

BOOK REVIEW

THE ONTOLOGY AND FUNCTION OF MONEY: THE PHILOSOPHICAL FUNDAMENTALS OF MONETARY INSTITUTIONS

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This ambitious new book on the foundations of money and monetary institutions, based on the author's Ph.D. dissertation defended in 2011 at the Universidad Rey Juan Carlos in Madrid, Spain (supervised by Gabriel Calzada), is an impressive interdisciplinary exercise. Part I of the book, "Metaphysics," dwells into the nature, origin, and valuation of money. Part II, "Epistemology," discusses what could possibly be known about monetary phenomena, and how this knowledge can best be acquired. Part III, "Ethics," proposes a framework for a moral assessment of

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monetary arrangements and institutions. The last part, "Politics," which spreads over one third of the book, addresses various issues, such as the history of fiat paper money in the USA, the optimum supply of money and credit, contemporary monetary policy and considerations about the future evolution of money. Five appendices, totaling fifty pages, detail the author's thoughts on topics as diverse as coined money in Greece, dollarization, financial repression and even the resource curse. The book also contains a ten-page glossary and an extensive index, both of which are meant to help the reader cope with the abundant concepts and authorities to which the author refers. Capitalizing on his interdisciplinary approach, Zelmanovitz hopes to reach a large audience that goes beyond the limited circle of scholarly economists. His plan will certainly be challenged by the book's price (in excess of hundred dollars).

The author's research project, though immense, is striking by its clarity: a normative prescription for improving a society's monetary institutions requires knowledge about the nature and value of money, a proper understanding of the limits of that knowledge and a realistic view about how it could be implemented practically, given the political constraints of the real world. This clarity results in a structural consistency that excites the reader's curiosity and renders the book pleasant and engaging. The trouble with it is that, despite bringing together different views from several social disciplines, the book is not entirely convincing. Zelmanovitz possesses a vast knowledge of both authors and issues that he puts on show; but he fails to develop a step-by-step criticism-proof argument that alone could gain the reader's endorsement. The remaining of this review will substantiate this opinion with a discussion of Zelmanovitz's views in three areas that are foundational of his project: the moral assessment of social institutions in general, the moral justification of central banking in particular, and the theory of monetary equilibrium.

WHAT DISTINGUISHES RIGHT FROM WRONG SOCIAL ARRANGEMENTS?

In the author's intellectual framework, a proper answer to this question is essential for grasping the essence of money, because

"the idea is to approach money as a social institution" (p. 1). Thus, the ethical appraisal of present-day monetary arrangements becomes encapsulated in the much broader question of the ethical assessment of social arrangements in general. Zelmanovitz's preferred criterion for right and wrong is heavily influenced by the objectivist philosophy of Ayn Rand: "It seems difficult to think about a better criterion to define what is right and wrong with social arrangements than measuring them in light of their capacity to allow and to promote human flourishing" (pp. 167–167). The more an institution contributes to the development of the individual persona, the more appropriate it is: "Humans by nature have conscience and intelligence and the very purpose of their social arrangements is to enhance their individual opportunities to reach the limits of their potential, to flourish as individuals" (p. 4). This natural tendency of the human being to purposefully seek his own flourishing would, presumably, have the added benefit of deriving irrefutable normative statements from the very essence of beings and things. Whatever promotes individual flourishing would be right and good, and hence morally justified. This criterion would offer a solution to the alleged impossibility to derive normative claims from descriptive statements: "In the same way, that exception to the fallacy of deriving an 'ought' from an 'is' applies to what is instrumental to living beings to realize their potential" (p. 2).

As attractive as might appear this functionalist version of a naturalistic moral philosophy, it is a source of deep confusion. First of all, it lacks universality. What exactly does "human flourishing" mean, and does it have the same meaning for any single individual? Is it to be approximated by improved material welfare, longer life expectancy, more profound spiritual development, reduced frequency of military conflicts, intensified trade, etc.? The author is never explicit about his own understanding, though at some point he declares that "the more a system allows the division of labor, the better it is" (p. 14).¹ The book somehow conveys the impression that human flourishing is to be understood as the individual pursuit of happiness, and that this would naturally result in

¹ Notice that this would imply that monastic communities, compared to worldly cities, are inferior social orders.

an ever-growing division of labor. However, a systematic analysis of the practical means to achieve this very abstract goal, and of its concrete working and implications, is lacking.

Second, Zelmanovitz is conflating *social* with *political* institutions. To be more precise, he sees the latter as ordinary human organizations: “[...] because political societies are no more than groups of individuals and their institutions are no more than forms of interaction among those individuals, with everyone pursuing his or her own interest in different fields” (p. 3). This general description, while not necessarily wrong, fails to make the very important distinction between the two mutually exclusive organizational principles of groups of humans: voluntary cooperation and forceful exploitation. It would hardly be an exaggeration to state that all progress in political and moral philosophy is due to the analysis of the implications of this simple but crucial distinction. While it is hard to believe that the author might not be aware of this, he prefers to avoid a rigorous discussion of how individual cooperation restrained by rightfully acquired private property differs from centrally imposed collaboration. Rather, he prefers to confine his discourse within the framework of notions like unintended consequences and spontaneous outcomes.

An obvious problem with that approach is that it grants to the political means of acquiring wealth as much legitimacy as to the economic means, to borrow a famous distinction made by Franz Oppenheimer (1926, pp. 24–27). Spoliation of others’ production and their accumulated property, i.e. the political means, becomes as moral as the initial appropriation through one’s own labor, production and exchange, i.e. the economic means. Put differently, violence becomes legitimized in all circumstances. Such a conclusion, which incidentally empties any social political theory from its scope and meaning, could not possibly be true: a society that would admit indiscriminate violence is self-destructing by design.

The insufficient analysis of what is or is not legitimate violence implies that the very important distinction between the social class of the exploited and the social class of the exploiters is missing from the book. Hans-Hermann Hoppe has shown that these categories are crucial for understanding social evolution (Hoppe, 2001, 2012). In addition, there can be no proper understanding of the state-organized redistribution of resources, as opposed to

the market-driven distribution of incomes, without recourse to this same opposition between producers and exploiters. Thus, it comes as no surprise that the author does not discuss at all state monopolies of money production in relation to their impact on wealth redistribution. Nowhere is there any mention of the well-known Cantillon effects, which have become the cornerstone of the Austrian economic and political analysis of fiat paper monies (Thornton, 2006; Dorobăț, 2014). Furthermore, had the author given a proper place to the analysis of political institutions, he would not have sought to integrate, at any cost, the catallactic with the chartalist theories of money. This endeavor, which is the core of Part I of the book, arrives at a dubious conclusion: “One must ask, can the state *create* value? I think that the answer to that question is undoubtedly yes and all forms of fiat money in circulation today are evidence of that” (p. 44, our emphasis). That fiat money, or for that matter any other good supplied by a monopoly, has value is no proof that its value is *created* by the monopoly producer. Fiat money value still springs out of its usefulness as appreciated by money users. Consequently, the determination of its purchasing power is subject to the market process, not to a decree that spells out the will of the monopoly producer. Any accommodation with the chartalist view implies a contradiction with the subjectivist theory of value, and hence great difficulties with providing a realistic account of monetary phenomena.²

IS CENTRAL BANKING LEGITIMATE?

The entire chapter seven is dedicated to a discussion of the rationale for central banking. Zelmanovitz rightly discards, even though without much discussion, the most common economic justifications. The question he raises is whether a good political reason for government involvement in money production could be found. He believes he has identified such a good reason thanks to the “qualitative distinction, both legal and moral, between taxation and expropriation” (p. 197). While the book does not offer a systematic presentation of that distinction, the author’s

² A case in point is an extreme monetary phenomenon such as a hyperinflation. A consistent chartalist must take hyperinflations as desired and designed by the state.

argument is quite clear. There are emergency situations when the protection of society against enemies could not be organized efficiently without confiscating individual resources. Inflationary money printing, which is one method of resource confiscation, is therefore admitted. This is confirmed by monetary history itself, which shows that governments have monopolized money production when they needed resources for their war efforts. This fact of life proves that central banks are morally justified. Each one of these three steps of the rationalization of state monopolies in monetary affairs deserves individual scrutiny.

First, is it true that centralized confiscation of individual property is an efficient means for gathering the supposedly large pool of resources needed to defeat a foreign enemy? The author himself explicitly provides the arguments for negating centralized confiscation, but oddly enough he draws the opposite conclusion: “Therefore, if protection of life and property is of personal value for all individuals, in different circumstances, different efforts may be necessary, *regardless of their individual preferences*” (p. 210, our emphasis). To the extent that this confiscation is at odds with individual preferences, it is undesired and thereby revealed as reducing people’s welfare. As a matter of fact, in the absence of individual agreement, the confiscator is no longer protector; he becomes the aggressor. Consequently, centrally commanded expropriation could not logically be a means for defeating a foreign enemy. After all, an enemy is defined precisely by his assaulting on individuals’ private property! It is still possible that the author has in mind a kind of a “market failure” situation, in which for technical reasons the “public good” security could not be provided in any other way but through central planning. However, the point that the market could not provide the much needed security against foes would have needed to be substantiated much more deeply, especially in light of the argument that either there is an economic science that establishes the superiority of the competitive principle in all areas of human activity, or there is no economic science at all (Molinari, 2009). Similarly, the author could have subjected the efficiency analysis of a centrally organized war economy to the logical test of the economic calculation argument (Mises, 2008, pp. 201–232).³

³ Generally speaking, Zelmanovitz adheres to the Hayekian intellectual universe, in which the achievements of the economic science are closely linked to the deeper

Based on this premise, which we believe is contestable, the author builds up his moral case for central banking: "If a central bank is understood as a modern proxy to the monetary prerogatives of government in general, only to be used in cases of extreme emergencies, then a moral defense for its existence may be found in this work" (p. 232). Let us note first that nowhere does the author discuss the mechanisms through which monopolized money production and inflation allow the central authority to seize the resources deemed necessary. The proof of the so-called "fiscal proviso" would have been a welcome occasion to present the Cantillon effects, which we already noted are missing in this work. Moreover, given that other means for collecting resources, such as taxation or bond issuance, are also available, the superiority of inflation should have been established. As far as the argument itself is concerned, it is straightforward that even if the premise were valid, it would justify central banking exclusively in the very specific cases of presumably rare emergencies. Would not this imply that, once the emergency has been resolved, the central bank should be declared unjustified in the new circumstances, and therefore dismantled? Fearing this type of criticism, the author comes up with a really astonishing defense.

Zelmanovitz provides a condensed summary of Rothbard's monetary history of the United States (Rothbard, 2002), in which he shows how fiat paper money and central banking became institutionalized in the context of budget deficits in need of funding. The whole point of this narrative is to convince the reader that the historical events rendered the acceptance of the "fiscal proviso" inevitable: "[...] to understand the 'fiscal proviso' as a mere act of force, deprived of any moral justification, even utilitarian ones, seems very unrealistic in light of the future events in the monetary history of the United States" (p. 220). In the concluding remarks to this chapter, the author becomes even more explicit: "This attitude of disregard for individual property rights is the 'natural' response of different governments in different historical moments. It is a 'fact of life'" (p. 231). In other words, the very existence of central banks, understood as the natural response of governments

integration and application of such notions as subjectivity, knowledge and expectations. The author is definitely not a proponent of the Misesian approach, which is firmly anchored in the entrepreneurial market process itself and its prerequisites, one of which are the objective conditions for rational economic calculation.

to somehow inevitable historical circumstances, provides a moral case in their defense.⁴ Two objections could be spelled out. First, the argument confuses historical explanation and moral justification, which are two distinct thought processes. Were they one and the same, all things would be right by virtue of their merely being what they are. Second, and this is related to the observations from the previous section, a full-fledged theory of the government would have been needed in order to show how the progressive setting-up of a central bank as a monopolist producer of fiat paper money is, indeed, in the nature of growing governments.

Even though the author believes that he has proved a moral case for central banking, he still describes himself as an advocate for a monetary reform that would allow the individual to fully accomplish his potential. This is the last point that needs to be reviewed in some detail.

THE THEORY OF MONETARY EQUILIBRIUM AND ITS IMPLICATIONS FOR MONETARY REFORM

It is unfortunate that, in his quest for an interdisciplinary approach to money and banking, the author does not present a structured exposé of the economic analysis of money, and more specifically of an economy's monetary equilibrium. Nevertheless, several of his comments suggest that he is a proponent of the real bills doctrine, which puts him at odds with the Austrian approach to money and banking.⁵ As a result of this view about monetary equilibrium,

⁴ Another general feature of Zelmanovitz's work is that practical facts often take pre-eminence over theoretical considerations. A case in point is his confession that "Ultimately, the argument in favour of a 100 percent reserve requirement that convinced me is Buchanan's argument that once base money is no longer expensive to produce, there is no more reason to have a banking system designed to economize on it" (p. 342). But this practical argument only begs the question why, then, fractional reserve banking still persists. The answer would require a thorough theoretical study, *inter alia* of redistribution effects and their links to vested political and economic interests.

⁵ Zelmanovitz is heavily influenced by the monetary disequilibrium theory of Leland Yeager. However, while Yeager (1986) conceptualizes about the monetary (dis)equilibrium in real terms, Zelmanovitz's discussion is exclusively in nominal terms. Both authors share the view that prices convey information and incentivize human action.

he is advocating a reform that would ensure the flexibility of the money supply in order to accommodate changes in the demand for money, while guaranteeing the stability of money's value. Finally, this reform would be driven by an ongoing tendency towards a higher level of abstraction and a growing dissociation between the unit of account and the medium of exchange functions. Let us elaborate on each of these points.

Zelmanovitz introduces the supply of and the demand for money in two very short paragraphs (pp. 238–239) and represents a neoclassical type of equilibrium in a chart (p. 244). He does not explain which forces actually bring about the monetary equilibrium, and what their impact on prices is. Had he done so, he would have discovered the real cash balances doctrine, according to which changes in the demand for money imply increased selling or buying of other goods against money, and hence changes in monetary prices. Whatever the stock of nominal units of money, i.e. whatever the supply of money is, price changes always guarantee that this nominal stock can satisfy any demand for real cash balances. The conclusion that changes in the purchasing power of money ensure monetary equilibrium at any time is the greatest achievement of the Austrian theory of money and banking. Building upon its foundations, Murray Rothbard declared “that there is no such thing as ‘too little’ or ‘too much’ money, and *that, whatever the social money stock, the benefits of money are always utilized to the maximum extent.* An increase in the supply of money confers no social benefit whatever; it simply benefits some at the expense of others, [...]” (Rothbard, 2009, p. 766, original emphasis).

The author adopts the exact opposite view, claiming that there are great social benefits to be expected from a flexible supply of money:

A relatively constant amount of money chased by a sudden increased demand will force fire sales and economic disruption. Even under relatively calm circumstances, a relatively inflexible monetary supply is not necessarily one that would adjust automatically to changes in the demand for money without somewhat important changes in money value (p. 326).

The idea that deflationary pressures are disruptive is recurrent: “If the government keeps the supply of money constant in face of an increased demand for money, or worse, allows its contraction, it

will force asset liquidations beyond the misallocations that need to be corrected, producing even bigger economic devastation, human suffering, and social unrest" (p. 242). The contraction referred to is specific to the fractional reserve banking system where loss of confidence during the downturn implies a decrease in the money supply: "[...] the banks are forced to 'deleverage,' that is, to call back the loans they made in order to repay the investors/depositors. Since the very essence of the system is the creation of multiple financial claims over the same amount of base money, [...], that liquidation becomes problematic" (p. 207). Only an accommodative monetary policy would alleviate these alleged problems:

Therefore, while the current monetary constitution remains in place, any decision by the central bank of not providing more liquidity for the banks, and consequently forcing all economic agents, in their increased demand for cash balances, to compete for a fixed supply of money, would represent an additional effort of adaptation from society on top of the effort required to liquidate all the existing misallocations (pp. 253–254).

There are at least three major problems with the contention that changes in the demand for money need to be matched by changes in the supply of money in order to avoid economic disruptions. First, as already pointed out, the monetary equilibrium is restored through market-driven price changes that both reflect individuals' new preferences to hold more or less money relative to other goods and adjust the demand to hold real cash balances to the existing nominal supply of monetary units. Second, the alleged social disruptions and hardship triggered by liquidations that would go beyond those necessary to correct malinvestments are pure myths (Bagus, 2015, pp. 94–108). Should prices go below what they would have been, this would imply that those entrepreneurs that buy assets at below-equilibrium prices make profits that are explained by the corresponding losses of the selling asset-holders.⁶

⁶ Notice also that the deflationary recovery situation is fundamentally different from that of an inflationary unsustainable boom. The deflation facilitates the redistribution of existing assets from failed entrepreneurs to capitalists that consider themselves better at the art of managing assets. The deflation does not lead to waste of resources. On the contrary, the inflationary boom consists in wrong investment decisions that imply aggregate net losses and waste of resources due to the non-convertibility of some capital goods.

Speculation and arbitrage would consume these possible gains until prices are restored to their equilibrium levels. From that point of view, it is even difficult to claim that there is an optimal level of liquidations corresponding to some needed adjustments, as these adjustments and liquidations are determined by the market process itself. Third, one of the book's themes is that limitations on our individual knowledge lead to a skepticism that is "reflected in doubts about the ability to know what the quantity of money existing in society is at any given time" (p. 141). If according to the author even the supply of money cannot be known exactly, how could the authorities know what the changed demand for money is, and how could they know how to accommodate it? It seems to us that if there were knowledge limitations, they would immediately discard the very possibility for a designed policy that could do better than the natural market process.

Based on his approach to monetary equilibrium, Zelmanovitz offers a very general blue-print for monetary reform that relies on the need for a built-in flexibility of the money supply. He sees two salient features of such a reform, which he also considers historically inevitable: "The time for a monetary system in which the unit of account will be entirely abstract and all monetary merchandise will be securities is very close" (p. 318). In other words, a double dematerialization of money should occur. First, securities alone would become the most commonly used media of exchange. The author does not provide a complete explanation of why this would be so. However, one could imagine that this is the case because the issuance of securities would provide the needed flexibility for the supply of money to automatically adjust to changes in the demand for money. Second, accounting would be conducted in an independent abstract unit, so that the flexibility of the medium of exchange would not be restrained in any way whatsoever.

How realistic is this proposal for reform? Without entering into much detail, let us mention what we consider as two stumbling blocks. First, while a unit of account could exist without also being used as the unit of measure for the medium of exchange, both units are bound to be linked to each other. If that were not the case, then the function of unit of account would be overtaken by the medium of exchange itself. For instance, the *French livre* has been indeed a pure accounting unit. However, at any given

moment, it was defined as a specific quantity of *sous*, *deniers* or *francs*. Even though this specific quantity has varied at different times, the link itself between the livre as a unit of account and the units of the circulating medium of exchange has been permanent. This practical example is not the result of a historical contingency; things could not have been otherwise. A completely abstract unit of account would imply that accounting itself has become abstract, i.e. disconnected from reality. This is logically impossible, as accounting has one purpose only, namely to provide the most faithful possible account of reality in monetary terms. For that account to be inter-subjectively communicable within a given community of individuals, the monetary terms in which it is expressed must be universally accepted within that community. This already implies that securities, each with its own characteristics and risks, could not become universal media of exchange, i.e. money. To the contrary, money appeared precisely as a solution to the tremendous problem of appreciating the liquidity of goods and assets with unknown marketability. To consider that securities could ever become the “monetary merchandise” implies one of two things. Either this would be a *de facto* return to barter, with all its implications in terms of hindered economic calculation, and hence reduced division of labor. Or this would imply that each security issuer has become an issuer of his own money. The result of this type of monetary freedom has been predicted long ago by the banker Henri Cernuschi (Mises, 2008, p. 443).

CONCLUSION

Overall, despite the weaknesses highlighted above, Zelmanovitz’s book will be appreciated by the initiated reader. It raises a very large number of relevant questions and puts together, in a thought-provoking way, a wealth of notions and concepts. However, these very same qualities that distinguish the diversified erudite are also pretext for some uneasiness, mostly related to the approach chosen.

First, the interdisciplinary approach is bound to economize on a systematic presentation of any of the specialized branches of knowledge that it exploits. This makes any such project both very difficult to understand by beginners and exposed to easy criticism

by specialists. Given these unavoidable pitfalls, Zelmanovitz succeeds rather well in this delicate exercise in versatility. However, the question remains to what extent this approach deepens our knowledge of money and of monetary institutions and policy. In particular, what is its superiority to an exclusively economic study of a very specific issue that would carefully elaborate on the existing (narrow) theory?

Second, interdisciplinarity often goes hand in hand with an attempt at reconciling various epistemologies and schools of thought. This is also the case with Zelamnovitz's book, which expresses his "convictions about the possibility in the future to recreate a consensus about good economics" (p. xxi). However, in science, truth alone is the single criterion for goodness. To the extent that concessions and compromises with the truth are needed for deriving an ecumenical position, consensus-building appears unscientific. Moreover, progress in science does not need consensus. Truth is out there to be studied and analyzed by all interested students, and arguably the discoveries of its various aspects have been consensus-breaking, rather than consensus-building. Admittedly, this is a much broader debate, which falls beyond the limited scope of this review.

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