

Fiat currency

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Of the latest batch of new glossary items I have posted about this morning the most important for many readers of the blog may be the one on fiat currency. For that reason I share it here because this is an issue which many people do not understand until it is explained to them:

[Fiat money](#) is the currency of a country that is declared to be the legal tender of that [jurisdiction](#) by its government.

A [fiat currency](#) has status as legal tender as a result of legal declaration, and nothing else. It is not backed by any physical commodity or [asset](#), such as gold or silver.

The value of the currency is instead determined nationally by the ability of the country that declares it to be legal tender to impose taxes on its population and to then collect them.

Internationally, the value of a fiat currency is determined by the relative trading strength of the country that issues it, and its perceived political stability, although short-term variations in the value of a currency might arise for speculative reasons.

Since the United States abandoned the gold standard in 1971, almost all the world's currencies are fiat currencies.

Since a fiat currency can ultimately only be created by a government it is government expenditure funded by the government of a jurisdiction borrowing from its [central bank](#) that gives rise to the creation of all fiat currency.

Taxation exists to withdraw the fiat currency that a government has put into circulation through its expenditure from circulation to the extent that is considered necessary to control the risk of [inflation](#) arising (see [reasons to tax](#)).

In a fiat currency system, government expenditure, the scale of a government deficit, taxation, and the control of inflation (see separate entries) are as a consequence all intimately related issues. This makes the artificial disaggregation of macroeconomic policy into fiscal policy and monetary policy deeply harmful to the overall control of the economy of a jurisdiction by its government.

A proper understanding of [fiat money](#) also puts it at the heart of macroeconomics, when at present it is treated as peripheral to that subject by neoclassical economics, or is even ignored by it.