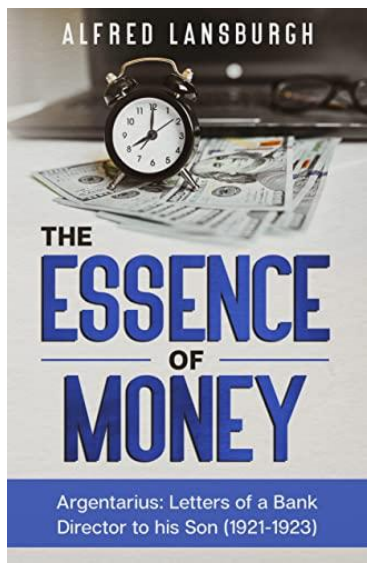




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The Essence of Money: Argentarius: Letters from a bank director to his son (Argentarius: Letters of a Bankdirektor to his Son)

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economic transactions, one service is always and without exception exchanged for the other. However, only one performance takes place in the present. The other only takes place in the future. Until this future point in time, a credit relationship exists, namely a claim of one party (the seller) to the still outstanding consideration of the other party (the buyer). This claim is secured by a transaction instrument called 'money'. The money provisionally takes the place of the outstanding consideration - whether as a pledge or as an instruction. It is therefore usually regarded as the consideration itself. How the money is constituted and who spent it is basically irrelevant. There is only one thing that matters, and that is that the money completely fulfils its task of securing a claim to goods.

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There is one sentence, my dear James, that you cannot hammer firmly enough into your mind. The sentence that constitutes the quintessence of my previous letter is: 'Money is the embodiment of a claim to goods that has arisen because someone has performed something but has not yet received the consideration. 'Or, more briefly: 'Money embodies the claim to equivalent consideration arising from a service. 'This sentence is the be-all and end-all of the entire theory of money. From it, everything that has to be said about money actually follows by itself. If only all nations would memorise this harmless sentence and never violate its meaning, there would be no monetary misery and no currency question in the whole world. As soon as the claim to consideration, which every market exchange of goods entails, is secured by money, an external change takes place with it. You recognise this immediately if you imagine a concrete case. Think of a worker who has done work for 200 marks, that is, who has acquired a claim to goods worth 200 marks. He has this claim exclusively against his employers until payday. (Up to the payday, every worker grants his employer 'credit'). However, at the moment when the employer pays the worker the 200 marks, the claim against him ceases to exist. The two are 'even'. But this does not mean that the claim itself is extinguished; on the contrary, it remains, embodied in money, in the unchanged amount of 200 marks. Only now the claim is no longer directed against an individual, the employer, but against the totality, the market. The worker can now collect the consideration promised him for his work wherever and in whatever form he wants. He can buy a pair of boots from the cobbler, food and cigars from the merchant, beer from the innkeeper. Only when he has done this and spent his 200 marks is his claim to property extinguished. Only then is the purpose of the exchange fulfilled, which the worker has undertaken with his employer: he has exchanged boots, food, cigars and beer for his work performance. The receipt of the money was only an intermediate stage, which was necessary because the employer did not himself have the goods which the worker wished to receive, because it therefore required a guarantee that the worker would actually receive the goods earned by his hands somewhere. Hold this quite firmly, my son: As long as someone has not received anything in return for a service, not even in the interim form of money, he has only a claim on a certain person, namely a claim on the recipient of his service. Our worker, for example, initially has a claim in the amount of 200 marks solely on his employer. But as soon as the same person has received money for his performance, he has a claim on the general public. Our worker now has a claim on the market, which must supply him with boots, food, beer, or whatever else the worker may choose, up to the value of 200 marks. In the first case, i.e. as long as the person rendering the service still has a claim on an individual person or a credit balance with that person, the relationship between the two parties is

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called a credit relationship. In the second case, i.e. when the renderer has received money, one no longer speaks of credit, although nothing has actually changed in the matter itself, but of purchasing power. One says that the recipient of money can exercise as much purchasing power on the market as is expressed in the amount of money received. Strictly speaking, however, there is still a credit relationship. The recipient of money still has his claim, only that he no longer has this claim against an individual person, but against the totality that constitutes the 'market'.

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There are three questions in particular. First, how much money, how much purchasing power must exist in a country? Secondly, how much market commodity does one receive for the individual monetary token, i.e. what is the value of the money? And thirdly: How is money created? Basically, all these questions answer themselves as soon as one sees in money only what it is, namely a reference right, and always remembers that in it a deferred consideration is embodied. But since human logic likes to make side leaps, and every deviation from the straight path here infallibly leads to error, I must help you a little in finding the answers that are actually self-evident. Firstly, how much money must circulate in a country? The most peculiar views on this are widespread among economists. Most of them believe that the quantity of money must stand in a quite definite relation to the production of goods, and that therefore with increasing production more money must be put into circulation; if this does not happen, then a 'lack of money' arises. This view, like every other view that sees money as an article to be increased or decreased according to plan, is fundamentally wrong. It is just as nonsensical as the view that one need only increase the entries in the land registers and house cadasters in the country in order to eliminate the housing shortage. One is certainly able to increase or decrease tangible objects, i.e. houses and flats. But one cannot double or halve an abstract right. And money is nothing other than an attested right. It is - one cannot repeat this often enough - the right to something in return, which someone acquires by giving away his own labour. For the worker who has given up his labour at the agreed price of 200 marks, the money he receives in return means nothing other than the right to procure the agreed counter-value by buying boots, food, beer, etc. His 200 marks correspond exactly to the quantity of goods to which he has acquired a right through his work. With every purchase he makes, his money stock, i.e. his right to goods, is reduced. For in the amount of his purchase he receives the corresponding definite consideration for his labour, for which he must of course give up the provisional consideration, namely the right to receive goods embodied in money; just as in the theatre you forfeit your coat-check token, your right to withdraw a coat and a hat, the moment you receive the things. Every person who has made an act of

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Therefore, there can never actually be 'too much' and 'too little' money. There is always just as much money circulating in a country as there are acts of exchange that have been carried out but not yet fully completed, but still remain in abeyance, so to speak. For money is precisely the certificate that an act of exchange has only been half completed, because the person entitled to receive the consideration does not yet have it in his hands; it is at the same time the legal document which legitimises its holder to receive the consideration. Since the money supply in the country must therefore always be exactly as large as the sum of all counter-performances not yet claimed, I cannot with the best will in the world see how the money supply can be increased or decreased by the state. Every arbitrarily created new monetary token signifies a legal title to the payment of a consideration, although no performance has ever taken place to justify it. It certifies an act of exchange which has been left in abeyance and which in reality has not been carried out at all, and is therefore to a certain extent a forgery. Conversely, any arbitrary reduction in the circulation of money, any destruction of money tokens, means a cancellation of vested rights to consideration and thus an act of violence. I would almost bet you, dear James, that

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Let us illustrate the matter with a practical example: A state in which a million banknotes are circulating issues another million for some reason. It thus issues entitlement certificates which, just like the money tokens already in circulation, entitle the bearer to purchase goods. Question: For the purchase of which goods? Answer: for the purchase of all kinds of goods; it is entirely at the discretion of the recipients of the new money which goods they want to buy on the market with it. We are therefore faced with the fact that a certain quantity of market goods, which until then had not yet undergone any change, is suddenly confronted with twice as great a demand, because the old and the new money tokens assert the right of subscription embodied in them. In a sense, a competition for the goods arises. Of course, this must have its consequences. It is an old, never disputed fact of experience that when demand is doubled and supply remains the same, the prices of goods rise. The doubling of the monetary tokens therefore leads to the market goods becoming more expensive. How great the price increase is, is a matter of scientific dispute. For the sake of simplicity, let us assume that the doubled demand leads to a doubled price. The result of the increase in money is that every holder of old money has to pay twice as much for his purchases as before. Here I hear another interjection: 'That's not true! The new demand stimulates the whole production to increased activity through the rising prices. As a result, new quantities of goods appear on the market very soon, which counter the increased demand with an increased supply and push the rising prices down again.' The interjection is not entirely unjustified. This effect can indeed occur, namely when the factory owners and their workers are stimulated by the price increase to increase their labour output. But this effect need not occur. Realise that rising prices lead to considerably increased profits, that the more abundant profits result in higher wages, and that in this way an ease of earning arises in the whole of production, which very often does not stimulate to increased labour, but to the contrary, to a certain ease and indolence. In such times there is often a call for a seven- or six-hour day in the air. It is therefore very easy for a decrease rather than an increase in the production of goods to occur. But even if production really increases and supply grows, this is always only the gradual and hesitant consequence of the immediate and impetuous rise in prices. The first and certain moment is always the price increase; the price reduction is a later and very questionable eventuality, which, moreover, at best mitigates the price increase somewhat, but never prevents it altogether. We must therefore already come to terms with the fact that the increase of money raises prices, and the only concession I can make to you, if need be, is that we presuppose the increase to be not quite so tempestuous as I have done above. Let us assume, then, in God's name, that a 100 per cent increase in money results in only a 50 per cent increase in prices. But what does it mean, dear James, if

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Money is a right and should not become an injustice. That is why the state must never take the liberty of wanting to create or destroy money arbitrarily, for in doing so it creates or destroys vested rights to goods.

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But what the state can do is to produce new signs of money mechanically. But these money tokens do not fulfil the purpose that money has; they do not provide the people with new rights to goods, they do not make the people one iota more powerful, but they only transfer long existing rights to goods, long existing purchasing power from their rightful owners to other people. They siphon off a certain part of the right to purchase goods, which belongs to the national community and is securitised in the old money, and lend this part to the holders of the newly issued money tokens. By producing such money tokens, the state only gives to the one what it takes from the other. It is not able to create anything new in this way. In a nutshell: the state does not create new money by issuing money tokens, but taxes one part of the population in favour of the other. That's the way things are, dear James. It

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The fact that by far the largest part of the purchasing power has been forcibly transferred from the old money to new products of the banknote press and artificially given a value to them can only be euphemistically called 'monetary policy'. More correctly, it is a brutal act of expropriation. And the only thing the state can do in relation to money. It can only expropriate money, i.e. property rights, never create them. But the fact that the state is unable to create

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abstract 'right' can never have a concrete 'value'. It can certainly transfer the value that any thing has from one person to another, it can regulate the ownership of this value, but it cannot embody the value in itself. You must not let yourself be misled by the fact that there is money of a certain kind which actually has approximately the concrete value which it attests, so that, for example, an English sovereign and a German double crown not only represent a right of subscription worth 20 shillings and 20 marks, but also really have this value by virtue of their physical nature, because they are made of gold. In this case, it is not the money, not the right to purchase goods, that has an intrinsic value, but only the metal on which the right to purchase is certified (by stamping). If you happen to have saved a double crown from the pre-war period into our paper present, you can immediately put it to the test by having the gold piece melted down. Although the gold is no longer a double crown, no longer money, it still has the same value as before, namely 20 gold marks or 4 3/4 dollars. The paper twenty-mark notes, on the other hand, which you still have from the pre-war period, have sunk deep, deep below this value. If money really derived its value from itself, from its quality as money, then the two money tokens, one representing 20 marks like the other, would have to have exactly the same value. In fact, only the double crown has retained its old value of 20 gold marks = 4 3/4 dollars, and this because it has always been something other than money, namely gold, i.e. a commodity of very special stable value. So we have to frame the question differently, my dear. We do not have to ask: 'What is the value of money? But: 'How great is the claim to goods that money guarantees? ' Put like that, however, the question answers itself. For what is the fundamental sentence that you have to memorise if you want to avoid my paternal wrath and permanent ignorance of the monetary system? It is: 'Money embodies the claim to an equivalent service in return for a service rendered. 'From this it follows without further ado that the claim to goods which money guarantees, or the ideal value which it therefore has for its owner, is exactly as great as the value of the preceding performance.

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Genuine money is only such money as preserves undiminished for its bearer the claim to consideration arising from a service. For according to its purpose and essence, money is nothing other than a legal claim. The fact that it also fulfils a number of other functions, e.g. allows the legal claim to pass from hand to hand, is of no importance apart from the main purpose, and as soon as it does not fulfil this purpose, or fulfils it only inadequately, it is no longer money, however well it may still fulfil the other functions

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Real money comes into being as a result of a very specific economic process and always has a performance as a prerequisite. It is not a creature of the state's legal system or of the state's arbitrariness, but a product of traffic. And as trivial as it is to know what a government is thinking when it prints its coloured notes, it is interesting to follow the emergence of real money.

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however, the two postpone the assertion of their claim, they thereby become the holders of a right of subscription, which they can exercise at any time and in any manner, and we then speak of monetary transactions. For this right of subscription is nothing other than money. Nevertheless, we do not see that physical money was created on this occasion. Rather, we see that the money which the baker and the craftsman receive, and in which the right of subscription is embodied, already exists and only changes hands. How is this? In the end, should the assertion that money arises from every service that is not immediately compensated with a service in return be false? And if it is false, when does money actually come into existence? For at some point, it is clear, every monetary token in circulation must have come into being.

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This in turn leads to a very interesting observation: namely, that the state cannot destroy money, even if it wants to. It can, of course, reduce the number of banknotes in circulation, i.e. withdraw and collect a few million banknotes. But in doing so it only does exactly the same as your friend with his fidibus. He takes away from individuals their rights embodied in the banknotes, but these rights do not disappear but accrue to the holders of the remaining banknotes. Each of these banknotes now accounts for a larger share of the totality of goods. It is common to say: 'The money has become more valuable', and this is correct. The claim to goods, the purchasing power, which are guaranteed by money, have actually increased in proportion to the numerical reduction of the banknotes.

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then, I have explained to you in an earlier letter that the State cannot, of its own free will, create money, i.e. no property rights, but can only transfer long-existing property rights to other persons, i.e. expropriate them, you see here the counterpart to this: The state cannot destroy existing money, circulating property rights, but can only transfer them to other persons, i.e. restructure the property rights. The only difference is that in the first case the totality of goods is distributed among an increased, in the second case among a reduced number of entitled persons, which in one case means a disadvantage, in the other an advantage for the individual money holders. From which you can see once again that the 'value' of money is never absolute, but is always closely related to the quantity of money and fluctuates with it.

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Because England in this way eliminated the bank as the creator of money and created a money for itself that was born out of living circulation, the country had the best money in the world until the great war, the only money that was really stable in value. But when, during the war, the creation of money was once again made a matter for the state and its printing press, and new signs of money were imposed on circulation that did not originate from the state itself, the full value of the claim to goods represented in money was, of course, a thing of the past. From this it follows, dear James, that a bad, money-spitting bank of issue is harmful, but a good one is superfluous. For the mechanical task of certifying the money created in circulation can be performed by any mint. It also seems as if this realisation is beginning to germinate here and there, less in Europe than in South America. There, some states, when they started to rehabilitate their monetary systems, deliberately refrained from founding central banks and instead set up 'conversion coffers', i.e. coffers that merely authenticated the creation of new money by issuing certificates for deposited gold that circulated in circulation like gold itself. Vox populi, which always cries for 'more money', is not satisfied with this, however, and since there are domestic political moments when one has to follow the 'street', it is questionable how long, for example in Argentina, reason will prevail in monetary matters. And we in Europe? We have paid such an

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have shown you how the superstition that it is the state which creates money, and that it is up to the state to decide on the kind and quantity of money, has taken its most disastrous revenge, in that the value of money has sunk deeply, in many cases to the bottomless pit, through this presumption on the part of the state to want to play creator: that a large part of the population has thereby been deprived of possessions, that is to say, has been dispossessed or robbed, depending on the opinion: that almost all our social struggles, with their attendant symptoms of political incitement, public immorality, general unscrupulousness in acquisition, epidemic robbery and murder, are a consequence of this disregard for economic laws: Indeed, even the German Revolution of 1918 was largely due to this disregard, because the arbitrary manipulation with the yellow coin, even more than the war, brought about the division of the people into the group of the exploiters and that of the exploited, and thereby created the mental disposition for the collapse. Above all, however, I have shown you to what a grotesque degree the governments everywhere have deceived themselves when they believed that by flooding the countries with vast quantities of bank and state notes they had sovereignly created 'new money' and 'new purchasing power'; how in fact they have done nothing other than dilute the purchasing power of the old money in order to transfer the greater part of it from its rightful owners to themselves and then further to certain privileged strata of the population.

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If the external value of German money is so much lower than its internal value, this means that German domestic prices are lower than the corresponding prices abroad. As a result, German goods must flow out onto the world market in enormous quantities. And indeed we see that this is the case today; the whole world complains about German slingshot competition and seeks to protect itself against it. But how is it then that the external value of the mark has not now risen at least to the level of the internal value? The strong German export of goods must be paid for by the hole and create a correspondingly strong demand for German means of payment abroad, i.e. raise the mark rate at least to the level of the domestic mark value. Why does this not happen? Why does the divergence between the internal and external value of the mark still persist?

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But above all: If the reparation tribute imposed on Germany really and absolutely has the consequence that the mark is exposed to a constant strong supply on the world market and is thereby depressed below its internal value, then we would have to reckon under certain circumstances for thirty years and more with two different market values, a higher domestic and a lower foreign one! For, as is well known, reparations are to extend over several decades. We would therefore not be able to think about rebuilding a healthy, stable German currency for thirty years or more. In fact, however, there is already a strong current in favour of starting the currency reform as soon as possible, and quite clever people believe that we can fortify the German monetary system very quickly if we seriously want to - in spite of our foreign debt and in spite of the reparations. How do we get over this new contradiction? And

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higher internal value of the mark means cheaper prices for German goods, which means mass exports, which are perceived as dumping competition on the world market, and finally means violent defensive measures by foreign countries, which do not want to have their industries ruined by this dumping competition. In other words, a bitter struggle in which import bans and prohibitive tariffs provide the ammunition, but which must nevertheless remain ineffective because the poor external value of the mark, which is synonymous with German indebtedness and payment obligations, keeps pumping German goods abroad like a powerful suction apparatus.

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This is why, in a country's foreign trade, the assets and liabilities do not always balance out exactly, as should actually be the case according to the principle of 'goods against goods', but rather that one side soon outweighs the other. The difference is provisionally balanced by the credit papers, i.e. by the promise of a later payment, and as long as this is the case and the difference still exists, a corresponding quantity of goods or services is de facto unpaid. Sooner or later, however, the definitive payment must be made in the only possible form in the consignment of goods or the provision of services, otherwise the person, company or community liable to pay commits a breach of trust.

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In this way, dear James, the inner logic of things, by means of the exchange rate, forces the foreign country either to allow the debtor country to pay off its debt in commodities, or to grant it a respite on this debt. There is no other possibility. For even if we assume that it is conceivable that the whole world would unanimously barricade itself against the goods of the debtor country by prohibiting imports, and that it would just as unanimously refuse any credit, - a precondition which every practitioner will laugh at as fantasy, - the German merchandise would nevertheless penetrate abroad by surreptitious means and in the most outlandish disguises. The power of the cheap exchange rate is absolutely insurmountable, and as long as a debtor country wants to pay, no power on earth can prevent it from paying in the way that is the only conceivable way in traffic from country to country, namely by handing over goods.

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Thus we see that the mediating role played by money in domestic trade is played by the bill of exchange in international trade. But the bill of exchange is as little a definitive means of payment as money. Like money, it is rather a provisional means, a place-holder, which represents the commodity (in the broadest sense, that is, including all services of some kind) until it, which constitutes the sole object of all traffic, allows it to be replaced by money, which then later replaces it again. The bill of exchange, therefore, as distinguished from money, is a provisional measure of the second rank, which stands in the same relation to money as the latter does to commodities.

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We have seen, dear James, that the exchange rate, which expresses the value of one country's money in units of another country's money, depends entirely on the country's balance of payments: that it improves when the country has more to demand than to pay, and that it deteriorates when the reverse is the case. But we have also seen that the exchange rate not only registers the state of the balance of payments but at the same time corrects it by setting the price level in the creditor and debtor countries in that relation to each other which makes possible the outflow of goods from the debtor countries to the creditor countries and in this way balances the balance of payments. This leads to several important conclusions. Firstly, the favourability or unfavourability of exchange rates does not depend exclusively on whether a country is very heavily indebted to other countries, or very lightly indebted, or not indebted at all, but much more on whether it is easy or difficult for it in a given case to settle a debt balance by exporting goods, or to make it irrelevant for the moment by drawing on credit. One country can easily cope with a high debit balance, while another has difficulties even settling a small balance: this is a question of export capacity and creditworthiness. Consequently, in one country a small deterioration in the exchange rate is enough to produce the desired effect, while in the other a very considerable deterioration in the exchange rate must occur in order to eliminate a relatively insignificant balance of payments liability. It follows, secondly, that it will be all the easier for a country to repay a debt abroad, and that it will suffer all the less from exchange rate fluctuations, the more it possesses certain goods which are excellently suited for export purposes. The exchange rates have the task of shaping the value of the individual national currencies and thus the price relationship between the countries in such a way as the state of the balance of payments requires, and they will fulfil this task all the more easily and quickly the more mobile the margins are which move from country to country as intermediaries for the settlement of payments. In the country which has the most mobile goods, i.e. those taken everywhere with the greatest preference - or an unlimited credit - even a very slight improvement or deterioration in the exchange rates establishes equilibrium in the balance of payments. It follows, thirdly, that the commodities to which it is chiefly incumbent to bring about the adjustment of the balance of payments by their outflow and inflow must have another quality than that of great mobility. Remember, dear James, in what way the exchange rate eliminates the passive balance of the debtor country. It does this by causing, through its own movement, the average

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Gold is the commodity which not only unites in the most perfect manner the two most estimable qualities of every export commodity, namely mobility and price stability, but which, in addition, even has the special characteristic of having a price-depressing effect as soon as it is in great demand and is sent abroad. And you will soon realise where this accumulation of estimable qualities in gold comes from.

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First of all, there is the great mobility. You know that most of the civilised states have somehow connected their monetary system with gold, although money, which you have come to know as a legal title that secures its holder the claim to a consideration corresponding to a previous performance, does not in itself need a connection with gold. It has just turned out in practice that money, as soon as it consists of gold or can be exchanged for gold at any time, fulfils its most important function much better than when this is not the case. The most important function of money, as we know, is to adjust the value of the consideration embodied in it exactly to the value of the preceding consideration, i.e. to ensure that the price level in the country is maintained as perfectly as possible. And there is no better way of achieving this stability than by identifying money, which measures and expresses prices, with gold, which for many reasons is subject to less fluctuation in value than other commodities.

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We do not need to go into the reasons for this high esteem of gold in its indelicate connection with money. It is sufficient if you consider the fact that gold is considered equal to national money in all civilised countries, because it can be transformed into such money at any time. For this fact is the real reason for the extremely great, almost unlimited mobility of gold. Since in the most important countries it is at least equal to currency money, it is readily accepted everywhere. A country which has sufficient quantities of this metal possesses a commodity with which it can always and under all circumstances cover a deficit balance on its balance sheet, without having to stimulate the buying appetite of foreign countries by offering a price reduction. For there is always sufficient buying power for gold.

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One can always count on gold being taken at the price which corresponds to the legal ratio in which it can be converted into the highest-value national money, i.e. the dollar at the moment. It will not fall below this price, even if it is offered in the largest lots. The country which possesses sufficient gold can therefore not only easily cover its balance of payments with it, without having to make any concessions with regard to the price of this export commodity, but it can also dispense with the stimulant of exchange rate deterioration.

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Gold-currency countries can thus easily pay their foreign debts at any time for several reasons. First, in gold they have a highly mobile commodity that can move out and back again at will, since all countries are happy to accept it in lieu of payment. Secondly, in gold they have a commodity whose price is stable and whose valuation does not fluctuate appreciably either at home or abroad. It does not fluctuate at home, because here it is taken at will for national money or given in exchange for it, and can therefore never be worth more or less than its fixed equivalent in national money. And its valuation by foreign countries does not fluctuate, or fluctuates only insignificantly, because the exchange rates, whose improvement or deterioration amounts to an increase or reduction in the price of all merchandise, are anchored between the upper and the lower gold point (export and import gold point) and can only ever oscillate back and forth in the tiny space between these two points.

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A reliable gold currency - remember that, my boy! - is not recognised by a high gold stock, but by the fact that the balance of payments of the country can be kept in equilibrium with relatively few gold exports, and that the gold that has flowed out returns as soon as the disturbed equilibrium is restored.

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What is 'world money', dear James? When economists and financiers use the word, they always mean gold. But is that correct? Are payments from country to country really made in gold? We have seen that this is not usually the case, that it is only very insignificant peaks of payments that are made in gold. And we have also seen that in this kind of peak regulation gold performs its main service not in its capacity as an internationally valued means of payment, i.e. as a kind of world money, but as a component of the currency in the exporting gold-currency country, i.e. as domestic money; namely, by flowing out, it reduces the money supply in the country, thus lowering the price level and creating the preconditions for the country to be able to meet its payment obligation in a way other than through gold rationing. Gold, then, cannot be called the world's money, but only its pacemaker. But what do we then have to regard as the world means of payment in which countries settle their debts and claims? You will probably answer me: The bill of exchange. We do indeed see that the private individual, the bank, the government, in short, everyone who has to make a payment abroad, procures a foreign bill of exchange, a so-called foreign currency, for this purpose and sends it to his creditor, with which he then fulfils his payment obligations. But please consider what a foreign bill of exchange basically is, and why it is generally taken in lieu of payment. You only need to read the text of the bill of

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Then you will see that the bill of exchange is a request to a domestic person or company to pay the amount in dollars, pounds, francs etc. to the legitimate holder of the bill on such and such a day. In a bill of exchange, therefore, you own a paper that has no intrinsic value, but only a derived value, namely derived from the dollar, pound or franc amount to which it gives a right. Consequently, it is not the bills of exchange that play the role of 'world money'; rather, the various national types of money in which they are denominated, and into which they must first be exchanged in order to determine whether the bills of exchange are 'good' or 'bad', share this role. The money, however, as we have seen before, is likewise without independent value; it is a reference note for goods, which the country has to deliver to the holder of its peculiar money on demand. Only when this delivery has taken place and the holder of the money received for the bill of exchange knows the quantity and value of the goods delivered, is the payment from one country to the other finally completed. Thus, in the final analysis, the commodity is the 'world money'. Among the innumerable types of commodities

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The actual world money, dear James, is therefore the commodity, divided into countless groups of different mobility and led by the most mobile commodity, gold. In addition to being world money, the commodity has the task of balancing the countries' balance of payments. And this is an extraordinarily important task. For in order that the legal order in the world economy may be maintained, and that every man in every state may receive what is due to him, the balance of payments of each individual country must balance at zero. If one country owes another, it must pay or it is bankrupt. Unless its creditors expressly grant it a deferment of payment, i.e. credit. This credit is then equivalent to a deletion of the corresponding debt item in the present and its re-entry on an account sheet in the future. The present balance sheet is thereby relieved, its liability balance reduced. However, the country must pay this reduced liability balance under all circumstances, because some foreign creditors have a claim on the amount of this balance which is due and which they inexorably insist on being paid immediately. For if they did not do so, they would have granted the country a corresponding credit, i.e. they would have agreed to the transfer of the debt item to a future folio and thereby relieved the present balance of payments.

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First of all, there is the interest rate, a real devil of an instrument, which produces the most extraordinary effects with fluctuations of a fraction of a percent, that is, with a subtle instrument. We have already become acquainted with it when we dealt with the value of the national money, and we saw then (in my letter of January 17) that it exerts a quite tremendous influence on this value and thus on the price level. Depending on whether the interest rate increases or decreases, it transfers 'resting' money into circulation or puts 'circulating' money into a state of rest, which increases the price in the first case and makes it cheaper in the second. In this way, he coordinates production and consumption in a far more appropriate way than the most precise planned economy with all its economic provinces and self-governing bodies is able to do. This interest, so inconspicuous and yet so powerful, also exerts an enormous influence on the external economic relations of the countries and contributes to a great extent to keeping the balance of payments of the countries in equilibrium. If a country has to make extraordinarily large payments to foreign countries, and if a significant part of the available purchasing power (i.e. liquid money) has to be reserved for the purchase of foreign exchange, so that the purchasing power remaining for domestic transactions becomes scarce and prices consequently fall until foreign countries intervene and provide the country with the foreign exchange necessary for payment, then interest alleviates this price pressure, which is always felt to be disturbing and easily develops into a crisis. It alleviates it by going up itself. The direct cause of its rise is the aforementioned scarcity of purchasing power, which increases the lending price for available money - nothing else is interest - accordingly. And the effect of its increase is that foreign countries now show a greater willingness than before to grant credit and thereby make part of the foreign exchange purchases superfluous. Many a foreign bank, which at 4 1/2 per cent interest flatly refuses any loan because the money in its own country yields the same return, can be found willing to grant a loan when the interest rate rises to 5 or 5 1/2 per cent. Here the mild means of interest replaces the sharper means of price pressure to the advantage of the national economy. Of course, here too a distinction must

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The export of gold thus works in two directions: firstly, by generating foreign credits like any other export and by reducing the national debt accordingly, but then, and mainly, by the intensive repercussions it has on the volume of purchasing power, thus on the price level and thus again on exports. The foreign exchange policy works in a similar way to this gold policy. It consists in accumulating a large stock of foreign means of payment in the form of bills of exchange and, when the exchange rate rises, to come to the aid of the market with them. Foreign exchange, since in this case it is almost always denominated in gold, is to be regarded as equal to gold, and its outflow therefore generally has the same effects as the export of gold. Some central banks prefer foreign exchange to gold because it is easily transportable, interest-bearing and, if necessary, can be used without loss of time in the country of origin.

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Finally, the fourth and last, very effective but relatively rarely used means in the service of the balance of payments is the reserve policy. This consists of the central bank of the country forcing the private banking community to increase its cash reserves (current account balances or deposits) when exchange rates are unfavourable. The effect is the same as in the case of a restriction of credit activity, except that it is even more prompt: the purchasing power in the country decreases to the extent that the central bank calls in and stores money - prices fall, exports increase, and the balance of payments improves.

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So here again, dear James, we come up against the arch enemy of any healthy economy, inflation. If mankind were even vaguely aware of the disastrous effects that the printing press exerts even in areas that seem to have nothing to do with it, every conscientious statesman would rather wither his hand before offering it for the operation of such an infernal machine.

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For, depending on whether the purchasing power embodied in the new slips of paper is asserted in the home country or abroad, it drives up either the price level or the exchange rates, thus disturbing the correspondence between the internal and external value of the national money. In politically and economically calm times, the new purchasing power tends to operate first at home and increase prices here, so that the money in the hands of the country's children already loses value if it is still valued and paid for abroad at its previous value. Conversely, in times of political disruption, a general mood of panic and, in particular, profound mistrust in the development of the value of the country's money. In such times, with persistent inflation, the newly created purchasing power tends to turn to foreign capital investments and means of payment, thereby pushing the foreign value of money deep below its domestic value. The movement of goods gradually corrects this disparity, but the correction is painful for the home country and no less so for the foreign country. For it is perceived at home as a shortage of goods, abroad as 'dumping' and leads to customs wars and other international entanglements.

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The foreign country can do nothing against dumping by force. Instead of achieving the desired end, it merely ruins the currency of the dumping country. And thus not only this country, but also the foreign country itself is seriously damaged, because to the extent that the external value of the money in the 'dumping' country falls, every import there is made more difficult.

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Have you, dear James, ever thought about why the economic institutions of mankind have such an extraordinary capacity for persistence and tend to outlast the political institutions by far? Governments come and go, administrative systems change, entire states come into being and disappear again, but the institutions that economic man has created remain.

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The old Roman Empire has been dead for 16 centuries, but the commercial institutions it created, the legal concepts it shaped for commercial intercourse, are still alive today. Where Babylon and Nineveh once stood, sheep graze; but the complicated banking system of those days has survived through the millennia, as have the giro transactions of the ancient Egyptians and the grain futures trading of the biblical economic dictator Joseph.

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The Austro-Hungarian Monarchy is in ruins. But the central bank it established still exists, and when the liquidation stage it is currently in is over, four or five new central banks will be active in its place, because none of the successor states of Austria-Hungary wants to do without an institution to which trade and commerce in the country concerned have become accustomed. The prejudice that a central bank is as much a part of a modern state as a mint and a treasury, and that it simply cannot exist without a central bank, also plays a role. This is, of course, a misconception. Central banks are by no means indispensable, and especially in countries whose monetary system is based on a sound foundation, they are superfluous. Nevertheless, they offer a number of conveniences to the economy of those states which know how to use them wisely, and this fact, in conjunction with the economic law of inertia, means that they always rise up again, like the Little Man, when an economic or political upheaval has once thrown them to the ground.

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is very interesting to note that wherever traffic has created such a bank money, i.e. a private money, out of an act of self-help, this private money has been more stable in value, more respected and internationally more usable than the official currency money of the state. The stable value of the bank money was guaranteed by the fact that every account holder could withdraw his credit balance in gold or silver if he wanted to. Consequently, the value of the bank mark - which, mind you, was not a monetary token at all, but only an abstract unit of account transferable from account to account - could never be worth less than the precious metal for which it was credited to the depositor and for which it could be exchanged back at any time.

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However, this excellent monetary constitution was immediately broken as soon as it was decided to lend out a part of the metal stocks of the giro banks, i.e. to make a mixture of giro bank and credit bank out of the institutions. For now it was no longer the circulation (through the issue and withdrawal of metal) that decided on the quantity of bank money, but the credit policy of the bank managers. By lending out the metal and crediting the depositor with bank money when the same metal was returned, they increased the quantity of bank money existing in the account beyond the metal cover and thus beyond the will of the market.

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And with that, my dear James, we have happily arrived at the central banks. For the debt certificates that the giro banks, deposit banks and goldsmiths put into circulation were basically nothing more than banknotes to be redeemed on demand. By introducing note circulation instead of giro circulation or alongside it, the giro banks became note banks all by themselves. Thus the oldest of the central banks still in existence today, namely the Bank of England and the Bank of Scotland, were initially a kind of giro bank with the right to issue notes. They were founded because towards the end of the 17th century the mischief of 'tilting and rocking' the silver currency money in England and Scotland assumed such proportions that the coins lost about 25 percent of their original real value, and trade and commerce longed for a bank similar to the famous Amsterdam one in order to obtain book accounts and notes against metal deposits, the value of which could not be diminished by any government arbitrariness.

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Thus, in a sense, the central banks have grown out of two different roots. One root reaches deep into the history of the development of banking and makes the central banks appear as the organic further development of the giro banks. The other root has its origin in the desire for credit on the part of entrepreneurs. The more the history of banking approaches modern times, the more the first root withers and the second root strengthens.

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The tasks which are set for a central bank today are in all countries of such a nature that no institution can fulfil them without violating some important economic law. The circle of tasks that may be assigned to a central bank without violating the dictates of economic reason is narrowly limited and easy to overlook. Any child can tell at a glance whether a particular task given to a bank is within the bounds of economic law or not. The touchstone for this consists in a single short question, which is: 'Can the bank carry out the task in question without altering in the slightest the quantity of money available in the country, or does the carrying out of the task entail an arbitrary increase or decrease in this quantity of money?' If the answer is: 'The money supply remains untouched', then the bank can confidently carry out the function assigned to it. If, however, the answer is the opposite, then it is a function that is fundamentally and under normal circumstances unacceptable. For the quantity of money in circulation in the country coincides to the penny with the legal claims to services and goods which have been acquired by previous services and have not yet been asserted at the given moment; and the sum of these legal claims may not be increased or diminished by any arbitrary act of a bank, however well-intentioned. Why this must not happen, and what the consequences are if it happens nevertheless, I have explained to you in detail in my letters on 'Money'.[1]

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There is no question, then, that a central bank is quite useful if it has the task of regulating and facilitating the circulation of money in the country without changing anything quantitatively. A central bank may therefore easily take parts of the circulating money, if it consists of gold and silver, and replace them with its own notes, which can be sent from place to place more easily than the heavy metal, and which, above all, can be adapted far more precisely to the individual turnovers of the traffic.

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Equally useful is a central bank which, on the basis of the sums of hard money deposited with it, opens book accounts for the depositors and manages the payments which these depositors make to each other by writing up and down from these accounts. If an institution limits its activity to these transcriptions (giro function), it is not a central bank, but a giro bank. It only becomes a bank of issue if it combines this function with the issue of banknotes, i.e. if it makes payment by transfer or by handing out banknotes, as desired: in the first case the institution carries out the cash management for its depositors all by itself, in the second case it leaves this work to those who want to make use of its banknotes.

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Therefore, a state which regards banknotes as an indispensable factor in its readiness for war and crisis must accustom the people to banknotes from a long way off. A people who know the use of the banknote makes no distinction between the normal covered note, which is a metal certificate, and the uncovered note of the crisis period, which is note money.

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Let us briefly summarise what has been said: The activity of a central bank is useful and in no respect questionable if its purpose is to substitute an easier-to-handle means of payment for the cumbersome metal, be it notes which circulate in place of the metal money deposited with it, or giro transfers which are made on the basis of this metal deposit. Furthermore, the central bank has an unrestrictedly useful effect when it uses sums of money deposited in cash, whether in kind or in the form of fully-covered notes or credit notes, to grant credit, whereby it must of course be presupposed that it observes the basic rules of banking credit transactions just as strictly as a bank without note privilege. As long as a central bank confines itself to the functions of money distribution, cash management and the granting of credit (in the sense of making available money stocks usable), it promotes the economy without triggering harmful side effects. A central bank is only conditionally useful if it serves the idea of savings, i.e. if it first replaces metal money with notes, but then does not keep the metal as collateral, but makes it economically usable; for example, by sending the metal abroad and leaving the equivalent value to the state, which is now in possession of foreign credit balances, without anyone in the country having given up a penny of purchasing power. In this case, the nation as a whole has been enriched - to the amount of the new foreign assets - by using a less valuable means of payment instead of the metal. This is permissible and harmless as long as the management of the central bank is able to maintain the circulation of money in the country at exactly the same level as it would be if the metal were still in circulation.

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Hold this quite firmly, dear James: a metallic monetary system is in itself as elastic as can be demanded, and needs no increase in elasticity from outside. The two elementary factors of the economy, 'interest' and 'price', ensure that there is never more or less money circulating in the country than corresponds to the economic need, and everything that man can do here lies in the negative field: he can ensure that interest and price are not disturbed in their money-regulating function, that therefore, as a result of arbitrary measures, false interest and price rates do not arise and the overall economic picture is falsified. There is neither a need nor a possibility for positive measures. A central bank, therefore, which is assigned the task of making the monetary system elastic by contraction and expansion, is condemned from the outset to unfruitful activity. In the best case, which is very rare, such a bank will do no harm, namely, if its management is clever and sensitive enough to obey the instructions given to it by the market through price and interest, and always to keep just as much money in circulation as would circulate if it, the bank, did not exist. In most cases, however, it will harm the economy, because its management will be inclined to enforce its own conception of the money requirements of traffic, i.e. to follow a policy which deviates from the automatic regulation of the economic organism. It must therefore be said that, from the point of view of elasticity, a central bank is at best superfluous, but usually harmful. This harsh judgement must be made even if the central bank is guided by sound principles in its efforts to adjust the money supply to the demand for circulation.

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If you want to put it bluntly, it is robbery: the big borrowers have stolen from millions of creditors, partly directly, partly in a roundabout way via banks and state institutions, even if the "transfer of ownership" has taken place in strictly legal forms, with the approval of the laws and the judges. I have described the process more mildly as "redistribution". But however it may be called, the fact remains that the great army of creditors has been impoverished by as much as the wealth of the great borrowers has increased. It is therefore not at all a question of an increase in national wealth, but only of a transfer into new hands of the capitals which were formerly the property of millions of savers and pensioners. One can see the new industrial centres that have been created or enlarged in this way, but one must not forget at the sight of them that they are rising on the ruins of destroyed workplaces and shattered livelihoods. The motto under which this gigantic process of restructuring has taken place is "mark equals mark". Law and tradition allow a debt incurred in gold marks to be discharged in worthless paper marks. They do not permit this out of ill will or folly, but simply because in a sensibly governed country the national monetary unit is the measure of value of all things, and because the imagination of no legislator could have dreamed that ignorance and recklessness could ever turn this fixed measure of value into such a soap bubble as has actually happened. It does not speak well for the state of our economic knowledge that not a single man in the countries afflicted by inflation and monetary misery has stood up and shouted to the governments: "Beware inflation is theft! A country without money of stable value is a country without law, and an inflationary state is a robber state!" But it seems downright humorous that the sworn enemies of capitalism, the nihilists and communists, regard the means of inflation and demonetisation as their strongest weapon and believe that they can smash the rule of capital with it!

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In their naivety, these people, in Russia as in Germany, have confused the terms "capital" and creditors. They believed that they could expropriate the capitalist exploiter in favour of the masses by means of the banknote press, and instead, in all countries, they expropriated the acquiring and saving people in favour of capital. Do you think that they have now become wise through experience?

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Usury is practised by every national community which extorts services from individual defenceless groups of the population without adequately compensating them for these services, as is done, for example, with regard to urban property, which is given little worthless money for much valuable living space. Usury is practised above all by the state, which has its services - the maintenance of order, of law, of traffic, etc. - paid for many times over what these services are worth; which, with the money taken directly or indirectly from the population (through the printing press), indulges in superfluous luxury by maintaining huge armies of officials, who could be dispensed with if it did not itself, with its foolish money economy, cause disturbances in every nook and cranny of traffic life, which it believes it can eliminate with its armies. But what the masses generally consider usury, what often seems usurious to you yourself when you walk through the streets and study the prices in the shop windows, is very seldom usury, but the justifiable self-defence of the earning classes to protect themselves against the decline of the purchasing power embodied in money. It is often downright a struggle of despair against the sinister powers that want to throw the merchant down by force into the proletariat. No law and no police, no popular protest and no street struggle can prevent prices from rising to the level at which the products flowing into consumption can be produced again.

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If one tries by force to push prices below this, their natural level, the inevitable result is that production, which has become unremunerative, comes to a standstill, the supply of the people comes to a standstill and prices finally - as a result of the disproportion between supply and demand - rise considerably higher than before. The state with its means of power cannot make this law ineffective, for example by taking production into its own hands. For even then it must submit to the law which raises prices to that level at which demand adjusts itself to supply; and if it increases demand by pumping new money into circulation again and again, it itself forces supply to oppose demand at an increased price level, because otherwise the correspondence between demand and the possibility of its satisfaction would be lost.

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Every economic process has certain economic consequences. These consequences cannot be eliminated by any law or administrative act. One can only change their outward manifestation. If, for example, a bad harvest causes the food stock of a country closed to foreign countries to fall by half and the price of bread, meat, etc., to rise so high that the poorer part of the population is condemned to starvation, the state can confiscate the stocks and distribute them among the population according to some formula.
