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Mr T Cuff
Via email: request-32780-dec444db@whatdotheyknow.com

Dear Mr Cuff

Thank you for your email of 15 April in which you ask under the Freedom of Information Act 2000 ('FoI Act'):

'...where money comes from? Its original source? And how it gets into circulation?'

These are big questions. This letter cannot do justice to the full range of monetary history research (that has been undertaken since at least the nineteenth century) that would be needed in order to provide you with a complete answer. Nevertheless, I hope the following points are helpful.

It is perhaps helpful first to deal with definitions. Economists have traditionally defined money by three functions that it performs: as a unit of account (e.g. pound sterling, US dollar, euro, Swiss Franc, Japanese Yen, and so on); as a medium of exchange (i.e. to facilitate trade in goods, services and financial instruments); and as a store of value. There is, however, no agreed consensus among academics on where money originally came from. In the nineteenth century, a theory was developed that attributed to market forces the development of coins (and other physical moneys) to facilitate trade, since trading with money was easier than barter exchange. (An economist called Carl Menger wrote a seminal article outlining this theory in 1892.) This approach has latterly been challenged by those who point to authorities (above all, monarchs / governments) issuing money which they are willing to accept back in payment (e.g. for taxes). (Among others, the present-day economist Charles Goodhart has written a number of papers on this latter theory.) If you are interested in gaining a more in-depth understanding of the historical / theoretical origins of money, then I suggest searching for more information on Menger's and Goodhart's works either on-line or at a library, and then following leads that their work points to.

Nowadays, it is central banks that have the ultimate role in creating money. They generally do so in response to the demand for money – through both the issue of banknotes and the creation of so-called 'central bank reserves' on the accounts of commercial banks (which use this money to make payments to one another).

The demand for money is usually affected by the level of interest rates. You may be aware that the Bank's Monetary Policy Committee (MPC) is responsible for setting Bank Rate to meet the Government's inflation target of 2%, as measured by the 12-month increase in the Consumer Prices Index (CPI). In addition, since March 2009 the Bank has been creating extra money by purchasing assets in order to meet its inflation target. This is referred to as Quantitative Easing (QE). Under QE, the Bank purchases assets and credits the relevant bank's reserve account with the additional funds. This generates an expansion in the supply of central bank money.

In terms of how money gets into circulation, in the rest of this reply I have assumed that your questions about 'money' relate to banknotes circulating in the UK and have responded on that basis. (As far as the circulation of coins in the UK is concerned, this is a responsibility of the Royal Mint. Information is available on their website at www.royalmint.com.)

Bank of England banknotes are currently produced by a company called De La Rue Currency and are distributed and circulated to the commercial sector under the Note Circulation Scheme (NCS). Details about the production, distribution and destruction of banknotes and the NCS are available on our website at www.bankofengland.co.uk/banknotes/about/distribution_circulation.htm

Finally, I should mention that the above information about banknotes relates to those issued by the Bank of England. You may already know that in the UK a small number of Scottish and Northern Ireland banks can issue banknotes. More information on this is available at www.bankofengland.co.uk/banknotes/about/scottish_northernireland.htm

Yours sincerely

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