

Lesson 07:
Indirect
Exchange
and the
Appearance
of Money

Author: Robert Murphy

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1. Lesson 07: Indirect Exchange and the Appearance of Money

4. Chapter: Lesson 07: Indirect Exchange and the Appearance of Money

1. Lesson 07: Indirect Exchange and the Appearance of Money Questions

4.1.1. What's the difference between direct and indirect exchange?

Author: Robert Murphy

What's the difference between direct and indirect exchange?

- In direct exchange, both parties plan on using (either for consumption or production) the item they obtain through the trade. In indirect exchange, at least one of the parties plans on trading away the item obtained through the trade.

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4.1.2. Why would specialization be impractical in a world limited to direc...

Author: Robert Murphy

Why would specialization be impractical in a world limited to direct exchange?

- A world limited to direct exchange would require a "double coincidence of wants" before a trade could occur. It would be impractical for someone to specialize in the production of services or goods that were of high value but rarely needed, such as (say) a heart surgeon or an orthodontist. In order to obtain enough food, clothing, and other goods for a comfortable living, the orthodontist would need to find—every week!— someone with meat, bread, etc., who needed work done on his braces, etc. In such a world, people would have to always be ready to fall back on their own production for necessities, and couldn't spend time becoming a true expert in a specialty. Note also that the orthodontist wouldn't be able to accept, say, 100 chickens from a farmer in exchange for a lot of dental work, because if the orthodontist then used some of the chickens to obtain other items, it would no longer be direct exchange.

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4.1.3. How does indirect exchange facilitate the strategy of "one step bac...

Author: Robert Murphy

How does indirect exchange facilitate the strategy of "one step back, two steps forward"?

- With the possibility of indirect exchange, an individual can "sell" her wares and receive something she doesn't directly desire, and in this sense has taken a step back in the goals she can satisfy with her possessions. But if she can then trade away the medium of exchange to obtain something she likes even better than the original possession, she has taken two steps forward.

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4.1.4. What are the disadvantages of indirect exchange without money?

Author: Robert Murphy

What are the disadvantages of indirect exchange without money?

- Without money, various goods all trade against each other directly. This makes it very difficult for someone to determine the "best deal" when he wants to unload a particular good and buy something else. He can quickly spot one way of doing so, but it's a very complicated problem to figure out if there is a more lucrative way. (One of the Suggested Activities elaborates on this idea.)

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4.1.5. Describe a society in which the people practice indirect exchange, ...

Author: Robert Murphy

Describe a society in which the people practice indirect exchange, but have not yet developed money.

- If there is indirect exchange, it means that at least some people in the society accept goods that they don't directly want (for production or consumption). So there are media of exchange. However, if money has not yet developed, it means that there is no one medium of exchange that everyone is willing to accept. In other words, some members of the community accept Medium of Exchange #1, while some others accept Medium of Exchange #2, and so forth. In a monetary economy, (virtually) everyone accepts the same medium of exchange.

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4.1.6. Explain the advantages and limitations of direct exchange.

Author: Robert Murphy

Explain the advantages and limitations of direct exchange.

- The advantage of direct exchange is that it allows people to make mutually beneficial trades, so that each person winds up better off. The limitation is that a person looking to make a trade needs to find someone else who desires what the first person is offering, and who also has what the first person wants. This requirement prevents many beneficial trades that involve more than two people.

Sample Partial Credit Answer

The problem with direct exchange is that a dentist who is hungry has to find a farmer who has a toothache.

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4.1.7. Explain how a community could use indirect exchange but not have money.

Author: Robert Murphy

Explain how a community could use indirect exchange but not have money.

- So long as some people in the community accept items in trade that they intend to trade away in the future, then the community uses indirect exchange. However, if it so happens that no single commodity is accepted as a medium of exchange by everybody in the community, then there wouldn't be a money. In other words, even though lots of people might accept objects intending to trade them away again, the people use different objects in this way.

Sample Partial Credit Answer

When someone visits another country, his money isn't accepted and he doesn't think what they use is "money" either. But the people in that country aren't using barter.

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4.1.8. Explain what economist Friedrich Hayek meant when he used the term ...

Author: Robert Murphy

Explain what economist Friedrich Hayek meant when he used the term "spontaneous order" in reference to the origin of money.

- Hayek meant that nobody planned the creation of money; it just happened naturally as the outgrowth of individuals trying to better themselves. Even so, money is a very useful institution that allows modern economies to work.

Sample Partial Credit Answer

Hayek meant that nobody invented money

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