

Notes from Dr. Robert Batemarco's Presentation

Austrian Economics, Business Cycles, and the Theory and Practice of Money – Segment I

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Determining the proper amount of money in an economy is an impossible job. It is a decision best determined by the markets.

“People don't realize that we [Federal Reserve] cannot forecast the future. What we can do is have probabilities of what causes what, but that's as far as we go. And I've had a very successful career as a forecaster, starting in 1948 forward. The number of mistakes I have made are just awesome. There is no number large enough to account for that.” – Alan Greenspan

There is no need for money if you produce everything yourself. Adam and Eve didn't need money in the book of Genesis. Robinson Crusoe didn't need money. So why do we need money? Because producing everything independently is very inefficient. Doing it all yourself is a poverty trap. Barter requires a double coincidence of wants. For instance, you can only trade with those who want what you have to exchange. Why is money such a big deal? Money is a big deal because it reduces the time, opportunity costs, and effort, and costs of trading exchanges.

Over a duration time, through trial and error one good is found to be universally acceptable as medium of change. As a medium of exchange, money does not increase satisfaction the way additional amounts of consumption goods or capital goods do.

A medium of exchange must be durable, divisible, and costly enough to produce and is scarce enough to have a high value. If someone says they don't have enough money, they are really saying they don't have enough goods or services. Money doesn't create goods and services in an of itself. In fact, more money often = more problems.

Money is developed through the market process. No one person, including kings, invented money. Furthermore, more money does not create more goods. Again, there is no correct amount of money. Gold and silver were so suitable as money that they were used for money from antiquity into the middle of the twentieth century. So why don't we use gold and silver today? Doing so would restrict State powers. The State is always hungry for resources. It could not resist the temptation to take control over money. This took centuries to fully come to pass. To do so, the State had to suppress property rights of money holders.

How does the state suppress rights with regards to money? Counterfeiting? In earlier millennium this included coin clipping and debasement of coins. The Roman Denarius was debased from 4.5 grams of silver to less than 0.50 grams as the Roman Empire declined. In today economy it includes bailouts and suspension of payments. Or requiring people to use money they don't want and forbidding them to use money they do want, i.e. virtual currency or cash payments.

Banking has evolved over centuries. The first banks were developed by those who made things like gold jewelry, i.e. the goldsmiths, who had vaults for safe keeping of metals, as they were warehouses for gold. Honorable origins indeed. Banks evolved from storing money to lending the money. By trading their gold certificates, people seldom had to withdraw their gold.

Bankers saw the gold they were storing as sitting there idly. So they brilliantly decided to put it to work by lending it out at interest. They created new certificates which they issued in exchange for IOUs rather than for gold. Gradually the gold on deposit was soon less than the promises to pay gold. This created the possibility of bank runs, or a fractional reserve banking system. Fiat money obtains its origins from the Latin - Let there be....money.

Summary:

Gold and silver became money originally through the market process.

The State(s) systematically reduced money's value by disrupting the market process to benefit itself.

Banks made money more convenient.

Banks also made money subject to losses in purchasing value.