



Toward a General Theory of Credit and Money

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“Practically and analytically, a credit theory of money is possibly preferable to a monetary theory of credit.”

Joseph A. Schumpeter

“Whether power to command the industry of others be not real wealth? And whether money be not in truth Tickets or Tokens, for recording and conveying such power? And whether it be of consequence what material the tokens are made of? ... Whether all circulation be not alike circulation of credit, whatsoever medium—metal or paper—is employed: and whether gold be any more than credit for so much power?”

Bishop Berkeley. *Querists*

Abstract. Money is not a thing but a species of credit, and hence a social relation involving rights and obligations. It emerged as the most abstract species in the course of the general process of evolution of credit. Formulation of a theory of credit is, therefore, logically prior to any theory of money. A framework proposed along this line by Macleod, during the second half of the 19th century, has been neglected until now. Combined with Walras’s *numeraire* and *etalon* concepts, this approach provides the foundation for a General Theory of Credit and Money, presented in this paper.

JEL classification: E5, E4, E0.

Introduction

Information Technology and deregulation are changing the meaning of the terms “bank”, “banking” and “money”. As money is increasingly recorded and transmitted in the form of digitally coded information, one is led to believe that perhaps money is not, and has never been a thing at all, as suggested by the medium-of-exchange concept. Rather it is a certain type of social relation about which the relevant information may be recorded and transmitted by a variety of means. This line of thought leads to a fresh investigation into the nature and origin of money.

Section 1 surveys some current developments in the payment system and shows that money and monetary policy are undergoing significant changes, which cannot be understood by means of the traditional concept of money. In Section 2 a distinction is drawn between “money” and “monetary instrument”, a concept that is treated more fully in Sections 10, 11 and 12. Section 3 argues that, coupled with certain questions arising from the dominance of Information Technology within the payment system, the said distinction is sufficiently fundamental to establish the grounds for the formulation of a new theory of money. Section 4 notes that money has a dual character in that it appears as one thing

from the perspective of an individual and another from that of the society. Section 5 observes that the contemporary concepts of money are confined within a paradigm that took shape during a period when metallic money dominated the payment system. It is suggested that the hegemony of this paradigm in economics has acted as the principal factor in preventing progress toward understanding the nature of money. Section 6 shows that although Walras provided a logical proof of the theoretical primacy of *etalon* over the medium-of-exchange function, and although he identified one of the two necessary components of any possible payment system, he did not succeed in breaking loose from the metallic paradigm. Consequently, he failed to draw the inferences that would have led him to the formulation of a General Theory of Credit and Money. In Section 7 it is shown that Wicksell's failure in this regard was also due to his metallic preconceptions. An initial view of the relation between money and credit is introduced in Section 8. This is followed, in Section 9, by the observation that it was not *indirect market exchange*, but rather credit and *indirect valuation*, that served as the basis of development of a unit of account, and that the latter *developed several millennia before the emergence of any media of exchange*. Section 10 shows that unit of account is prior to medium of exchange not only in history but also in logic. In Section 11 it is noted that, whenever and wherever a physical object has served as a medium of exchange, its sole function has been that of an instrument for recording and conveying information about credit relations within the community. But such function could have been, and indeed at times has been, carried out by arrangements which made no use of any physical objects at all. Thus, contrary to Menger's view, *a medium of exchange is a historical, not a logical category*. Section 12 shows that, from the dawn of history to the present, money has never been anything more or less than a person's outstanding rights against the expected stream of assets, goods and services supplied within the economy. Monetary instruments are devices that record and convey information about monetary rights. Section 13 provides a brief account of Macleod's credit view of money and Section 14 shows that this view provides a framework for unification of the theories of utility and money. Section 15 proposes two definitions of money, one from the perspective of an individual, and another from that of the payment system as a whole, showing that the two are subsumable under the notion of unconditionally transferable credit. The result of this analysis is presented as a unified theory of money. Section 16 shows that any payment system has only two essential components, namely, *etalon*, formulated by Walras, and the credit concept, formulated by Macleod. Section 17 notes that, because of hitherto improper concepts of money, property rights in money have not been well understood and are still wanting effective definition within the existing legal frameworks. This is one reason why the credit-forging activities of the state and banks have gone on so freely, in spite of their colossal external costs. In Section 18 the concept of monetary externality is defined and a particular taxonomy of its principal distinct parts is provided.

1. Money and Information Technology

In a few years nearly all banks will be offering direct banking, defined as all the various ways in which a bank customer can be served without the involvement of a person at a