

Lecture 2: Chapters 3 and 4

<http://www.oddgods.com/articles/2006/n24a>

The money is commodity money—Gold.

I. Decision Time

II. Money-Substitutes

A. Definition

B. Purpose of Definitions

C. “Cash” as a Verb

D. Redeemability in Practice, Not Law

III. Commodity Money

IV. Fiat Money

V. Credit Money

VI. Nominalist Theories

VII. The State and Money

VIII. Bimetallism

Important—Money substitute. What is it? Money substitute is a claim on the money in the narrower sense. It is money in the broader sense.

Gold is the ultimate money.

A debit card not a credit card.

No bank card.

Is a personal check a money substitute? Yes, if the merchant believes that there is money in the account.

Suit the end of economic theory. Legal theorist who talk about money and credit they have their ends. They pick certain terminology for certain reasons. We shouldn't adopt that the legal system has developed. We pick for purposes what is it we are trying to do.

Why a category as a money substitute. Money in the broader sense.

Questions for the Professor: Week 2

by [Matt Gilliland](#) - Wednesday, 18 January 2012, 09:04 AM

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Is the property of money as an index (rather than a measure) what makes purchasing power flexible for a fixed quantity of money (subject only to demand for cash balances)? I am thinking here specifically of Rothbard's assertion that any size money supply is sufficient to meet the needs of any given economy.

Are Bitcoins an example of private fiat money?

by [Louigi Verona](#) - Friday, 10 February 2012, 05:32 AM

Yeah, that same diagram was in the lecture. And I do understand that fiat money is money in the narrower sense. Only it makes me look at the current fiat money system as weird. You know, like - something's fishy! This isn't right)

Basically, fiat money is thus just something created by the government and then enforced. That does lead to an arbitrary redistribution of such money, doesn't it. If you can just print it.

by [Peter Surda](#) - Friday, 10 February 2012, 03:08 AM

Louigi,

fiat money (unlike bank note in a gold standard system) is not a claim, rather it is money in narrower sense. Please consult the diagram: http://mises.org/books/Theory_Money_Credit/AppendixB.aspx

The writings of the Austrians (not only Mises, but others too) explain that fiat money came to be as a devolution of prior commodity money systems. Bank notes were originally warehouse receipts for the deposited gold (silver, whatever). Gradually, this claim was weakened (e.g. by fractional reserve banking, suspension of specie payments, central banking, legal tender laws). After the elimination of the claim is completed, the result is fiat money.

Some Austrians will probably admit that this is not the only way fiat money can develop, but I think they would all agree that this seems to be the most common pattern.

[Louigi Verona](#) - Friday, 10 February 2012, 01:58 AM

So the difference of fiat-money from a bank-note is that a bank-note is redeemable into money in the narrower sense (i.e. gold) and fiat money is just money with which you cannot go to the government and ask for gold, but it is still accepted by everyone as money. Right?

If this is so, how does that go in line with what Mises says about the limited ability of the state to create money? How can fiat money be if it is not value in itself and it is not redeemable into anything that is of value?

by [Peter Surda](#) - Thursday, 9 February 2012, 02:59 PM

Let me try to answer Q1 the way I understand it. It depends on what "well accepted bank-note of a private bank" means. In the classical gold standard with competitive bank note issue, private bank notes were money substitutes. In the Hayekian competitive paper currency system, if they have a special legal status, they are fiat money because they are not redeemable into anything. If it has a backing with variable market price, such as a bond or share, but no special legal privilege, it can be credit money.

Hey Professor Murphy!

Two questions.

Q1. What is the difference then between fiat money and a well accepted bank-note of a private bank? Am I correct in understanding that basically there is no difference?

Q2. In this lecture I got a little confused. Subjective theory of value - what exactly does it say - that this is how things SHOULD work or that this is how they REALLY work?

by [Peter Surda](#) - Wednesday, 8 February 2012, 05:34 AM

Fernando,

thank you for your reply.

I have not read the particular article you reference yet, but I read others by Selgin, and I also emailed with him.

I think the definitions that you refer to are accurate. Fiat money is a subset of money (in the narrower sense), and fiduciary media are a subset of money substitutes. For a more "modern" terminology, we can use "derivatives" or "financial instruments" instead of money substitutes.

Appendix B of the book as a diagram which explains it:

http://mises.org/books/Theory_Money_Credit/AppendixB.aspx

The category I propose, "money as service", can be positioned in the into three positions of the diagram, depending on what actually happens. If it is a payment system with a fixed exchange rate, such as Western Union or Paypal, it falls under "money substitutes".

If it is a payment system has a floating exchange rate to monies, it must logically be a third type of "money in the broader sense" alongside money in the narrower sense and money substitutes (since it is not a claim, it can't be a substitute). An example would be hybrid services like Bit-pay. Bit-pay allows a customer to pay with Bitcoins, while the

merchant can choose to receive a fiat currency instead, because Bit-Pay offers to perform a forex exchange on the open market in the background.

A third one, if this "money as service" has a floating exchange rate and becomes widespread and people start accepting it without the forex into fiat, i.e. evolves from a medium of exchange into money, it must logically be classified as a fourth type of "money in the narrower sense" alongside fiat/commodity/credit.

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Re: Questions for the Professor: Week 2

by [Fernando Arteaga](#) - Tuesday, 7 February 2012, 11:20 PM

Peter, I wouldn't take Hoppes assertions too seriously. See this paper by Selgin and White: http://mises.org/journals/rae/pdf/rae9_2_5.pdf

Yet i do thing this would be important for Proffessor Murphy to answer:

What's the difference between fiduciary media and Fiat Money? Or more correctly: What's the relation between fiduciary media and Fiat Money?

Mises does not clearly explains both (at least not in chapter three). And as we see in the Selgin paper, Hoppe still does not understand the difference.

Mises starts chapter three writing about bank notes and token coins (which he actually asserts that, by serving as a solution of the "big problem of small change," functioned as a kind of fiat money) and dismisses them by saying they both are "Money Substitutes" not actual money(On a later chapter he explains that money substitutes could be divided into two groups: Money Certificates as a substitute completely covered by real money; and Fiduciary media, as a substitute not covered (at least not in full) by real money).

The actual definition of Fiat Money by Mises is "money that comprises things with a special legal qualification" (page 74 in the Liberty Fund Edition) or more precisely "money consisting of mere tokens which can neither be employed for any industrial purpose nor convey a claim against anybody" (page 429 of Human Action, Fox & Wilkes edition) . And the definition of Fiduciary Media is "claims of a given sum on demand, which are not covered by a fund of money, and whose legal and technical

characteristics make them suitable for tender and acceptance instead of money in fulfillment of obligations that are in terms of money" (page 311 in the Liberty Fund edition)

by [Peter Surda](#) - Monday, 6 February 2012, 03:12 PM

Dear Professor Murphy,

Q1:

would it be accurate to say that in Chapter IV, Mises argues that an attempt to force people to use a particular new money is not merely a legalistic, but primarily a logistical problem? I find it odd, because various interpreters of Mises that I've read so far appear to claim that he was arguing that government cannot "invent" new money, whereas my impression, as explained above, is that Mises claims that it is possible. I also don't understand why Mises thought that this is an important point. Is it just some academic issue he had with the other authors, akin to the disagreement you have with Graeber?

Q2:

Mises enumerates three types of money: commodity money, fiat money and credit money. I humbly submit that a fourth option is possible: money as a service. For example, the article by by Kuznetsov (Fiat Money as an Administrative Good): <http://mises.org/daily/4262> can be interpreted this way. It would also explain Bitcoin in case it develops into money in the future. I emailed with Prof. Hoppe about this and he said that money as service is absurd because:

Services lack essentially all money properties: divisibility, durability, portability, etc.

What do you think?

Q3 (more to do with last week's lesson, but I only found out too late that I can ask questions through the forum and I had technical issues which made it difficult to ask during the lecture):

In a Mises Daily article The Origin of Money and Its Value, <http://mises.org/daily/1333> , you write:

We can trace the purchasing power of money back through time, until we reach the point at which people first emerged from a state of barter.

Does this mean that the concept of money must arise from barter (which makes sense and corresponds to what you said in the last week's lesson), or that all particular monies must arise from barter? The latter seems dubious. You said yourself in a speech a couple of weeks ago: <http://mises.org/media/6824/How-the-Private-Bankers-Are-Using-the-Financial-Crisis-to-Reshape-World-Government> that:

the way the interventionists have spun this it's just ludicrous right so more than any other currency in the history of civilization, the euro is first of all the fiat currency, it was never linked to anything else.

(emphasis added)

The reason why I'm asking is that when I emailed Prof. Hoppe about Bitcoin, he said first:

I don't see how bitcoin fulfills the conditions for an introduction as money as explained in Mises' regression theorem (a prospective money must have been originally traded as a regular good in barter).

(emphasis added)

Then when I asked him if this means that a good that was invented after the inception of a monetary system can only become money if the economy reverts temporarily to barter, he said no (well, at least I think that's what he meant). Isn't that a contradiction?

Maybe this question is better postponed until we discuss the regression theorem?

When we produce we're demanding money, so a growing economy would naturally require more dollars.

QUESTION: Austrians don't like "positivism" which attempts to derive laws from experience and verify by empirical observation. But at the same time Austrians claim that economics is not a normative science but it is a value-free or "positive" science. So the word "positivism" seems to be both good and bad, how come?

<http://mises.org/resources/6584>

From Danny Sanchez to All Participants(05:57:57 PM)

Slides available here:

https://docs.google.com/open?id=1kumLo8oNCGbZxvOEcK2ntJErCEE_5mHRjGfjfMquS3xLmneWTLsFvQNGTBK

From Danny Sanchez to All Participants(06:18:33 PM)

Menger: "A commodity is more or less saleable according as we are able, with more or less prospect of success, to dispose of it at prices corresponding to the general economic situation, at economic prices."

From Danny Sanchez to All Participants(06:18:49 PM)

"The interval of time, moreover, within which the disposal of a commodity at the economic price may be reckoned on, is of great significance in an inquiry into its degree of saleableness."

From Danny Sanchez to All Participants(06:20:41 PM)

Liquidity is not an either/or thing

Danny Sanchez: Everything has some degree of liquidity

From David Burns to All Participants(06:21:26 PM)

liquidity is not pregnancy... your assets can be a little liquid

From Patrik Korda to All Participants(06:21:44 PM)

I'm thinking cash, gold, short-term bonds, things that are the most liquid

The classic monetary theorists (for example Hicks) tell us that money has no actual definition but only is defined by its functions. The money functions are three: medium of exchange (for mises the primary function), unit of account and store of value (for mises the secondary functions)

From Stuart Knight to All Participants(06:29:10 PM)

portability, durability, divisibility, scarcity.

From Antony Zegers to All Participants(06:29:16 PM)

Limited Supply

From Patrik Korda to All Participants(06:30:16 PM)

I think Mises only accepts the first one in this book: a medium of exchange. The other functions flow from the fact that it is a medium of exchange in the long run

From Danny Sanchez to All Participants(06:30:43 PM)

Mises and Rothbard also said that money is not a rigidly definable praxeological category, although "indirect exchange" is.

From Stuart Knight to All Participants(06:31:52 PM)

you havetoclosethe phone pop up

From Danny Sanchez to All Participants(06:32:22 PM)

In case anybody finds it useful, I wrote my own little study guide to chapter 1 here:
<http://community.mises.org/danielsanchez/study-guides/mises/tmc/chapter-1-the-function-and-origin-of-money/>

From Joe Dambach to All Participants(06:32:40 PM)

i had to accept the integrated voice conference, then muted the microphone.

From Jason Mackenzie to All Participants(06:33:13 PM)

thanks for the study guide Danny!

From Danny Sanchez to All Participants(06:33:43 PM)

you're welcome!

From Peter Parsley to All Participants(06:33:46 PM)

I also wrote study guides to chapters 2 & 3. You can find them here:

<http://community.mises.org/danielsanchez/study-guides/mises/tmc/>

Actually theyre not "aggregations" in chapter 2 of the Theory of Money and Credit Mises actually!

What did Murphy mean by “decision time” on the first slide of Week 2’s lecture?

Choose one answer.

- a. Historically, the US government had to decide whether to link paper dollars to gold.
- b. Would the examples be in terms of fiat money or gold?
- c. Would we go through the book from a modern perspective or from the pre-Bretton Woods perspective?

Question 2 Which of the following is a money-substitute in the United States today?

- a. A \$20 Federal Reserve note.
- b. A US Postal Service money order.
- c. A gold coin.

Question 3 What must be true of a money-substitute?

- a. It entitles the bearer to commodity money.
- b. It must consist in paper form.
- c. It is redeemable on demand.

Question 4 What guides Mises when he chooses his definitions?

- a. The force.
- b. The desire to justify capitalism.
- c. The goals of economic theory in the case of money.

Question 5

Which of the following is a proper use of “cash” as a verb?

Choose one answer.

- a. A US citizen in 1928 could cash Federal Reserve notes for gold.
- b. On the basketball court Mises would often cash from downtown.
- c. For convenience, people often cash in their Federal Reserve notes for checking deposits at banks.

Question 6 For economic theory, a money-substitute must be redeemable

Choose one answer.

- a. in practice.
- b. for most of the time.
- c. by law.

Question 7 In Radford's POW camp, what was actually the money?

- a. Slim Jims.
- b. Tobacco.
- c. Cigarettes.

Question 8 What was Mises' view on fiat money, in this book?

- a. Countries that had used fiat money had always regretted it.
- b. It prevailed in Western nations.
- c. It was theoretically possible but he wasn't sure it had ever existed.

Question 9

What's the difference between credit money and a simple bond?

- a. The bond isn't a medium of exchange.
- b. Credit money is a claim on future money.
- c. A bond is a claim on future money.

Question 10

What did the politicians INTEND to create with bimetallic legislation?

Choose one answer.

- a. A parallel standard.
- b. The hokey pokey.
- c. An alternating standard.