

## The Fiat Standard – Lecture 6 (What Is Fiat Good For?) • Study Notes

*Fiat is not without advantages. While it undermines savings and stability, it excels in three areas: **government finance, salability across space, and bank profitability**. These features explain why fiat persists despite its destructive consequences.*

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### 1) Three Claimed Benefits of Fiat

1. **Government Finance**
  2. Allows governments to spend first, then bill the public later via inflation.
  3. Enables wars, welfare states, and expansive bureaucracies.
  4. Discussed in depth in earlier chapters and *The Bitcoin Standard*.
  5. **Salability Across Space**
  6. Fiat vastly outperforms physical monies (like gold) in ease of transfer.
  7. Credit entries can move quickly, cheaply, and globally—without moving metal.
  8. **Bank Profitability**
  9. Fiat is optimized to make banks profitable via **fractional reserve banking**.
  10. With central bank backstops, banks can expand credit risk-free.
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### 2) Salability: A Core Concept

- **Definition (Carl Menger):** Money = the most *saleable* good.
- **Salability** = ability to sell at minimal loss (narrow bid–ask spread).
- Determined by **liquidity** and **market depth**.

## Dimensions of Salability

1. **Across Time**
  2. Hardest money (highest stock-to-flow ratio) best holds value.
  3. Gold excelled historically; Bitcoin surpasses all.
  4. **Across Scales**
  5. Ease of divisibility and re-aggregation.
  6. Gold struggled at small scales; silver played a role until banks/notes solved divisibility.
  7. **Across Space**
  8. Cost and speed of transport.
  9. Physical goods (gold, silver, cattle) are heavy, costly, and risky to move.
  10. Fiat = pure information (ledger entries), far cheaper to move globally.
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### 3) Gold vs. Fiat in Spatial Salability

- **Gold:**
- Example: moving a 12.5kg bar (~\$700k) across the Atlantic.
  - 1919:  $\approx 0.2\%$  of value, plus risk of shipwreck salvage ( $\sim 3\%$ ).
  - Early 2000s:  $\approx 0.05\text{--}0.1\%$ , but  $\sim 4$  years to repatriate Germany's gold from the US.
  - Today:  $\approx 0.5\%$  of value per trip, 2–3 days transit.
- A bar could “pay for itself” after  $\sim 200$  round trips just in transport costs.
- **Fiat:**
- Wire transfer: \$10–50, arrives in 2–5 days.
- Credit card: 1–3% fee, instant authorization (but not final settlement).
- Final settlement still slow (weeks/months via central bank rails).
- Nonetheless, far cheaper and more convenient than moving physical gold.

**Conclusion:** Gold's poor spatial salability gave banks/central banks monopoly control over payment rails, paving the way for fiat.

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## 4) The Faustian Bargain

- To transact globally with speed, society accepted **credit-based rails**.
  - Result: gave up secure savings in gold for convenient payments in fiat.
  - Banks became gatekeepers; governments inevitably captured the rails.
  - Fiat's persistence reflects this tradeoff: efficiency in space, collapse in time.
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## 5) Bank Profitability Under Fiat

- **Fractional reserve banking** thrives because central banks remove failure discipline.
- Gold standard limited leverage through bank runs; insolvency = liquidation.
- Fiat standard: insolvency  $\neq$  death—just bailout and expansion.

### Key Turning Points

- **1913:** Federal Reserve created  $\rightarrow$  formalized lender of last resort.
- **1930s:** FDIC + separation of retail/investment banking.
- **1980s (Greenspan era):**
- “Too big to fail” doctrine.
- Greenspan put = guaranteed rescues via interest rate cuts.
- Glass-Steagall repeal blurred retail/investment distinction.

### Modern Reality

- Most fiat creation today = **shadow banking system** (investment banks, hedge funds, repo markets).
  - Little regulation, no formal backstop—but practically guaranteed bailouts.
  - Banking profits from credit expansion *and* money creation.
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## 6) Fractional Reserve Banking: The Illusion

- Keynesian view: FRB necessary for growth.
  - Austrian view: false—credit doesn't create capital, it reallocates it.
  - Analogy: issuing more tickets does not increase stadium seating.
  - Expansion only redistributes wealth, usually to the first receivers (Cantillon effect).
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## 7) Core Takeaways

- **Fiat succeeds at three things:**
  - Funding governments.
  - Moving value cheaply across space.
  - Making banking highly profitable.
  - These advantages explain fiat's resilience, but also its parasitic nature:
  - Governments parasitize citizens.
  - Banks parasitize depositors.
  - Savers are systematically destroyed.
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## 8) Study Prompts

1. Define **salability** and explain why it is central to money's function.
  2. Compare gold vs. fiat in **spatial salability**—why did fiat win?
  3. How does fiat subsidize banks while eliminating the discipline of insolvency?
  4. Why does “too big to fail” create moral hazard?
  5. Why is credit expansion not equivalent to capital formation?
  6. What is the **Faustian bargain** society accepted in trading gold's security for fiat's speed?
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## 9) Quotable Ideas

*“The inadequacy of gold’s salability across space is what required trust in banks and central banks.”*

*“Fiat’s killer application is not stability or savings—it is moving credit cheaply across space.”*

*“The Fed was not the cure to the disease of insolvent banks. Insolvency was the cure. The Fed was the antidote to the cure.”*

***“Fractional reserve banking does not increase capital any more than printing stadium tickets increases seats.”***