

## COMMENT ON RASHID'S "ROTHBARD ON MONEY: A CRITICAL TEXTUAL EXEGESIS"

ROBERT BATEMARCO

What this paper does effectively, albeit unintentionally, is to show the importance to Austrian monetary theory of the regression theorem developed by Ludwig von Mises in his 1912 *Theory of Money and Credit*. A thorough understanding of this theorem would make clear both why money must develop from a commodity on the free market and why the assertion that money is a commodity does *not* "deny that its demand . . . has been greatly altered once the commodity becomes chosen as money."

The regression theorem was a way to solve the problem of circularity in determining the marginal utility of money. In a money economy, prices contain a time component not present in a barter economy. This means that the money commodity's marginal utility depends on the already existing money prices of tradeable goods. The value of money yesterday was, in turn, influenced by what it was worth the day before. As this sequence continues further into the past, it threatens to turn into an infinite regress, which would tell us nothing about the initial source of money's value or why anyone would ever have accepted it in exchange for real goods in the first place. Mises's ingenious escape from this trap was to recognize that there had to be a day before the commodity in question became money. If money's value on its first day as money is influenced by its value on the previous day, then its initial monetary value had to be based solely on its value as a commodity.<sup>1</sup>

This proves that money arose out of a previously bartered commodity, since a commodity not already accepted in exchange would have no basis to be valued as a medium of exchange (Rothbard 1962, p. 237).

---

ROBERT BATEMARCO is an adjunct professor of economics at Marymount College.

<sup>1</sup>For Mises's original explication of the regression theorem, see Mises (1934, pp. 129–31).

As previous value is but one of the factors which determine the value users currently put on money, there is nothing to prevent other factors from playing a role. Specifically, the knowledge that the commodity is now money, i.e., universally accepted in exchange, can be fully expected to increase its value.

A second area of disagreement Rashid has with Rothbard is over whether it matters what the money supply is. Rothbard used David Hume's example (which assumes an equiproportional overnight increase in everybody's money holdings) to illustrate the impact of a money-supply change. Rashid correctly characterizes this example as inferior to an elucidation of the same point based on process analysis, which additionally demonstrates that *how* we arrive at a particular quantity of money *does* matter. Of course, none of this was news to Rothbard. He fully realized that real-world creation of money occurs, *contra* Hume, by specific people producing new money and spending it on specific goods sold by specific merchants. In using Hume's example, Rothbard knowingly chose a best-case scenario in which the creation of money does neither good nor harm. Rothbard himself labeled that example oversimplified and based on a "magical" situation (1962, p. 671).

Another point regarding Rashid's comments on David Hume is that while Rothbard may have ignored Hume's "two-faced policy regarding inflation," on page 92 of *What Has Government Done to Our Money?*, he has dealt with it elsewhere. Rather than "wondering whether Rothbard was aware how closely Hume adumbrates an attitude later made explicit in Keynes," we can find what he thought by referring to page 427 of his magisterial *Economic Thought Before Adam Smith*. To quote,

For while Hume conceded that it does not matter for production or prosperity what the level of the money supply may be, he *did* lay great importance on *changes* in that supply. Now it is true that changes *do* have important consequences. . . . But the crucial point is that all such changes are disruptive, and distort economic activity and the allocation of resources. But David Hume, on the contrary, in a pre-Keynesian fashion, hailed the allegedly vivifying effects of increases in the quantity of money upon prosperity, and called upon the government to make sure that the supply of money is always at least moderately increasing.

The last major contention of Rashid's paper on which I wish to comment is that money's being a measure and store of value is a corollary of its use as a medium of exchange. Here, I believe Rothbard's point is more definitional than empirical. Being a medium of exchange is money's essence—what makes money money. This means that by definition money's ability to serve as a measure of value and store of value is secondary. Rashid's contention

here—the fact that a commodity is already a store of value is a major factor leading people to select it as money—is valid, but on an empirical rather than definitional level. Thus, Rashid's view here is not inconsistent with Rothbard's view.

Finally, I find it irresistible to answer an easy question posed by Rashid. As to why "the growth of banks, when natural, is good," according to Rothbard if the money supply is immaterial, his answer would be as follows. Natural growth of banks means that they remain either depositories which do not lend out those deposits or intermediaries which do not issue liabilities payable on demand. In either case, they do not create any new money.

When all is said and done, then, there seems to be a lot less disagreement between Rothbard and Rashid than meets the latter's eye. The biggest issue on which there is a gap separating Rashid from Rothbard (and Mises) is in the necessity of money originating from a commodity. Here I believe the regression theorem makes clear why Rothbard is correct and Rashid is incorrect. On other issues, either there is agreement to be found between the two in other works of Rothbard than that "lucid monograph" *What Has Government Done to Our Money?*, or the disagreements come from looking at the issues at different levels, so that differences are not contradictory.

#### REFERENCES

- Mises, Ludwig von. [1912] 1934. *The Theory of Money and Credit*. Indianapolis: Liberty Classics.
- Rothbard, Murray. 1962. *Man, Economy, and State*. Los Angeles: Nash Publishing.
- . 1963. *What Has Government Done to Our Money?* Auburn, Ala.: Ludwig von Mises Institute.
- . 1995. *Economic Thought Before Adam Smith*. Cheltenham, U.K.: Edward Elgar.