

A Reply to Fred Foldvary and Austrian Monetary Theory

by Stephen Zarlenga

Prof. Fred Foldvary has taken issue with some of my conclusions in the study, "Henry George's Concept of Money" (see GJ #96 — L.D.) Several of Prof. Foldvary's objections originate in his belief in Carl Menger's theory of the origin of money. Menger's origin theory is at the base of Austrian monetary ideas, in which the misplacement of trust in the omniscience and omnipotence of the "invisible hand" lends an element of hubris, where it is considered unnecessary to actually check and measure results. Foldvary asserts, following Menger, that money evolved in a spontaneous market process rather than being commanded by governmental law. In 1994, I issued a paper challenging Menger's theory. Menger uses four historically based arguments to support his idea that money began without institutional sponsorship. I noted that three of those arguments — commentaries from Aristotle, Plato and Julius Paulus — actually all supported an institutional or legal origin of money! Menger's fourth argument is a demand for historical proof for opposing views. Menger, however, cites no no places or times germane to the argument. I challenged his method — an attempt to divine an historical event only from deductive logic. I also challenged his logic and facts.

Henry George characterized Menger's origin theory as ridiculous:

Though this explanation of the difficulties attending barter has been paraphrased by writer after writer since Adam Smith, it is an exaggeration so gross as to be ridiculous. The butcher with meat that he wanted to dispose of would not have refused the exchange offered by the brewer and baker because he himself was already provided with all the bread and beer that he had immediate occasion for. He would say, "I will give you the meat you want on your promise to give me the equivalent in bread and beer when I call for them." (SPE, 508)

The willingness of Georgists to take up the questions of monetary reform is a highly welcome development. If the American Monetary Institute has been at all instrumental in this, then it's an encouraging sign that we are fulfilling our mission. But credit must also go to Robert de Fremery (1916-2000), a long-term monetary reformer and Georgist. It is important that de Fremery's efforts be recognized and appreciated, though even Bob was not aware of how advanced George's monetary views were, and how closely they conformed to his own monetary conclusions that issuing money must be a function of government. — S. Z.

Confusion Between Money and Wealth

At first, Foldvary appears to agree that it is a mistake to confuse money with wealth. But he then clouds the question when he writes, “the use of commodities for money does not confuse money with wealth”. In fact it does — unless the commodity item is being used entirely as a symbol — because tangible commodities *are* wealth. Eleven lines later he confirms this confusion: “Commodity money works best when it is both useful as real wealth and can be carried around as currency”.

George understood that wealth is tangible and he repeatedly identified the abstract nature of money: “It is important that this purely representative character of money should be thoroughly understood and constantly kept in mind, for from the confusion resulting from the confounding of money with wealth have flown the largest and most pernicious results.” (SPE, 493-4)

George cited Archbishop Whately on the harmful effects of this peculiar confusion: “It has for centuries done more and perhaps for centuries to come will do more, to retard the improvement of Europe than all other causes put together.” (SPE, 141) George also noted that “These are not the effects of the confusion of a term. The confusion of the term is one of the effects of the influence upon thought of the same special interest.” (SPE, 141, 142). Nevertheless, even among Georgists this error continues to be made, by those who think that money has to be “backed” by something more than the reasonably applied fiat of a functioning state.

Why is it so harmful? Because it has fostered the misdefinition of money, and it is through such misdefinition that the private interests George refers to (essentially the banking plutocracy), have been able to take over a society’s money system and thereby dominate the society, deforming humanity in the process. If money is clearly identified as an abstract social power embodied in law, it becomes much easier to understand that this institution belongs in the hands of government, just as the law courts do.

The Attack on Government

An aspect of the Austrian and other economic schools, however, is their drumbeat against government. Foldvary warns against public control of the monetary system by saying: “governments have created such common evils as genocide, wars, environmental destruction and labor prison camps.” But such anthropomorphizing of government misses the key point. History shows conclusively that government issued money systems in this country have a far better record than privately controlled money systems.

For example, the public colonial currencies were issued in an orderly way, never exceeding the amounts authorized by their legislatures. They

helped build infrastructure, making the colonies livable. The Continental Currency (\$200 million authorized, \$200 million issued) gave us our nation. The Greenbacks (\$450 million authorized, \$450 million issued) preserved the Union. All US-issued currencies compare very favorably to private bank-issued notes, the notes of the 1st and 2nd Banks of the US, and the Federal Reserve System. The Austrians complain about the Continental Currency losing its value, without realizing that it was the Brits who counterfeited untold billions of them, as they did the French *Assignats*. The German hyperinflation was done under a privately owned and controlled *Reichsbank*! I go into considerable detail on these historical examples in *The Lost Science of Money*, because it is important to stamp out the “big lie” created by propaganda against government. It is crucial to check history — even though economics has, by and large, moved away from the historical record into rarefied mathematics, in a futile attempt to emulate the physical sciences.

Free Banking Misinterpretation

Foldvary’s many statements praising free banking sound like he is reciting history, but they are entirely theoretical, and ignore the bad results already observed from such systems in America. Henry George:

The evils entailed by wildcat banking in the United States are too well remembered to need reference. The loss and inconvenience, the swindling and corruption that flowed from the assumption by each State of the Union of the power to license banks of issue ended with the war, and no-one would now go back to them. (SP, 178-9)

The record clearly condemns the private issuance of money. What to do? Blame it on the government! Foldvary asserts that this corruption and swindling were caused by government intervention into banking. The states forced these banks to accept state bonds. The states did force them to hold state bonds as part of the new “free banking” legislation, but Foldvary misses the beneficial effect of these laws. The assets of the state banks had consisted largely of the generally worthless promissory notes of their owners. So whatever else went on, the new state laws requiring government bonds as reserves substituted a superior asset to that which the banks had been using before.

Fred Foldvary cites no examples of where “free banking” worked better than government control, or even where a reduction of government control improved banking results. What the facts show is that as government control increased after 1836, banking results improved substantially. Because the new laws were labeled “free banking” laws, the period after 1836 has been generally misidentified as a free banking period, although its better results were much more likely due to greater government regulation of banks*.

Is the Federal Reserve Governmental?

Foldvary denies that the Federal Reserve system is a private banking system, calling it “governmental” from the beginning. If so, there shouldn’t be much concern if it gets nationalized, the way the bank of England finally was in 1946. That private central bank also masqueraded as a government entity. For example, Adam Smith said it functioned like a great engine of State. The Federal Reserve System is not a part of our government, but it has a special privileged relationship to government. Its notes, unlike yours or mine, have been made legal tender for all debts, public and private.

According to Foldvary, “the interest [the Fed] gets on its holdings of US bonds is transferred to the Treasury”. Actually, the Fed retains 10% of the interest. But more important, most of the money creation in the system is done by the member banks, and they don’t turn over that seignorage to the Treasury. Also, the Fed has never been independently audited. That could never be, if it were really part of government. In fact the Fed is operating with many of the advantages of governmental power, such as the privilege to create money, but without the responsibilities that would be expected from a governmental body. It’s an ideal situation for a banking plutocracy, and it has worked really well for them.

What is much more important than the interest, though, is the power involved in deciding what gets funded in our society and what does not. Bankers would gladly pay for that privilege. The power to create money belongs only in the hands of government, acting on behalf of the entire society, not the narrow interests of particular segments.

Fred Foldvary urges us to follow George’s advice and think for ourselves. That isn’t lost on Georgists; indeed, it’s a big reason why they are drawn to these ideas in the first place. But thought has to be based on reality, not on flights of theoretical fantasy. George’s method was to insist that theory stand the test of facts. That’s why his views, including his monetary views, are still relevant to us. Was George the final word on money? I’m happy to report that there has been progress since, in the areas of monetary history, theory and reform; particularly in formalizing an accurate concept of money. However, even though it was not the primary focus of his life’s work, George had more than enough of the picture to understand exactly what kind of money system was required by justice: he favored government issued greenbacks, and so do I. **GJ**

**see Richard Salsman’s Breaking the Banks characterizing the free banking period as from 1838 to 1862 (p.89-111). See Peter G. King, On the Economics of Private Money; Journal of Monetary Economics 12, 1983, p.127-158. — S. Z.*

For full references, see the bibliography in The Lost Science of Money. — L. D.