

An Answer To Stephen Zarlenga

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Stephen Zarlenga wrote a paper (1994) titled *A Refutation of Menger's Theory of the "Origin of Money."* Like my *Critique of Austrian Economics* (2004), it includes an appendix in which he re-prints the insulting and unsubstantiated referee comments that Judith Thommesen wrote, as well as his own unsuccessful efforts to get his paper assigned to a real economist. Clearly, I am not the first person to encounter the Dragon Lady, though I am one up on Zarlenga: The Mises Institute did not (as far as I know) report him to the police as a terrorist.

Since the Austrians are afraid to respond to Zarlenga's paper, I will do it for them. In the section titled "The Circularity of Menger's Reasoning," Zarlenga writes:

So liquidity is caused by liquidity. I stress that I'm not referring to the increased liquidity which a money commodity would exhibit by virtue of its becoming money. We are considering its liquidity before it would have become money. Thus to really explain a commodity's liquidity, [Menger] would have to explain why supply, demand, and markets develop for a commodity. If you use only liquidity to explain them, you are in a circle. We know why markets developed for cattle or wheat. But has Menger really explained why markets would have developed for "These little discs... which in themselves seem to serve no useful purpose (1984, p. 6)" except if they were already money (1994, p. 8)?

In my book (1999) I use the term "commodity money," not "gold." I did not want to mention any empirical facts because my work is purely theoretical. I specifically did not want to mention gold because, while I am not an historian, I did grow up on a ranch and I was always uncomfortable with the image of cattlemen attaching so much value to jewelry that they would make the material it was made of into their medium of exchange. Too girlie! Cows are money and a calf from the next roundup is the obvious monetary unit. It continues to be so today: Modern ranchers make purchases on credit by pledging a calf to be delivered the following fall. We know that gold *coins* have value but, except for teenage girls and dentists, nobody sees use-value in the material the coins are made of.

Let us consider the case of the dentist. If he pulls a rancher's tooth and demands a calf in payment, what is he to do with it? Keeping a cow in town would ruin him with feed costs while any rancher can keep the animal in his herd at no cost. Thus, it makes sense for the rancher to pay the dentist with a claim on a cow from his herd, similar to the warehouse receipts that goldsmiths are known to have issued millennia later. The goldsmith's receipts were made of paper but, since the origin of money predates Gutenberg's invention, receipts for cows would have to be stamped into a coin. Gold is the best choice for technical reasons, though other metals were sometimes used.

Small ranchers would have neither the means to mint coins nor the trust of the community to accept them, so they would have to sell some of their cattle to a large rancher in exchange for coins to be used in case of emergencies, like toothaches. Zarlenga asks (p. 1), "Does [money] obtain its value from the material from which it is made, or from its acceptability in exchanges due to the sponsorship or even legal requirements of the government?" He clearly intends to prove that gold coins were never issued by merchants but only by governments. I agree. Wealth is power and the largest rancher in the community *is* the government. Or the government is the largest rancher, whichever way you want to look at it. In our example, the dentist did not issue the coin, the local cattle baron did.

The most difficult part of ranching is the cattle drive and one can only imagine what it was like before the invention of railroads. If the Mexicans of a hundred years ago had had to drive their cattle, not just to the railhead in Phoenix, but all the way to Chicago, Chicago would have been a much smaller city. The limiting factor on the size of cities was not how well organized the city government was, but how well organized the ranchers were. Besides picking up the trash, there is not much to running a city, but driving cattle hundreds of miles takes real organizational skills.

Zarlenga writes (p. 4), "That such censorship [of the Greeks by the Romans] occurred in the monetary area appears likely. For example, in the Athenian Constitution coming down to us, we can find out how the garbage was collected, but we will search in vain to learn how Athens [*sic*] state coinage system was run." Actually, I suspect that our copy of the Athenian Constitution is intact. The reason that we know so much about how they collected garbage is because that was the city government's only real job.

They did not mint coins. Historians have focused on these glorified ragpickers in the city while overlooking the more interesting economic activity of minting coins that was being conducted by cattlemen in the countryside.

Corporations did not exist back then but, if all the ranchers in a community sell their cattle to one man in exchange for gold coins and agree to help him drive the herd to town, chasing strays regardless of their brand, and then settle with him after all losses have been accounted for, they have almost formed a corporation. After he trades the cattle for wheat and oil and other bulk items, he distributes it to his men by selling it to them for the coins he purchased their cattle with. But his men all have shopping lists of their own, so it is natural that the retailers in town would accept the coins of the cattle baron. They know that there will always be an inter-town demand for them because the cattlemen come to town every fall and any townsman who anticipates needing a cow to butcher before winter must, in the meantime, obtain one of the coins in trade.

Casinos in Las Vegas will accept their competitor's chips (actually called "checks," but I will say "chips" to avoid confusing them with demand deposits at banks) even though they are under no obligation to do so, and it is technically illegal under Federal law. Similarly, the several cattle barons who drove their cattle to the same city would come to accept each other's coins, provided that they were all the same weight, about 130 grains as recorded by Zarlenga. A cattleman would not want to lose a sale just because a customer had someone else's coin. The cattleman could redeem it later through the clearing house at the local saloon where the cattlemen gathered. There it is easy to locate the issuer and trade coins straight across, with the balance to be delivered in cattle the next morning at the feedlot.

So it was that 130-grain gold coins gradually came to be thought of as money, regardless of whose mark was on them, and by people who had no immediate need for a cow. This result requires only that the clearing house functioned smoothly in the sense that anyone who did not have enough cattle to meet his obligations was no longer allowed to issue coins. And, not to put too fine a point on it, by "no longer allowed to issue coins," I mean they were executed. Participation at the clearing house was not considered optional. Merchants did not have the capability or the authority to execute a cattle baron, but his peers did. They were competitors, after all, not friends.

They all sold their cattle to the same townsfolk and, where their territories overlapped, their men were actively, if surreptitiously, engaged in rustling each other's cattle.¹

Thus, I will concede Zarlenga's point that only governments and not merchants issued coins, but I would undercut his argument by observing that the cattlemen of antiquity did not divide their world into private-sector entities such as corporations and public-sector entities such as governments. Without firearms it would have taken, literally, an army to protect a cattle drive from thieves. Historians are unanimous in considering the presence of troops to be evidence of a government, so it is not surprising that Zarlenga claims that it was governments and not merchants who issued coins. But I would argue that what historians call a government was more like what we would call a corporation, but one with a military wing.

Also contrary to Zarlenga's thesis, that coinage requires the stamp of approval from a legitimate government, observe that the chips issued by Las Vegas casinos function as money, yet nobody mistakes a casino for a government. Casinos have no authority beyond their property line and the legitimate government, the Feds, strictly prohibit accepting casino chips in trade. Yet people do so all the time. When I worked in Las Vegas (not at a casino), I was sometimes paid in chips. Small businesses, but not the national chain stores, would accept chips for groceries and such. If it were not for the Federal law, it is easy to see how private coinage could come about.

The government discourages people from accepting casino chips in trade by making it illegal but, simultaneously, they encourage such trade by insisting that gamblers must pay taxes on their winnings but cannot declare their losses as a business expense. Thus, when a gambler wins big, rather than be confronted with a W-2 form at the cashier's cage, he simply walks the chips out the front door and then foists them on everybody to whom he owes money. People do not have to fill out W-2 forms if they redeem only small quantities of chips so, once his bucket of chips has filtered through the local economy, they will eventually all be trundled back to the cashier's cage. How long they remain in circulation is anybody's guess, but I doubt it is

¹ Did you hear the one about the cattleman who was invited to dinner by his nearest neighbor and, in conversation, bragged that he had never eaten his own beef? His host replied, dryly, "You have now."

long enough to inspire a casino to keep less cash on hand than they have outstanding chips.

Anarchists should not take this example to imply that a private entity such as a casino is more “sound” than the federal government. People look for an alternative to dollars because they fear the IRS, not because they distrust the Federal Reserve. Las Vegas locals have little in common with anarchists hunkered down in northern Idaho waiting for the dollar to collapse. Nevertheless, motivation aside, the fact that casino chips are readily accepted in Las Vegas belies Zarlenga’s contention (p. 13) of “an institutional origin of money rather than a market origin.”

Zarlenga (p. 13) writes that “One of the main points... is that early gold coinage was designed to represent the ox/cow commodity money unit, already recognized in most advanced societies.” Apparently the government, in their wisdom, simply recognized that gold would work better than cows and decreed that, henceforth, 130 grains of gold would be the equal of one cow. Zarlenga concludes (p. 15), “This has deeply negative implications for the Austrian School, for the Libertarians, and for the free bankers, which they would be well advised to investigate now.” As a libertarian and a free-banking theorist who has just conceded most of the cow-token argument to Zarlenga, it would seem that I am in big trouble. But why? What do events that took place thousands of years ago have to do with anything today?

The only really crucial point, both for Axiomatic and Austrian Economics, is whether or not Zarlenga has successfully attacked Mises’ regression theorem. He has not. Mises traces the value of gold back to when it only had use-value and not yet any exchange-value. But being minted into coins to represent cows is a use just as much as being made into necklaces is a use.

All that Zarlenga has really done is push the origin of money back through another stage. We already know from Mises (1971, pp. 368-373) how the English were caught unawares in 1844 when they passed Peel’s Bank Act, which limited the issue of banknotes but not of checking account balances. Before that we know that the warehouse receipts issued by goldsmiths gradually began to circulate so freely that the issuer lost his fear of having them all redeemed and was able to print receipts for more gold than he had in his vault. Until recently, that was the end of the story.

Now, thanks to Zarlenga, we can add another chapter to the history of money. Before paper receipts for gold coins were issued, the gold coins were themselves receipts for cows and, like banknotes and then checking accounts, it is probably true that more coins were issued than there were actual cows in the herd. The coins were, to use Mises' term, fiduciary media. But that really is the end of the story because the cows were not tokens for anything, they were just cows. They were valued because they were good to eat. Cattle have liquidity, as Menger used the term, because their good eatin' is universally acknowledged and, hence, they are universally accepted in exchange.

So, three cheers for Zarlenga. He added another chapter to the history of money. But the scary talk about "deeply negative implications for the free bankers" and how "this paper most likely deals a death blow to the core thesis of the Austrian School" was uncalled for. As long as Mises' regression theorem remains intact, the theory behind free banking is safe. If Zarlenga wants to deal the Austrians any death blows, he needs to attack Mises, not Menger.

In Zarlenga's response to Thommesen's referee comments, he addresses her accusation that he is ignorant of Mises' regression theorem by asking, "Is Commentator saying that Menger's 'origin' can't stand on its own merit and must be propped up by von Mises?" Clearly, the fact that Thommesen declined to present any historical data to contradict Zarlenga means that she *is* saying that Menger's *Origin of Money* cannot stand on its own merit. If Zarlenga had concluded his paper by saying, "Menger was a poor historian," then neither I nor the Austrians could complain. But if he is going to talk about "deeply negative implications for the free bankers" and "a death blow to the core thesis of the Austrian School," then Thommesen is right: He needs to critique Mises, who never claimed to be an historian but only to have correctly deduced *a priori* theories. Free banking theorists are not historians and their core thesis is Mises' regression theorem, not events of millennia past. One does not criticize a chiropractor because he is unable to explain how *homo erectus* came to stand upright.

All Zarlenga has really done is to dig up Menger's last publication before he retired and call it the "core thesis" of the school he founded, while ignoring his major work (1981), published 21 years earlier when he was still a young

man. In Hayek's exhaustive biography of Menger's career (Menger, 1981, pp. 11-36), the only mention of the *Origin of Money* is in a footnote:

With the publications in the year 1892 [Footnote: In addition to those already mentioned there appeared in the same year a French article, 'La Monnaie Mesure de la Valeur,' in the *Revue d'Economie Politique* (vol. vi) and an English article, 'On the Origin of Money,' in the *Economic Journal* (vol. ii).] the list of Menger's major works which appeared during his lifetime comes to an abrupt end (1981, p. 31).

Calling the *Origin of Money* the core thesis of the Austrian School is like writing a biography of Mike Tyson and then devoting the entire book to overanalyzing the ear-biting incident without ever mentioning any of the man's pre-prison bouts. Zarlenga's lack of historical context is made clear when he lists his source (p. 18) as "C.M.R.E. monograph #40, 1984, translator not noted." Any university library would have the *Economic Journal* back to 1892 and, if Zarlenga had looked it up, he would have known that Menger's paper was translated by Caroline Foley. I cite original sources in my critique of Mises (2004) and discuss only Mises' major works (1966, 1971), while graciously overlooking the low-quality papers he wrote after becoming a bitter old man in New York, where Rothbard met him.

If anything, Zarlenga should see himself as extending Mises' theory, not refuting it. Cattle barons holding a clearing house for gold coins in a saloon is, theoretically, no different than bankers holding a clearing house for currencies in London, as Mises would describe occurring thousands of years later. And, just as Mises would observe, it was at these clearing houses that the dishonest banker (cattle baron) who had issued more checking account balances (coins) than he had gold (cows) to cover would be found out. If the penalties had been as high in 1844 as they were in antiquity (they executed anyone who could not meet his obligations), the problems that befell the English after their ill-conceived Peel's Act would have been averted.

I explain in my book (1999, p. 188), though in more abstract language, that the reason that the townsfolk can accept a cattleman's coins is because the cattlemen themselves accept each other's coins *only until the next clearing house meeting*. Cattlemen have private armies and, if a townsman is refused redemption, he has no recourse except to spread the word that he caught that man out. But that is sufficient because the cattleman who is caught short cannot survive the next clearing house meeting. His peers have private

armies too. This is a point that has mystified many. They see coins of various marks accepted freely in town and they do not realize that they are accepted freely *in town* only because they are *not* accepted freely at the clearing house.

The townsfolk do not accept a money substitute (coins in antiquity, checks in 1844) because the issuer “vied for their acceptance” as Kindleberger (1996, p. 62) claims. They accept it because the issuer is alive, which is taken as evidence that he has survived the latest clearing house meeting. If they go to the feedlot to redeem a man’s coins and find that his cows are all gone and, in their place, the cattleman’s head has been put on a stake, then they know that his coins are no good anymore. The material the coins are made of, gold, is not yet considered money (it will be thousands of years before gold, not cattle, is money), but it has *use-value* and can be sold to the mint in the same way that flour can be sold to the baker. It is back to this use, the minting of cow-tokens, that Mises’ regression theorem traces the value of gold, not to the making of pretty necklaces.

In conclusion, I must commend Zarlenga for his scholarship in researching events that took place thousands of years ago. It may seem that, having conceded to Zarlenga the bulk of his argument that gold coins were tokens for cows, there is little difference in our positions. But the one point that Zarlenga misses is the keystone, without which his whole thesis collapses: *Cow-tokens were issued by the people who owned the cows.*

The church elders did not just write the equation “130 grains of gold = one cow” on the bulletin board at their temple and expect people to obey it. How could that work? The only reason someone would accept a gold coin is because the issuer was known to have a herd of cattle and to have proclaimed that anybody who brought one of his coins back to him would get a cow. Zarlenga is right that the merchants in town did not issue the coins, but he did not look far enough when he decided that the city government did. The coins were issued by a rural cattle baron. They *circulated* in the city, but they were not *issued* by any entity, public or private, in the city.

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