international acceptance of Greek coins as money reflected the growing economic activity in the world. Trade between nations was expanding, and traders in different countries needed a way to pay for goods and services that were crossing borders and to settle accounts.

### **Money Reflected Nations in Positions of Power—and Their Decline**

Not surprisingly, the nations that dominated militarily were often the same ones that dominated economically. For example, with the rise of the Roman Empire, Roman coins came to replace Greek coins as the money used in trade between nations.

Early Roman coins tended to be struck in bronze. Eventually, a silver coin called a denarius appeared. This was worth 10 bronze coins and was considered to have the value of a day's pay for a skilled tradesman.

As the Roman Empire began to decline, however, fewer silver coins were used. Toward the end of the Empire, coinage largely consisted of gold pieces and small bits of bronze.





*Noble, Edward /II, 1351-1361, England. National Currency Collection, Bank of Canada; photography James Zagon, Ottawa. (A hammered coin)*

## **Growing World Trade Created Challenges for What Served as Money**

As world trade increased, more money was required to support the significant increase in transactions. As a result, commodity money became more difficult to use. Problems arose, such as how to have enough money, how to make it easily portable and how to ensure that it was widely accepted around the world. Therefore, as commerce expanded, people tended to use more metal coins (specie) and less commodity money. The value of metal coins was more dependable, and coins could be easily transported.

## **As Technology Changed, So Did Money**

But, over time, other changes to money occurred. The Renaissance brought improvements in technology. Before then, designs had been hammered onto coins. Adaptations to the screw press resulted in more standardized coins that were harder to counterfeit. The better-quality coinage and improved standardization made possible by the new technology also helped to increase the widespread acceptance of money.

As people throughout the world became more used to money and accepted specific coins, there was less concern about the intrinsic value of the coins. People were increasingly willing to accept that a particular coin might be worth more for what it could buy than for its intrinsic value.

### **Origins of Our Dollar**

As a note of interest, a large silver coin called a thaler was minted in Bohemia, beginning in 1518. In Holland, a coin of this size was called a daalder. This became “dollar” in English and was the popular term for the Spanish-American 8-reales coin. It is the origin of the term dollar that we use today in Canada.

In the early settlement days of what was to be Canada, Spanish-American dollars were widely used. Let’s look more closely at how money evolved in Canada.

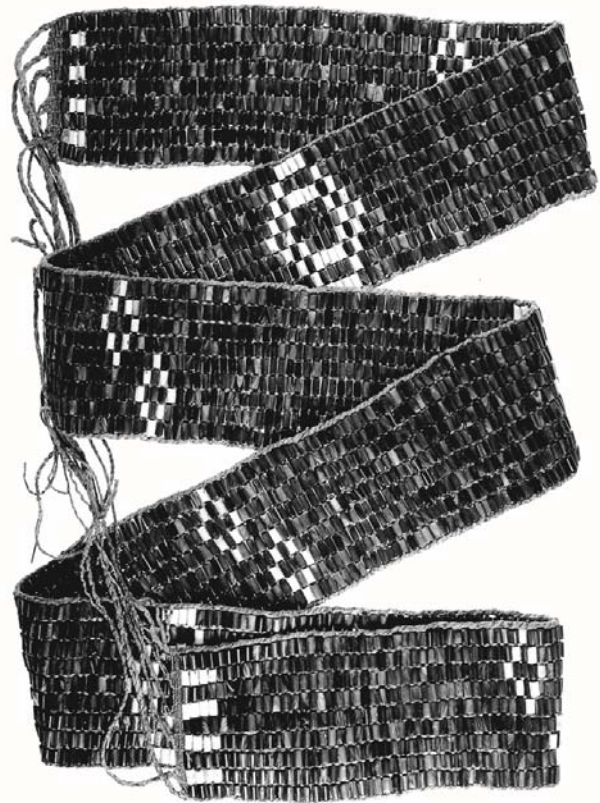


## 2.3 THE EVOLUTION OF MONEY IN CANADA

### Shells (Wampum) and Furs as Forms of Commodity Money

The first Europeans arrived in present-day Canada in the early 16th century. For the next 200 years, the fur trade, in which furs were traded for a range of other goods, was their primary commercial enterprise. Indigenous peoples were integral to the success of this industry, as it depended on their traditional knowledge, technology and trade routes. However, furs were not the only commodity to be used as a form of money. For millennia, long before the arrival of Europeans, diverse Indigenous nations had developed a robust commercial and trading network that depended on diplomacy and allies. Wampum (the actual Algonquin word is wampumpeag), featured white tubular beads crafted from whelk shells by people living on the Atlantic coast. These beads were strung together with purple beads made from the quahog (an Atlantic hard-shelled clam). Wampum was a store of value and was traded widely as a commodity.

The value of a commodity that serves as a medium of exchange is not constant in all areas. It is subject to the laws of supply and demand. For example, furs were more valuable in the Prairie regions than in central regions because fur-bearing animals were less common on the Prairies. Shells had more value inland than they did by the sea, again because they were less common inland.



*Wampum Belt, n.d., Pre-Colonial/Early Fur Trade. National Currency Collection, Bank of Canada; photography James Zagon, Ottawa.*

### The Made Beaver

Over time, some standardization of value evolved with the unit of account called the made beaver, which was equivalent to the value of one prime quality skin from an adult beaver. Beaver fur took on particular importance because the beaver hat was extremely popular in Europe and the animal had been over-hunted there.



*1-made"beaver, Hudson's Bay Co. (Eastmain), n.d., Canada. National Currency Collection, Bank of Canada; photography James Zagen, Ottawa.*

In his 1985 book, *Company of Adventurers*,\* Peter C. Newman provides the following information about the made beaver.

*At the fur-gathering end of the commerce, all goods were quoted in terms of their beaver equivalents, so that two otter skins, eight pair of moose hooves or ten pounds of goose feathers each equalled one made-beaver.<sup>1</sup> A moose hide or the fur of a black bear would fetch goods worth the equivalent of two made-beavers. Indians [Indigenous peoples] could get an impressive array of goods for their catch, as shown in this tally taken from the standard of trade as it existed at the Hudson's Bay Company post at Albany Fort in 1733:*

<i>Coloured beads</i>	<i>¾ pound</i>	<i>for</i>	<i>1</i>	<i>Made-Beaver</i>	
<i>Kettles, Brass</i>	<i>1</i>	<i>“</i>	<i>“</i>	<i>1</i>	<i>“</i>
<i>Lead, black</i>	<i>1</i>	<i>“</i>	<i>“</i>	<i>1</i>	<i>“</i>
<i>Gun-Powder</i>	<i>1½</i>	<i>“</i>	<i>“</i>	<i>1</i>	<i>“</i>
<i>Shot</i>	<i>5</i>	<i>“</i>	<i>“</i>	<i>1</i>	<i>“</i>
<i>Sugar</i>	<i>2</i>	<i>“</i>	<i>“</i>	<i>1</i>	<i>“</i>
<i>Tobacco, Brazil</i>	<i>2</i>	<i>“</i>	<i>“</i>	<i>1</i>	<i>“</i>
<i>    Ditto Leaf</i>	<i>1½</i>	<i>“</i>	<i>“</i>	<i>1</i>	<i>“</i>
<i>    Ditto Roll</i>	<i>1½</i>	<i>“</i>	<i>“</i>	<i>1</i>	<i>“</i>
<i>Thread</i>	<i>1</i>	<i>“</i>	<i>“</i>	<i>1</i>	<i>“</i>
<i>Vermilion</i>	<i>1½ ounce</i>	<i>“</i>	<i>“</i>	<i>1</i>	<i>“</i>
<i>Brandy</i>	<i>1 gallon</i>	<i>“</i>	<i>“</i>	<i>1</i>	<i>“</i>

<sup>1</sup> "Made-beaver" constituted the money of the new frontier, not in the sense of a medium of exchange but in the sense of a unit of account. When coins were eventually introduced to facilitate the fur trade, they were made-beaver tokens. Minted of brass or stamped out of the copper bindings of kegs shipped to the bay from London, they were imprinted with whatever fraction of made-beaver they represented and could be spent like cash inside HBC stores. A prime quality beaver usually represented a dozen tokens; a bear skin, twenty. The last tokens were aluminium pieces for use in the white fox trade, issued in the eastern Arctic by the HBC in 1946. The standard fluctuated from time to time and from factory to factory, depending on the trading circumstances.

From Furs to Coins—and Some New Challenges

As the economy in this new land developed and more European settlement occurred, more traditional forms of money found their way into use, particularly European coins from exploring and trading nations such as England, France, Spain and Portugal. The two nations most significantly involved in what would become Canada were England and France.

\* Source: Newman, P. C. 1985. *Company of Adventurers*. Markham, Ontario: Penguin Books Canada. Copyright © Power Reporting Limited, 1985. Reprinted by permission of Penguin Books Canada Limited.

Where French power was stronger, French coinage was used. But a problem arose from the chronic shortage of coinage everywhere in North America. This problem was made worse when France expected its colonies in New France to make payments for taxes, supplies, etc. in coin (that is, in silver and gold). This put a drain on the cash available in the French colonies.

### Playing Card Money

Around 1685, the French colonial authorities addressed the shortage of coins by developing an interesting form of money—playing card money. This was a form of fiat money, since the cards didn't have intrinsic value or, at least, not anywhere near the value that they had as money in exchange for goods and services. Playing card money was one of the early forms of paper currency in Canada.



50 livres, French Regime playing card money - Reproduction, 1714, Canada.  
National Currency Collection, Bank of Canada; photography James Zagon, Ottawa.

Playing card money worked as follows. The cards were cut into halves, quarters and so on. The seal of the treasurer of the colony was put on each card with wax. Then the governor, the intendant and the clerk of the treasury each signed the card. These cards were accepted as money and could be used as payment for goods and services within New France.

### For Money, a Decline in Trust Leads to a Decline in Value—and Acceptance

After the fall of New France in 1763, the British eventually refused to redeem the card money the French colonists had been using. To be fair, the French authorities had been over-issuing the cards by this time, causing their value to depreciate, so they were almost worthless even before the English arrived. Whenever money is not generally accepted, it loses its value and ceases to function as a medium of exchange. This was a particularly harsh blow to the French settlers, who suddenly found that their card money had no value. The result was a considerable distrust of paper money among early French Canadians. The French were not the only ones to be skeptical, but they had a particularly good reason to be so.

### For Money, Many Types Can Also Lead to Confusion—and a Decline in Acceptance

In the early days of the developing economy in Canada, many different coins were circulated as money. Even flattened buttons were used. The variety of forms of money began to make the exchange process confusing because people didn't know what they could and could not accept.



\$1, Quebec Bank, 1835, Canada. National Currency Collection, Bank of Canada; photography James Zagen, Ottawa..





\$1, Montreal Bank, 1819, Canada. National Currency Collection, Bank of Canada; photography James Zagen, Ottawa..

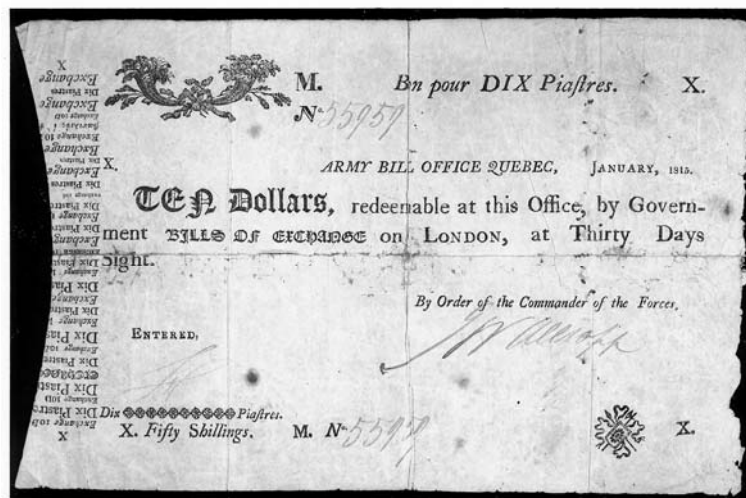


5 shillings, Bank of New Brunswick, 1820, Canada. National Currency Collection, Bank of Canada; photo- graphy James Zagen, Ottawa.

## 2.4 THE EVOLUTION OF BANKING IN CANADA

### The War of 1812—Army Bills

Amid the nervousness about the different forms of money in circulation, the United States declared war on Britain in 1812. Sir Isaac Brock, the recently appointed governor of Upper Canada, thought that the Americans might attempt to move into Canada. Brock realized that weapons and other equipment would have to be acquired to prepare for war. He was hampered, however, by a shortage of currency in the colony. Without money, he couldn't buy what he needed.



\$10, Army Bill, 1815, Canada. National Currency Collection, Bank of Canada; photography James Zagon, Ottawa.

To address the problem, the government ordered that a paper currency called army bills be issued to pay wages and acquire the needed goods. These bills were issued in Spanish dollar denominations. At first, there was resistance to accepting the army bills, but they gradually won the confidence of merchants. After the war was over, the bills were redeemed by the government for silver and gold. As a result, army bills continued to be accepted and held their value. This experience helped to build people's confidence in paper currency.

### **Growing Faith and Confidence Led to New Banking Efforts— and New Faith in Fiat Money**

While confidence in paper currency was growing, new efforts were launched to establish banks. The first successful bank was the Montreal Bank, established in 1817. It eventually became the Bank of Montreal, which received its charter in 1822, although the first chartered bank was the Bank of New Brunswick, in 1820. It was eventually taken over by the Bank of Nova Scotia.

With the establishment of banks and people's growing trust in them, the use of paper (fiat) money increased. The banks issued paper notes that served as money in much the same way that our bank notes serve as money today. People could exchange the bank notes for the goods and services of merchants, because the notes could be redeemed on demand at the issuing banks for gold or silver.

We mentioned earlier that the Spanish-American 8-*reales* coin was popularly referred to as a dollar. These Spanish dollars were sometimes cut into quarters, and one-quarter of a Spanish dollar was equal to 2 *reales*, or "two bits." That is why, to this day, some people refer to our quarter as two bits. The Spanish dollars that circulated in Canada were not minted here, but in places such as the Spanish colonies in Central and South America. However, when the Ottawa Branch of the Royal Mint was established in 1908, the first Canadian coins were produced domestically. Today, Canada also produces money for other countries. It is an area of experience and expertise that Canada has developed.

### **With More Banks and More Money, Confusion Arose Again— Along with Counterfeiting**

As more banks were established, notes of various forms were issued by these banks, leading to confusion and uncertainty. One of the problems was that some of the new banks failed after issuing money. With so many new banks, some succeeding and some failing, more confusion arose. As you might expect, people became increasingly nervous about accepting the various bank notes. A merchant might be afraid to accept a note issued by a bank located in another area, fearing it may have failed.





\$115 shillings, The Commercial Bank of the Midland District, Kingston, 1843, Canada. National Currency Collection, Bank of Canada; photography James Zagon, Ottawa. (A legitimate bank note)

This confusion created a perfect environment for counterfeiters—and they flourished. Ghost, or phantom, banks were established. These banks didn't have a head office and, frequently, no offices at all. Unscrupulous people would pick a name that resembled the name of a well-known Canadian bank and approach a printing firm to produce paper currency in that name. These bank notes would then circulate in Canada and the United States. This went on for a while, until the merchants and others caught on to what was happening. That counterfeiters could get away with this deception was a sign of the banking problems that existed. Change was needed to restore confidence in money—and in the banks.



\$4120 shillings, Commercial Bank of Fort Erie, 1836, Canada. National Currency Collection, Bank of Canada; photography James Zagon, Ottawa. (A ghost bank note)

## 2.5 CENTRALIZING AND ORGANIZING MONEY IN CANADA

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**Facts and Figures:**  
*Currency Act, 1858, required government accounts to be kept in decimal currency*

**Facts and Figures:**  
*Currency Act, 1858, adopted the dollar as Canada's official unit of account*

### **The Need for More Standardization and Control of Money—The Currency Act**

There was a clear need for a single currency to be used by all people for all transactions. Sir Francis Hincks, who was involved in journalism, politics and the development of the railway in Canada, played a major role. In the 1840s and 1850s, Hincks pushed to establish a national currency for Canada. But the British treasury officials resisted his efforts, for several reasons. For one thing, institutions were earning income from issuing currency. These institutions didn't want to lose that income. However, change was necessary.

By legalizing transactions in decimal currency for the first time, the Province of Canada's Currency Act of 1853 started us on the road to a decimal-based currency. Then the Currency Act was revised in 1857 to require all government accounts be kept in decimal currency, and this system has continued to the present day. By this act, the Province of Canada adopted the dollar as the official unit of account, and coins were struck in denominations of 1 cent, 5 cents, 10 cents and 20 cents, somewhat different denominations than we have today.

### **Control of Our Coins and Paper Currency—From the Banks to the Federal Government**

It wasn't until 1867 and Confederation that government notes (rather than just bank notes) were issued—first as provincial notes and later as Dominion notes, so called because Canada was then known as the Dominion of Canada. (Note is simply another term for paper or polymer currency.) With Confederation, Parliament took control of the currency. The *Bank Act* of 1871 repealed any provincial acts in conflict with federal control. Chartered banks issued notes in frequently used denominations such as \$4, \$5 and \$10.

The government also issued notes—\$0.25, \$1, \$2, \$50, \$100, \$500 and \$1,000—covering the larger and smaller denominations. Over time, the government took over issuing all notes, such as the \$4 note in 1882 and the \$5 note in 1912. You might assume that people used bank notes more than coins for transactions, as they do today. In fact, this wasn't the case in the 1800s. It wasn't until the First World War that bank notes took on a more prominent role in transactions.

**Facts and**

**Figures:** Coins were the primary currency for day to day transactions until the First World War in Canada

**Economic**

**Insight:** Bank of Canada is responsible for paper currency in Canada

**Economic**

**Insight:** Royal Canadian Mint is responsible for coins



## The Creation of the Bank of Canada in 1935

Individual banks in Canada issued currency until 1944. Revisions to the *Bank Act* in 1934 provided a schedule for a reduction in bank-issued currency over the next 10 years. The following year, in 1935, the Bank of Canada was established. As the country's central bank, it eventually assumed total responsibility for issuing currency.

As of January 1, 1950, all chartered bank notes still outstanding became the liability of the Bank of Canada, which received a payment from each chartered bank equal to the amount of notes it held.

Even today, if you have one of the redeemable bank notes issued by a chartered bank, the Bank of Canada is legally obliged to accept it. In fact, about \$8 million worth of unredeemed bills would still be accepted. Most of these bank notes have likely been destroyed. However, when cleaning up the attic or rummaging through your grandparents' basement, don't hastily discard any currency that you might find!

To this day, the Bank of Canada maintains responsibility for issuing bank notes in addition to its other responsibilities. The Royal Canadian Mint looks after coins.

## Producing Money—An Area of Canadian Expertise

Periodically, the Bank has changed the style of the currency issued. The first major change to bank notes occurred in 1937, followed by other changes in 1954. A more modern style was introduced in 1969. Further changes were made in bank note series introduced in 1986 and over the years 2001 to 2006. In 2011, with the use of polymers, the Bank began the process of changing the look, style, and composition of our currency to the way it looks today. This link <https://www.bankofcanada.ca/multimedia/life-bank-note-lab-wallet/> will take you to a look at how our new currency is designed and produced.

## The Evolution to Fiat Money Was Important for Economic Development—and a Global Economy

As we near the end of our brief look at the history and evolution of money, it is important to note the significance of evolving from commodity money and specie to fiat money. We spent some time examining people's reluctance to accept fiat money. Today, because of our secure financial system, fiat money is commonly accepted. People willingly accept a piece of paper legally denoted as having \$100 worth of purchasing power. The acceptance of fiat money paralleled the development of our financial system—and people's trust in that system.

***Facts and  
Figures: Canada  
produces paper  
currency and  
coins for many  
other countries***

This widespread acceptance of fiat money has had important consequences. As our economy has grown and produced more output, the number of exchanges has increased rapidly. Millions of exchanges now take place in our economy on a regular basis.

The acceptance and availability of fiat money greatly enhanced the efficiency with which goods and services are exchanged. This evolution is significant, because it allows money to effectively support a modern economy.

We have now completed our journey through the history and evolution of money, both in the world and in Canada. Today, millions of people engage in billions of transactions, and billions of dollars are invested each year to enable our economy to grow and expand. And we have an efficient, sophisticated financial system to support such activity.