

## UNEMPLOYMENT

# AS A PROBLEM OF TURNOVER CREDITS AND THE SUPPLY OF MEANS OF PAYMENT

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**A DEFENCE OF THE "BANKING SCHOOL" OR "REAL BILLS DOCTRINE"  
AGAINST THE INFLATIONISTS, THE DEFLATIONISTS AND THE "CURRENCY SCHOOL",  
WITH A FUNDAMENTAL DISCUSSION OF "FREE BANKING" PRINCIPLES & PRACTICES.**

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*Two peace books by John Zube contain also much on monetary freedom. They are now accessible either through [www.territorial.info](http://www.territorial.info) or [www.panarchism.info](http://www.panarchism.info)*

*The libertarian CD-ROM project is also especially intended for free banking writings: [www.butterbach.net/project.htm](http://www.butterbach.net/project.htm)*

*Many more monetary freedom titles can be found in LMP's literature lists.*

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"Since banks cannot even issue their own currencies, they are not allowed a free market in the very commodity (money) in which they deal!"

Terry Arthur in "95% is Crap".

"All writers on Scottish banking agree in praising its effects on the prosperity of the country. Within 150 years, under the double influence of her banking and educational system, Scotland sprang from her barbarous state to the position of being the most prosperous country in Europe. Adam Smith, quoting from a report, states that the trade of Glasgow doubled within fifteen years of the establishment of banking there."

Henry Meulen in, *Free Banking*, chapter VIII.

"Credit money, based on human products:

Each producer mints his own money

in conjunction with his own banker.

That is the true function of bankers - dealers in debt."

Dr. H. G. Pearce.

"Good and honest banking is not impossible - it's just illegal." JZ.

"As the government obviously cannot supply an honest and inflation-proof currency - let private enterprise do the job!" - J.Z.

To provide for monetary exchanges is no more a sovereign right of governments than to provide nappy exchanges. - J.Z.

"... governments cannot be trusted with power to determine what traders should use as a medium of exchange."

Leonard E. Read, *THE FREEMAN*, 1/75.

"Cetero censeo: Exclusive and forced currency must be destroyed - in a monetary revolution, by being out competed and refused.

We won't have widespread peace, freedom and wealth without this step." - J.Z.

"It is State interference with the money supply that causes the alternation of boom and slump - the succession of boom and slump that provides the chief target of criticism in the socialist attack on capitalism."

Henry Meulen, in "THE INDIVIDUALIST", 6175 .

... state control of money was generally started as a source of revenue."

Henry Meulen, in "THE INDIVIDUALIST", 12/74.

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# UNEMPLOYMENT AS A PROBLEM OF TURNOVER CREDITS

## AND THE SUPPLY OF MEANS OF PAYMENT

### A) BANKS OF ISSUE AND BANKNOTES AS MEANS FOR ORGANISING MUTUAL TURNOVER

#### 1. NEED FOR AN ORGANIZATION LINKING PRODUCTION AND CONSUMPTION.

It is manifestly not enough to state theoretically that the proceeds resulting from production are turned into incomes by the payment of wages and other costs. Instead, a firm and regular organized relation between production and consumption must be established.

One might see the ideal of such an organization in a CONTRACTUAL AGREEMENT of the individuals concerned, to obtain goods and services of every kind ONLY FROM ONE ANOTHER. In such an association, under proper organization, unemployment could never exist. Thus it could guarantee job opportunities to its members. (2)

During the historical development, not such marketing associations but historically grown communities played a role. During the Middle Ages it was especially the village and town economy which served, extraordinarily, to organise the relations between producers and consumers. With the end of the medieval system these organizations were largely abolished. Their place was taken, in the modern economy with its numerous private exchange communities, by the BANKS. Thus the banks should not only be considered as profit-making enterprises.

Right from the beginning they had to fulfil certain functions in the life of the community which were of the greatest importance for the mutual employment of the citizens. One of the most important means of the financial technique used was the BILL OF EXCHANGE.

To describe in detail the development of banks as the payment and sales communities of the present, out of the transactions in bills of the late Middle Ages, would require too much time here. Thus it should suffice to reconstruct and isolate this development for today with the example of an ISLAND economy.

#### 2. BILL TRANSACTIONS

Let us leave for a moment our modern and all too complicated environment and examine the simple economic life on a small island. Everybody produces and everybody exchanges his goods for those products of other producers which he requires. The necessary import is paid for by exports. As MEANS OF EXCHANGE in the widest sense, only CONVEYANCES and MONEY are required for this. The problem of the PHYSICAL TRANSPORTATION of goods from place to place is today almost entirely solved. Railway and automobile see to that. But the monetary transactions are still unsolved and misunderstood.

How can one best explain money and credit transactions under such simple conditions? We need merely assume that EVERYTHING IS FIRST PAID FOR WITH BILLS. Thus, through the sale of my products, I acquired a CLAIM FOR THE SALES PRICE, an ASSET IN MONEY. The thus acquired asset is here, as in the modern economy, the NATURAL MEANS OF PAYMENT OF THE INDIVIDUAL, which, in principle, suffices everywhere:

When I buy my own requirements from various suppliers, then I have to give these suppliers only BILLS by which I CEDE to them this claim. The suppliers, in turn, can now use the claim, which belongs now to them, in order to pay for THAT which they had bought. If the bills are made to fall due at the day of the most important annual fair, then they need only be CLEARED when due, precisely as is done now on the Exchange settlement days. Thus all payment transactions could be settled. Should some traders have bought MORE than they had received for their own products, then the small remaining balances had to be paid in CASH, e g. in coins, which usually did not make any difficulties. It is clear that this method of payment, which existed for centuries, served best for the exchange of

goods. Moreover, it could NOT be DISTURBED BY FOREIGN INFLUENCES, unless a shortage of paper or ink arose.

### 3. THE TRANSITION TO THE MODERN CREDIT SYSTEM

This type of economy presupposed that everybody associated in this payment community, was known to the other members and thus had a certain amount of CREDIT. (That credit would have permitted the carrying over of small and still unsettled balances from the last clearing day to the next one, rather than forcing the debtor to pay in cash. - J.Z., 26.12.02.)

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This fundamental condition was shaken WITH THE ABOLITION OF THE GUILDS. A nameless proletariat arose of workers working by the day or week. These did no longer receive the major part of their income in free board and lodging at their master's house and a single payment at the annual fair. Instead, they were more and more paid weekly, with a cash wage which, originally, could not be supplied in cash means of payment. The old system could no longer cope with this new task. The bills were mostly for large and uneven amounts. They were indivisible and thus useless for wage payments. They were neither guaranteed not, as yet, due. Thus they were unsuitable as general means of payment.

### 4. THE SCOTTISH BANKNOTE AS THE BASIS FOR THE CLASSICAL SYSTEM OF NOTE-ISSUING BANKS

From 1695 onwards the SCOTTISH NOTE-ISSUING BANKS created the BANKNOTE and thereby established the modern money and credit system. THEY CONVERTED the bills made out in uneven and much too large amounts into TYPIFIED PIECES, let us say of 10, 20, 50, 100 RM (or Francs, Pounds or Pesos) and ADDED THEIR OWN SIGNATURE. Thus they INSURED them in order to eliminate the credit risk. These banknotes were, so to speak, "CUT UP BILLS". They must not be confused with the notes of the Bank of England, which originated from the deposit certificates of the goldsmiths and which, under Peel's Bank Act, have still not entirely lost the character of gold deposit certificates, even today.

While the rise of the modern factory system had INTERRUPTED the circulation of the means of payment (the bills) at the point where the manufacturer wanted to pass on to his anonymous workforce the means of payment he had received, as wages, the circulation became CLOSED AGAIN by means of this invention. THE BANK, AT THIS POINT, CONVERTED THE CUMBERSOME BILLS INTO HANDY AND GUARANTEED PIECES WHICH THEN CONTINUED THE PROCESS OF CIRCULATION.

Now we need ONLY insert ANOTHER THREE COMPLICATIONS: TURNOVER CREDIT, CASH-LESS BANK TRANSFERS and the MONOPOLISATION OF THE NOTE ISSUE, to find ourselves IN THE MIDST OF THE MODERN MONEY AND CREDIT SYSTEM and to be able to understand HOW IT IS POSSIBLE THAT THE UNEMPLOYED MAY NOT PRODUCE THAT WHAT THEY WANT TO CONSUME AND WHY THE WORKERS ARE NOT PUT INTO THE POSITION WHERE THEY CAN CONSUME WHAT THEY HAVE PRODUCED.

### 5. THE DEFERRED PROCEEDS FROM SALES AS THE BASIS FOR TURNOVER CREDITS

Let us look, first of all, somewhat closer at HOW the SCOTTISH BANKNOTES GET INTO CIRCULATION and, what is almost still more important, HOW THEY RETURN FROM CIRCULATION.

The manufacturer, who delivers the bill to the bank, almost always sells ON CREDIT. The wholesaler, supplied by him, PASSES THIS CREDIT ON to the retailer. Thus is made possible the GOODS STORAGE at the retailers which has become economically indispensable and without which neither the selection of goods nor their continuous supply are possible.

While the manufacturer receives only bills when selling his goods, bills which fall due in e.g., 2 months, he has IMMEDIATELY to pay the WAGES for the labour spent on the products, to his labourers. THIS TIME INTERVAL IS ALSO BRIDGED BY THE SCOTTISH NOTE-ISSUING BANK.

It replaces the later due bills with IMMEDIATELY DUE ONES and with this "DISCOUNTING" it supplies a further extremely valuable service in addition to the "TYPIIFICATION" and the "GUARANTY" which were already spoken of.

## 6. THE TURNOVER CREDIT

The bank which discounts the customers' bills handed in by the manufacturer, and which thus converts an inconvenient means of exchange into a convenient one, does also grant CREDIT as it simultaneously discounts, i.e. supplies IMMEDIATELY DUE SECURITIES for those which are NOT YET DUE. It gives the credit exclusively in its own notes.

This credit is a pure goods and turnover credit since it serves not for a loan on stocks, for speculation or other purposes, but, exclusively, for facilitating the sale of goods on short terms, i.e. for bridging the transport and sales period. **Genuine turnover credit is only granted on the proceeds of goods already sold.**

## 7. THE TURNOVER CREDIT BUSINESS OF BANKS

While circulating, the banknotes, thus put into trading, represent the equivalent to the products sold by the manufacturer but which have not yet got into the hands of the ultimate consumer.

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When the manufacturer has sold goods for 100,000 RM (Francs, Pounds, Pesos) and, correspondingly, discounted bills for 100,000 RM (3) then these 100,000 RM wage monies must remain in circulation UNTIL THE DAY on which the wage earners decide upon PURCHASES in the stores. For the same period, naturally, the products remain unsold to the ultimate consumers. On the day of the sale to the ultimate consumer, THE PATH OF THE GOODS ENDS AND THE REFLUX OF THE NOTES BEGINS. Then the goods have been removed from the storekeepers' shelves and require no further financing. The storekeepers use the banknotes received to pay the WHOLESALERS from whom they received the goods and the wholesalers pay with these receipts the MANUFACTURERS who, in turn, and with these means repay their credits from the bank.

Hence the circulation period of the sold goods BEGINS approximately when the corresponding wages are paid and it ENDS through the transfer of the goods into the hands of the ultimate consumers, exactly AT THE POINT where the notes in the pockets of the wage earners are spent and begin their reflux.

The circulation period of the goods and that of the commercial bills, that is, the length of the goods credit and the circulation period of the banknotes, must therefore have been approximately EQUAL in the classical banking ideal.

By this correspondence of the origin of the goods with the origin of the money circulation, and of the end of the goods with the end of the money circulation, which was always DEMANDED by the BANKING THEORY and which was realized by the practice of the Reichsbank until 1914 (4), a MUCH MORE PRECISE QUANTITATIVE REGULATION OF THE MONEY CIRCULATION is achieved, as well as a much more certain exclusion of unsuitable credit demands, than can ever be offered (5) by the CURRENCY THEORY and the policy to stabilise the price level, especially after the ruinous experiences of the last few years.

IT IS THUS THE TASK OF SUCH A BANK TO GRANT THE BILL CREDIT FOR JUST AS MANY DAYS AS THE NOTES USUALLY REMAIN IN THE POCKETS OF THE WAGE EARNERS (which depends on the distribution of the household budget expenditures over the whole wage period), PROLONGED BY THE PERIOD REQUIRED FOR THE REFLUX OF THE NOTES FROM THE STOREKEEPER TO THE BANK.

Should the wholesaler, or any other link in the chain, feel inclined to temporarily invest the money received, then the maturing of the bills will prevent him from obstructing the rapid reflux of the notes.

Many bank directors of today will, it is true, not want to admit THAT TODAY ALSO the activity of the credit bank ought scarcely to differ from this process - as will soon be shown. For then they would confess that their own operations with parcels of shares, large scale credits and other "transactions" have not the significance which one would like to ascribe to them.

## 8. THE REDEMPTION OF THE BANKNOTES ISSUED

With what means, therefore, does this ideal turnover credit bank redeem its banknotes?

Not by keeping a gold treasure in readiness, like a goldsmith's bank which issues gold deposit certificates in the speculative hope that the bearers will hold on to the notes for a long time (Bank of England) - but, simply, through a kind of WITHDRAWAL WHILE RETURNING THE BILLS OF EXCHANGE RECEIVED. This withdrawal is nothing but the reversal of the exchange act which was first undertaken. The credits were granted for the period corresponding to the movement of the goods from the manufacturer into the hands of the ultimate consumer. They become due when the stocks of goods are sold. The manufacturers are also ready and forced to repay them (because they must have sales receipts and must redeem the discounted bills), and the bank does nothing else but merely reverse the initial exchange.

Upon return of the banknotes, it surrenders the now paid for bill documents. IT EXCHANGES THE BANKNOTES INTO BILLS OF EXCHANGE. AFTER, PREVIOUSLY, HAVING CHANGED THE BILLS INTO NOTES, THAT IS, IT UNDERTAKES A RETURN DEAL.

Provided, it issues all notes in the indicated manner then it requires no gold reserve.

**The note circulation is sound if the bank declares itself willing to accept its own notes in this way, in all payments to itself and at any time, and if, moreover, it takes care that continuously as many payments as possible are to be made to its cashiers - by granting SHORT term credits and credits exclusively upon sales proceeds and to sound debtors only.**

The secret of the value of such free notes lies in the continuous DEMAND for them - because notes are continuously needed for making due payments to the bank.

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## 9. THE NOTE CREDIT AS EXCHANGE OR CONVERSION CREDIT

According to the admirable classical system, a turnover credit is thus merely an exchange or conversion credit in which inconvenient means of payment are transformed into convenient ones or claims from sales are transformed into claims against a bank. All the disturbances under which today's credit system suffers, cannot happen under this system as discount or exchange credits, to state it again, are only granted for as many days as are needed to get the goods from the sale at the factory into the hands of the ultimate consumer. This period coincides with the number of days for which the wage earners retain the banknotes in order to have enough means of payment until next pay day.

## 10. THE SOURCE OF TURNOVER CREDIT

**It is thus ALL NOTE HOLDERS TOGETHER who finance the whole goods turnover from the producer to the consumer. The note holders, between them, have in this always as much purchasing power as there are goods in transit and in the hands of the wholesalers and retailers. Through holding the notes, the note holders extend to the banks as much credit as is required for financing the passage of these goods.**

With the spending of every 100 RM (Francs, Pounds or Pesos) note by the note holder, in the stores, the equivalent of 100 RM worth of goods are paid for and require no longer any financing. The note circulation is, correspondingly, reduced and, lastly, the credit to the bank, and by the bank, is reduced by 100 RM.

Thus the goods turnover is financed from a source which is ADEQUATE regarding amount and duration and is inexorably correlated to the yield.

## 11. ELASTICITY AND PREVENTION OF ABUSES

Always as much money is issued under this system as goods are produced and, continuously, as much money is withdrawn from circulation as goods are consumed. It need never happen that goods in all spheres are simultaneously unsaleable due to there being not enough money around because any "increase of the quantity of money would bring the danger of inflation" etc. Here we can never have either a shortage or an excess of turnover

credit because RISING SALES by manufacturers PRODUCE also additional bill material and additional amounts in banknotes, in the pockets of additionally employed labourers, during the payment period, and vice versa, - if only no serious technical mistakes are made.

DEFLATION is not possible under this system since the banks will compete with each other to grant advances upon the rather limited genuine claims out of goods sales, with the result that the interest rates for sound credits cannot rise by much above the handling costs of the banks.

An EXCESS is likewise not possible, in spite of the absence of a metallic cover, for on the same day that the notes return, the advanced sales proceeds of the goods also arrive at the bank. On this day the notes are returned to the bank by people who want to repay credits just due to be repaid. The notes are RE-EXCHANGED just like mortgage bonds of a mortgage bonds are credited on the current account of a mortgage debtor, when he hands them in for amortisation purposes.

ONLY A CREDIT TRANSFORMATION, NOT A CREDIT CREATION occurs. The mortgage banks are likewise incapable of producing an inflation, if they do nothing but transform difficult fungible mortgages into easily fungible mortgage bonds, thus giving an existing claim a better form. Every abuse, every step beyond this, spells INFLATION.

Apart from credit transformation there exists only the credit creation which is ALWAYS inflationary. Only the absolute restriction to transformation excludes inflation. (On the qualification on this statement see below. Legal tender is required to inflate a paper currency. Otherwise this "creator" creates merely a discount of his currency. - J.Z., 26.12.02.)

12. EXCLUDING THE DANGER OF INFLATION THROUGH THE PRINCIPLE OF A FREE MARKET RATE FOR MEANS OF PAYMENT, THUS AVOIDING COMPULSORY ACCEPTANCE AND FORCED VALUE (LEGAL TENDER).

This restriction to transformed credit requires effective safety measures so that it does not remain a mere idealistic principle with compliance being left to the good will and discretion of the banker. The Scottish system recognises

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the weakness of men and is distinguished from all other systems by technically excluding inflation through an organisational measure, i.e., THROUGH THE FREE MARKET RATE FOR BANKNOTES, which is the opposite of compulsory acceptance and forced currency (legal tender), both of which are not improvements but a "deterioration" of banknotes.

Once the bank issues TOO MANY banknotes, i.e. as soon as it makes advances upon other claims than for the purchase price claims from goods sales, or grants longer credit periods, it can no longer redeem the notes by re-exchanging them. Then it must try to pay with somehow obtained cash means, gold, foreign exchange etc., when the notes return. When this abuse reaches noticeable proportions, then the notes are depreciated (discounted) as the necessary demand for them is no longer achieved by sufficient maturities of bills. The notes of this bank depreciate by comparison with other sound means of payment in the country. They are then only reluctantly accepted and only at a discount at perhaps, 90 % or even 70 % of their nominal value.

Such a bank could not grant any new credits at all as the debtor would receive only 70% and would risk having to repay the depreciated credit at 100% and, moreover, his labourers would refuse to accept as bad means of payment. One would refuse to accept such notes like one refuses to accept cheques drawn upon an insolvent bank.

(Note by JZ: Here Rittershausen seems to overlook the other side of the coin: A new debtor does not have to take a loan of 100 RM in these banknotes as a loan of 100RM, reckoned in stable value RM, but e.g. only as one of 70 RM, if this rate corresponds to their exchange rate on the market. Naturally, he could also altogether refuse these notes. But he would not be likely to do so in our example. Seeing that the issuer has to take his own notes at any time at par (otherwise he would be liable to fraud charges), the debtor could immediately repay his 70 RM - in stable RM - with a mere 70 RM - in nominal values - of these depreciated notes, thus leaving the bank with a loss of 30% and him with a profit of 30 RM - in, admittedly, depreciated - notes. This, probably more than the reverse, would prevent the bank from over-issuing - in its own interest!)

Such a system is only feasible when several note-issuing banks exist parallel to each other and when, apart from the banknotes, also sound coins and State paper money circulate. It existed, in almost all countries of the world, for more than 100 years.

(Note by JZ: The sound coins could be private ones. Likewise, the sound State paper money could be replaced e.g. by sound private local currencies made of paper. What is really necessary for the development of a free market rate of means of exchange, is only stable value reckoning. This could, for instance and for the time being, be achieved by a free gold market, freedom for pricing in gold weight units and a free market rate for all exchange media which transfer such gold weight values.)

### 13. PROVISION OF EMPLOYMENT THROUGH TURNOVER CREDIT

#### OR THROUGH INVESTMENT CREDIT?

Time and again we meet the assertion that the provision of employment through sound exchange of consumer goods by means of credits would act inflationary. This question is, therefore, of decisive importance.

If one will not or cannot employ labourers through investments by means of latent capital formation then, obviously, one must achieve that the unemployed produce themselves those goods which they want to consume and, furthermore, that they are placed in a position where they can consume what they have produced. For this only sound banks and turnover credits are prime necessities. Means of production and tools are mostly available in abundance, in the form of shut-down factories etc. Moreover, the still operating factories and agricultural enterprises would gladly engage unemployed, if sales were no problem. And additional sales would begin from the moment the unemployed are set to work in these factories - because from then on they would receive wages and additional income which they would spend (thereby giving orders).

Such income would, in the meantime, consist in the advances of the banks, until the money circuit is completed, the goods circulation made possible thereby, the money has flown back to the issuing bank and the goods are consumed.

Advances and banknote issue must precede. They cannot follow the turnover of goods, for otherwise, because of lack of means of exchange, there would be no such goods turnover.

Once the money circle is closed and the goods are consumed, then this game can begin anew. Thus a continuous process of exchange is begun whereby in most countries more than 3/4 of the population live:

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Namely from the mutual production for one another, from the mutual sale to one another.

Although in most countries the present crisis was probably initiated by a disturbance of the process of investment and capital accumulation, it has, nevertheless, been greatly aggravated by the subsequent increasing disturbances of the turnover and exchange process.

Every attempt to provide employment in this way is, usually, thwarted by the argument that inflation would occur. This is all the worse as this way of providing employment is, obviously, the easiest and most natural one. It does not require any long-term indebtedness with all its dangers. Neither customers nor banks run greater risks: the turnover credit is usually repaid within a few weeks. The unemployed are not employed just ONCE for one or two years, for an expenditure of several milliards, instead, they are PERMANENTLY RE-INTEGRATED in the natural process of production.

That a healthy process of capital formation and investment is always continuous but works over longer periods of time, the author has shown in his monograph "Arbeitslosigkeit und Kapitalbildung (Unemployment and Capital Formation)", Fischer, Jena, 1930. But there the continuity is more difficult to recognize, more dangerous and less popular. This is one reason to PRIMARILY restore the turnover process, the basis of our whole economic life, the precondition for the activity of saving and investing.

### 14. THE CONCEPTS "VALUE STANDARD" AND "FORCED, CURRENCY" (LEGAL TENDER)

To understand the argument of a danger of inflation, which is always upheld against any provision of employment by means of organising the turnover credit, we have to briefly analyse these two basic concepts and to call attention to certain aspects which were no longer sufficiently observed by the schools of monetary boom and bust theories of the last few decades, no matter how dominant they had been before the war in all large countries of the continent, from Germany to Spain.

The VALUE STANDARD is no more than the legal declaration that the legal unit for measuring values is called this or that name, say Reichsmark or Peso, and is equal in value to so or so many grams of fine gold. The best parallel for this is the MEASURE OF LENGTH called the "metre", which is equal in length to a bar of platinum kept in a deep cellar in Paris. All metre measures the world over which are longer or shorter than this bar are wrong. They are not metres. Likewise, all Reichsmark notes which are worth less or more than the determined amount of gold, are wrong and are not Reichsmark. In this simple situation it seems inconceivable how an inflation is possible at all.

But even this is explained by the metre parallel. If the government, e.g. in order to aid the textile industry, passed a law that a metre measure need merely be made of PINE-WOOD in order to be a legal metre measure (Forced Metre), then the inflation begins. Then the dishonest merchant, who would cut a piece from this metre measure off, in order to receive more money for the same bale of cloth, could no longer be prevented from doing so, for in every prosecution the court would have to admit that the quantity of the cloth was correctly measured inasmuch as the legally prescribed pine-wood metre was used. This economic abuse would not at all be stopped by e.g., breaking the platinum bar in Paris (or by abolishing the gold standard), BUT, EXCLUSIVELY, BY REVOKING THE ACT WHICH CONFERS LEGAL MEASURING POWER TO ANY OTHER METRE MEASURES THAN THE ONE ORIGINAL METRE IN PARIS.

(Note by J.Z., 26.12.02: In this version this is not a good analogy. Wooden, plastic, cloth and steel tape meters are extensively used and mostly reasonably accurate. Shortening would be noticed because they have millimetre and centimetre markings and because numerous competing measures are owned by the buyers. Thus a cheating merchant would soon be found out and denounced and might lose his business. Without legal tender the cheap length measures are, nevertheless, good enough & voluntarily accepted substitutes length measures for most purposes, just like the agreement upon a gold weight unit for pricing and clearing only, would be a good substitute for a gold coin or gold bar of the same weight. Thus the single metre standard, in rare metal, can be cheaply and effectively substituted by millions of meter measures made out of cheap materials, serving many of the length measuring requirements of the world, while the single and original one in Paris could serve only for a small fraction of all needed length measures. The rare metal original does not have to be present for all or even any transactions, except a standard for checking cheap substitutes that are mass produced. Even this checking is done mainly with cheap substitutes. It does not have to be used in payment. Nor do accurate gold weight units have to be stored by issuers as a security or redemption fund somewhere. A free gold market would be enough to test the value of any paper currency reckoning in gold weight values. Through the free gold market the whole stock of gold, that is on the market at any time, could serve as a "redemption fund", while the issuer need neither possess any and nor redeem any of his notes with gold - but just with goods, services and receipts for the payment of other debts owed to him. Legal tender for shortened length measures would permit a government to pass as metres deteriorated length measures of, say, 95 cm, 90 cm or even less. The fraud involved would be so obvious even to not so intelligent people, that it could not be continued for long, as can be a depreciated and depreciating paper value standard under legal tender and the issue monopoly.)

**Likewise, INFLATION OF MONEY CAN ONLY OCCUR WHEN ONE CONCEDES CERTAIN PAPER MEANS OF PAYMENT THE LEGAL TENDER CHARACTERISTIC according to which they have still to be taken as 100 even if their value is only 90, i.e. when money is given FORCED CURRENCY.**

It is inconceivable how the original metre in Paris could be changed by some ironmonger selling spurious metre measures. Likewise, I could not understand how the gold currency of a country could be inflated by some bank issuing private notes that are worth only 90 or 80. Certainly, the note-holders can be cheated - but a general price increase cannot happen. At most, when no redemption is provided, everyone would hurry to bring the notes TO THE BANK for payments (at their nominal value) and the bill debtors of the bank would express a keen demand for these notes.

However, if the bill is bad, the bills had to be continuously prolonged - because the bank had issued notes on long terms, or the debtor got into undisclosed payment difficulties, then there is no application for such deteriorated notes, NO DEMAND for them, which could raise their exchange rate to par within a few hours. Instead, a lasting

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discount occurs - as we have seen in the history of the note-issuing banks, again and again. The bank is then paralysed. It is ripe for liquidation and other banks take its place.

## 15. A DANGER OF INFLATION IN PROVIDING EMPLOYMENT EXISTS ONLY

### WHEN THERE IS A FORCED CURRENCY

This principle cannot be stressed enough against the argument that inflation would threaten. All accessory means of payment which are not legal tender can, in case of abuse or over-issue, only ruin themselves but never the legal currency. The problem of a double currency can also no more arise among such free means of payment than with payment by cheques.

**Value standard and means of payment should be sharply distinguished.**

**Gresham's Law applies only to the coexistence of two inconvertible forced currencies and not to means of payment with a free market rate.**

With non-compulsory private means of payment one can no more inflate THAN ONE COULD DESTROY THE VALUE OF SHARES ON THE SHARE MARKET WITH DEPRECIATED SHARES. If Mr. L. issued 100 million Reichsmarks of worthless shares of a "Gigantic Share Company", and if he found buyers, then these unfortunate people have certainly lost their money. But it would not be obvious how the market price of IG Farben or Rio Tinto shares could possibly be reduced thereby. On the contrary, this instance demonstrates that the IG Farben Share would only be ruined if the government passed a law to give the Gigantic shares legal tender, if, to stay with our image, it declared these shares to be DELIVERABLE FOR IG FARBEN SHARES. Then, indeed, the IG Farben shares would fall very much and then Gresham's Law would also come into operation. The old and genuine IG Farben shares would disappear from the market.

Exactly as on the share market, so also on the money market (for banknotes etc.), the multiplication of redeemable money substitutes can never depreciate the currency (value standard). This followed already from the example of the metre measure.

The great money theorists have expressed themselves unambiguously on this subject:

Compare, among others, Knapp, "Staatliche Theorie des Geldes (State Theory of Money, 4th. edition, p. 161, von Mises, "Theorie des Geldes und der Umlaufsmittel" (Theory of Money and of Circulating Media ), 1924, p.331, Adolf Wagner, "Zettelbankpolitik" (Banks of Issue Policy), 1873, p. 36, Lexis, "Handwoerterbuch der Staatswissenschaften" (Encyclopaedia of Social Sciences), 3rd. edition, article "Cheque" etc., Carl Menger, ibid, article "Geld" (Money), vol. IV, pp. 601-603, J .G. Courcelle-Seneuil, "La Banque Libre" (The Free Bank), Paris, 1867, Horn, "Bankfreiheit" (Free Banking ), 1867, - it was also published in French, de Viti de Marco, "Finanzwissenschaft (bei Staatspapiergeld)", (The Science of Finance) (under state paper money ), 1931, see also the Acts concerning the "Kgl. Giro- u. Lehn Banco", 1765, the Royal Prussian Bank and the Reichsbank until 1910 (continuing explicit rejection of compulsory acceptance), R. Just, "Geldinflation" (Money Inflation ), Jena, 1921, p. 113 ff., Dr. Walter Zander, "Eisenbahngeld und Arbeitslosigkeit" (Railway Money and Unemployment ), Annalen der Gemeinwirtschaft, 1934, vol. 1, U. von Beckerath, "Die Durchfuehrung der Vorschlaege von Milhaud", (The Realization of Milhaud's Proposals), ibid, 1934, vol. X/1, Henry Meulen, Industrial Justice through Banking Reform, London,1917, etc.

Even Lord Overstone has said:

"When I mismanage my private bank then I am ruined but the public will suffer only little. But if the Bank of England makes a large mistake, then the bank can, indeed, save itself" (with the aid of legal tender - the author) "but extensive harm is caused for the whole community."

(Note by JZ: The last quotation is re-translated from German into English!)

A revival of the theory of a free market rate for means of payment appears, therefore, urgently necessary - in the interest of providing employment. Probably the period from 1815 to 1844 in England, with its doctrine resting wholly on legal tender, was as much a temporary error in the history of money as the after war period which we experience now.

The above named authors! whom we cannot quote here for lack of space, bring convincing and astonishing proofs for this supposition.

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## 16. THE GIRO TRANSACTIONS AS THE COMPLETION OF THE CLASSICAL SYSTEM

In principle, this originally Scottish credit and banknote system - this system of well thought out mutual provision of jobs, does not differ from the simplest bill of exchange operations which were our starting point. Even the GIRO TRANSACTIONS which we will now describe, amount only to a refinement and not to a deviation from the idea that the BANKING SYSTEM IS AN ORGANIZATION FOR MUTUAL GOODS SALES and has no other purpose than this.

("The banking system" as far as note issuing banks are concerned, issuing banknotes and other paper means of exchange. There are several other kinds of banks for other purposes. - J.Z., 26.12.02.)

We have so far assumed in our sketch that the entire payment circle is achieved entirely with banknotes. But today we see a large part of all payment transactions conducted in the much more simple and cheaper cash-less method of GIRO TRANSACTIONS: The retailers, who received from the 45 milliard Reichsmark of wages and salaries in Germany, in 1927, almost 40 milliard Reichsmark, do not attempt to bundle up these notes and dispatch them by registered mail to their suppliers (usually in other locations). Instead, THEY PAY THE DAILY TAKINGS ALREADY ON THE NEXT DAY into the nearest deposit and cheque bank and use the credit balance thus gained FOR TRANSFERS TO THEIR SUPPLIERS. While formerly the circuit for about 90% of the circulating cash ran as follows:

PART 1: Bank - pay office of the manufacturer - wage earner - shop,

PART 2: Shop - wholesaler - manufacturer - return to the bank,

today only the first part of this circuit is undertaken by the cash circulation as already the shopkeeper returns the notes to the bank and thereby ends the note circulation. Indeed, the retailer does not deposit this money into the account of the MANUFACTURER, who was debited with the turnover credit when the banknotes were originally issued, but, instead, he deposits them on HIS OWN account. Thus, with this deposit, the credit transaction is not at all finished but merely transformed. In this way the GIRO DEPOSITS at the bank RISE by exactly the amount that the banknote circulation was diminished on the same day. With the additional deposits the credit grant is CONTINUED. These new transferable deposits, taking the place of the second part of the classical circuit scheme, now WANDER, in form of bank transfers, THROUGH a long chain of bank accounts of the suppliers and sub-suppliers, until they arrive at last at the account of the original manufacturer. With that the bank credit which originated the banknote circulation is repaid. Simultaneously, the giro deposits drop to the original amount. Detailed researches showed that the cash circulation in Germany lasts today about 11 days and the subsequent giro circulation through the various clearing networks, another 15 days. Thus the CREDIT LIMITS of the banks for such credits should, in the average, be set for about 26 days.

Thus it is no longer all banknote holders together who today, by their possession of the notes which represent a credit grant, finance the goods circulation in an elastic way. Instead, almost 3/5 of the credit sphere does now originate from the owners of actually continuously turned-over giro accounts.

NOTE circulation and giro accounts COMBINED, however, have remained as elastic as, previously, the note circulation was on its own. Both ARISE from a TURNOVER CREDIT and DISAPPEAR through its REPAYMENT. Both are independent of the amount of savings deposits and of capital accumulation in a country and, also, independent from the intake of foreign credits. It is thus incorrect to speak of the necessity to accept foreign turnover capital. Both (note circulation and giro accounts), do not represent a fundamental change compared with the previous simple bill of exchange circuit but merely a refinement.

## B) THE GRADUAL DESTRUCTION OF THE CLASSICAL SYSTEM, FROM 1909 TO 1932, AS CAUSE OF THE DIFFICULTIES ENCOUNTERED IN RE-INTEGRATING THE UNEMPLOYED

### 1. CULMINATION AND DECLINE OF THE CLASSICAL SYSTEM

With the development of the GIRO AND CHEQUE TRANSACTIONS (which, however are yet capable of a large expansion as should be stated here quite expressly), the classical system could be considered as essentially COMPLETED. It was working for more than a century in Europe without leading to serious inflations or abuses. It has survived economic CRISES like that of 1857, which were equal to the present one. It has, therefore, undoubtedly, PROVEN itself.

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How the decline and fall of this once famous system is to be explained may here remain undiscussed. It happens, indeed, quite often that too great successes lead to stagnation, to a replacement of leading personalities by mere representative people - until it is almost too late, even for the best manager, to save the old system.

### 2. THE OBSCURATION OF THE CLASSICAL BANKING CONCEPTS THROUGH THE SEPARATION OF FUNCTIONS BETWEEN NOTE AND DEPOSIT BANKS

We will confine our description to the German conditions. This development went on in England, France, Spain, Italy and the U.S. almost exactly alike, as the reader can easily ascertain. Just as with the rise of the system, so also with its decline - only the general outlines of developments can be described here as the intention is ONLY to point out THE TEACHINGS of this great development over a century, the lesson for the catastrophic position of the banks AT PRESENT.

The first downward step is certainly to be seen in the SEPARATION OF THE NOTE ISSUE from the deposit bank business, by which our present-day banking operations are already externally distinguished from the Scottish Bank System. With this we come to the CENTRAL NOTE-ISSUING BANKS, today existing in almost all countries, and regarded as an untouchable achievement of the human spirit, but which, perhaps already in 50 years, will be abandoned in the lumber room of history as a scarcely intelligible concept.

This separation of functions was essentially HISTORICALLY developed. Aside the banks of issue, which discounted bills and also accepted deposits, there arose, in most countries (6) large JOINT STOCK BANKS which practised the deposit business and, as a counterpart, also the current account credit system (originally as an open financing of turnover without the bills of exchange discipline) and they DEVELOPED OVERPOWERINGLY. Naturally, they could only finance the last 3/5 of the goods turnover according to the classical system, as they could only seize for themselves the CASH-LESS part of a portion of the payment transactions. With regard to cash they remained dependent on the banks of issue.

(Note by JZ: I suspect that the growth of the banks of issue was retarded largely by the convertibility requirements imposed by the Currency School - which also led to a much smaller involvement in the growth of the clearing and transfer transactions.)

Thereby the simple structure of the classical system was OBSCURED for the first time. **The banks of issue thus became "banks of banks"**. Today they issue about 80% of their notes no longer to businessmen whose orders for raw materials and goods turnover they can clearly see in their accounts, but to BANKS which assure them that the NAMES of the bill debtors SOUND so well that they would even "unseen" stand surety with their endorsement, an assertion that has ALMOST NOTHING TO DO any longer with the INTENDED TURNOVER OPERATION and with the TRANSFORMATION OF SALES PROCEEDS into means of PAYMENT. It already embodies **the fatal substitution of the security principle for the turnover principle**.

Moreover, the large deposit banks do not present ALL goods bills to the central bank but merely some and this sporadically, when they are in need of cash. Thus the note issuing bank has lost all effective control.

Finally, the deposit banks offer their customers convenient current account credit and hence the businessmen have forgotten how to pay with bills of exchange - while the note-issuing banks continued to insist upon the old principle of commercial bills. Thus the banks of issue had finally to be satisfied with receiving obvious finance bills as the good bill material had become very rare.

NOW THE BANK OF ISSUE HAD TO ATTEMPT TO "FEEL OUT" (7) THE PROPER QUANTITY OF NOTES AS IT HAD LOST THE DIRECT CONTACT WITH THE EXCHANGE PROCESSES OF THE BUSINESS WORLD. INSTEAD, IT BECAME A CASH SUPPLY CENTRE FOR THE LEADING BANKS. Not the bank of issue determined how much it should issue but the leading banks fetched as much as they just needed. BUT WITH THIS ONE ARRIVED AT THE BORDERLINE OF THE NOW ENDLESS AND NOW RESTRICTED ISSUE OF NOTES WHICH IS CHARACTERISTIC FOR THE PAPER MONEY THAT, IN CONTRAST TO BANKNOTES, HAS RIGHTLY GIVEN THIS DANGEROUS TYPE OF MEANS OF PAYMENT A BAD NAME and which is an obstacle to the provision of employment.

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### 3. THE CENTRALISATION OF THE SYSTEM OF NOTE ISSUE AS AN INDICATION FOR THE TRANSITION FROM BANKNOTES TO PAPER MONEY

Hand in hand with this development ran the centralisation of the system of note issue. The State entered into close relations with one of the note issuing banks. He gave it privileges and entrusted all its payment transactions to it and accepted its notes at its pay offices. The notes of such a bank were bound to gain an unsound diffusion. They were NO LONGER EXCLUSIVELY based upon the fact that the institution EXCHANGED the new sales proceeds, daily arising from the continuous sales of the whole production, or rather the bills based on this, into a more convenient means of payment, but also, to some extent, upon the CREDIT OF THE STATE. This bank became the "central bank of issue" while the other banks of issue either disappeared or became insignificant.

**THIS MONOPOLISTIC SYSTEM which in such purity exists in no other sphere, could never have maintained itself if it had not offered - not to the State as a community of people - but, instead, to the STATE AS THE EXCHEQUER, IMMENSE ADVANTAGES.**

FR. KNAPP described the frequently recurring cases in which the State, in its emergencies, EXPLOITS THIS RICH BANK AS A SOURCE OF CREDIT:

"When this bank, semi-coerced, grants its "guardian", the State, large credits, which have nothing to do with the goods turnover, the question arises: '... HOW CAN IT REDEEM THE BANKNOTES FURTHERMORE? IT IS IMPOSSIBLE.' "

(Because the State cannot repay on the day the notes are presented for payment, i.e. after about 26 days.)

Knapp continued:

"This is well understood by the State. Accordingly, it decides, first by decree and later by law: The bank is released from the obligation to redeem."

The State then declares

"these notes to be legal currency (equal to LEGAL MEANS OF PAYMENT) ..."

Thus these notes get LEGAL TENDER for all payments between private people. Through this highly noteworthy process, which is usually only seen as a terrible accident, the cool observer can state the following: Money transactions do not come to an end although the currency HAS CHANGED ITS CHARACTER. IT DOES NO LONGER CONSIST OF SPECIE BUT OF PAPER. THE STATE HAS FALLEN INTO THE PAPER MONEY ECONOMY" (8 & 9)

The legal tender money represented by such "banknotes" with forced currency, obeys quite different laws than the genuine turnover bank money of the private payment community which has been described by us. In particular, IT CAN BE MULTIPLIED WITHOUT LIMITS AND IT CAN BE FORCED UPON PEOPLE AND IT IS THUS EXTREMELY DANGEROUS WITH REGARD TO INFLATION.

#### 4. THE FALL OF THE CLASSICAL SYSTEM THROUGH THE ABANDONMENT OF CONVERTIBILITY AND THE INTRODUCTION OF A FORCED CURRENCY (LEGAL TENDER)

Thus F. Knapp, the past master of German monetary theory, has described also for those, who cannot always follow his views, in a convincing and impressive manner and already a decade before the war, the approaching downfall of the classical credit system which, not so long afterwards was realized in Germany and in almost all countries, France excepted. Germany declared by an Act in 1909 the REICHSBANK NOTES TO BE LEGAL TENDER. Hence anyone had to accept them, nilly willy, at 100% . From then on no one could refuse them even when they were worth less than the gold value of the creditor's claim. The REDEMPTION OBLIGATION, this last weak barrier, fell later, in 1914. After the war, during the period of reconstruction of the German economy, precisely when a return to the sound pre-war principles would have been most advisable, in order to expedite a healthy recovery and to avoid spurious credits and non-transferable reparation payments, one has not even recognized the need to get away, again, from legal tender. The author has not heard of a single case of such a demand having been made.

The less important redemption obligation existed for little more than one year, from 17/5/1930 to 13/7/1931, at a time when the German credit system already threatened to break apart under the burden of the unbearable short term foreign indebtedness.

In such a desperate situation the redemption policy was unable to develop its healing powers - as the free market rate and the understanding of it were missing.

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#### 5. THE ABANDONMENT OF THE REDEMPTION OBLIGATION AND ITS CONSEQUENCES

As long as the redemption obligation existed, or, to quote Knapp again,

"as long as the bank is obliged to redeem its notes in money issued by the State, the State need take no further steps to keep the banknotes in their accessory position." (10).

Thus all other precautionary measures against the danger of inflation were superfluous because inflation is only possible under the rule of legal tender.

(Note by JZ: If the latter is true then rare metal redemption by the issuer, like other precautionary measures, is also unnecessary.)

Now, after the ABANDONMENT OF CONVERTIBILITY of the notes, SPECIAL BRAKES BECAME NECESSARY: THE GOLD BRAKE or gold cover, the unreliable and always lagging PRICE STATISTICS and, finally, after these have become unsuitable, the foreign exchange brake. With this the classical concept, whose renewed realisation is so necessary today, which sees in the money and credit system an aid to the goods turnover, has become ABANDONED AND A QUITE DIFFERENT KIND OF MONEY has been raised to the throne, i.e., PAPER MONEY as opposed to the banknotes. It is a peculiarity of paper money to fluctuate widely and without any stability between inflation and deflation. Only paper money can be subject to the excesses which we experienced in the years 1923 and 1931/2. Moreover, paper money deals with the financing of turnover only, so to speak, by the way, without achieving substantial results.

#### 6. THE IDENTITY OF THE RULE OF LEGAL TENDER, THE CENTRAL BANKING CONCEPT AND INFLATIONISM

This dangerous and economically condemnable regime of legal tender (11) would never have been resolved upon if it had not, apart from its advantages for the Exchequer, one characteristic which defeated all objective considerations:

**According to the dominant view the FINANCING OF WAR was impossible without a "strong bank of issue". Accordingly, in Germany in the year 1909, following the precedent set by other countries (12), as a preparatory measure for the possible war, the REICHSBANK NOTES WERE DECLARED LEGAL**

**TENDER. Again and again and in all countries, during discussions of the central bank problem, it was stressed how important a strong central bank of issue would be in case of war. With this argument the purely economic arguments, which mostly favoured decentralisation, were silenced, in all countries. (13)**

In reality, the FREE NOTE-ISSUING BANKS were, in case of war NOT 'STRONG,' MERELY BECAUSE THEY COULD NOT CAUSE AN INFLATION. THEY COULD not give the State any war credits because four weeks later they would have gone bankrupt because of this inflationary abuse.

It was overlooked that, according to Frh. von Stein (1812), we have, in a properly managed STATE PAPER MONEY WITH A FREE MARKET RATE, a much stronger and a harmless means to finance war.

(Note by JZ: Here it should be admitted that a large scale and unpopular war could be easier financed with inflation because thus its true costs could be better hidden from the population. Naturally, for the peaceful man this is only one more argument against legal tender.)

BEHIND THE DRIVE TOWARDS A "STRONG CENTRAL BANK" THE INTENTION WAS HIDDEN TO PRODUCE AN INFLATION, SOMETIME, and this is only conceivable when the redemption obligation is repealed and LEGAL TENDER IS INTRODUCED. THE IDEA OF CENTRAL BANKING AND INFLATIONISM ARE IDEOLOGICALLY AND HISTORICALLY INSEPARABLE. It is thus not surprising that Cassell and more and more representatives of the central banking system do recommend today the abolition of the gold standard and thereby publicly reveal themselves as inflationists. Every radical opponent of inflation must lastly also be an opponent of a "strong central bank" because this inevitably seduces into a legal tender regime and, thereby, into inflation. Likewise, he must wish for a restoration of the currency conditions prior to 1910, when the German economy, not without reasons, passed through an unprecedented period of prosperity without being threatened by inflation.

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#### 7. AFTER THE FALL OF THE BANKS FOLLOWED THE DESTRUCTION OF THE GERMAN MONETARY SYSTEM - BY THE CHANGEOVER FROM MONEY BASED ON COMMERCIAL BILLS TO MONEY BASED ON FINANCIAL BILLS

This long prepared decline was followed by a CATASTROPHIC BREACH which is now to be described. Until the summer of 1931 the Reichsbank complied with the paragraphs 28 and 25, sections 6 and 21 of the Bank Act which limited the activity of the Reichsbank quite definitely, namely, in essence, to the discounting OF BILLS OF EXCHANGE MATURING IN AT MOST THREE MONTHS. Aside from gold, and cheques in transition, these ALONE WERE PERMITTED AS COVER FOR THE NOTE ISSUE.

Par. 28 runs:

"a) Gold cover of 40%.

b) For the remainder, discounted bills and cheques which satisfy the requirements listed in par. 21."

This Par. 21 determined, at the end of section 2:

"THE BILLS DISCOUNTED BY THE BANK SHALL ONLY BE GOOD COMMERCIAL BILLS."

**Dr. Hjalmar Schacht commented upon this important clause in his Commentary, on p. 142, as follows:**

**"With regard to the purpose of the banks of issue, the previously applied principle that the bills discounted by the bank must exclusively be good commercial bills, has been expressly laid down in the new Bank Act. Thereby the Bank is PROHIBITED from discounting any other bills, e.g., the so-called FINANCE OR CREDIT BILLS or of bills which are drawn for speculative purposes."**

The penal clauses also refer to these two paragraphs, thereby stressing their importance still further.

CONSEQUENTLY, the Bank Act allows ONLY TWO KINDS of banknotes which we may name, with G. Ramin, in order to state the subject quite plainly, GOLD MONEY AND COMMERCIAL BILL MONEY. (14)

This does also correspond to the terminology of paragraph 28.

CONTRARY to these provisions, since the credit crisis of 1931, THE REICHSBANK HAD DISCOUNTED FINANCIAL BILLS to the amount of about 2,000 million Marks. This is generally known and documented by the creation of the "Akzept und Garantiebank" (Acceptance and Guaranty Bank). These financial bills were accepted to

maintain the solvency of the illiquid credit banks which had exaggerated the deposit system. Here the Reichsbank did not give advances upon sales proceeds but, instead, took over the illiquid assets of the large banks and savings institutions, assets which do not liquidate themselves but require continuous prolongations, contrary to the 3 months limit. In addition, it granted the municipalities and savings institutions credits of over 1,300 million RM, also of a long term kind. As it was not authorised to grant these credits, either, it masked these illiquid loans by transforming them into bills and by the involvement of the "Akzept und Garantiebank" (Acceptance and Guaranty Bank) which was especially founded to bypass the law. Thereby it offended against a further clause of the current Bank Act: Par. 25, sec. 6 determines that the Reichsbank may NEITHER INDIRECTLY NOR DIRECTLY grant any credits to the Reich, its component States and the municipalities, apart from a current account credit of 100 million RM and a treasury bill discount of up to 400 million RM (paragraphs 21, Nos. 2a and 3g).

Moreover, the Reichsbank neglected everything necessary to ensure the disappearance of this illegal and dangerous financial bill money and to restore the lawful condition.

#### 8. THE REICHSBANK IS, TEMPORARILY, THE-LARGEST MORTGAGE BANK.

#### LACK OF A HEALTHY BANK SYSTEM PREVENTS THE RE-INTEGRATION OF THE UNEMPLOYED IN THE ECONOMY

Through the Reichsbank's ignoring, from 1931 to March 1933, the provisions of the Bank Act and issuing financial bill money for half to two thirds of its note circulation, a prolonged moratorium for the banks was, indeed, avoided. But this did not improve the situation of these institutions and of the industries and masses of workers dependent upon them. The obligation towards the Reichsbank took the place of the vanished deposits. The Reichsbank thus became, so to speak, the largest depositor of the banks and was prevented from taking action. It became increasingly more dependent on the banks. The debtors became less and less solvent since the goods turnover steadily diminished because the healthy turnover credit could no longer be sufficiently financed. (Compare on this the remarks of Dr. Schacht, among others.)

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Only the forced sales of the means of production themselves remained, that is of the factories and the real estate and they would yield almost nothing and led to the total depreciation of all book values and to the greatest discontent of the masses of unemployed which grew parallel with this development. No longer goods turnover but real estate assets become now the basis for Reichsbank loans. Therefore, it became, for a time, the LARGEST MORTGAGE BANK OF GERMANY and its notes at that period might accurately be called non-interest bearing MORTGAGE BONDS in small denominations. The German banks, being dependent upon the Central Bank, were also paralysed thereby. A BANKING SYSTEM WAS LACKING to make the circulation of goods possible and to organise the mutual securing of employment by the people, by mutually giving orders. In consequence, under the influence of these and the following mistakes, THE NUMBER OF UNEMPLOYED in Germany INCREASED TO 6 MILLION. If one includes the statistically not recorded and thus omitted unemployed, then one arrives at approximately 8 million. (Compare the table below.)

T A B L E I

At the close of	Number of Employed (1)	Social Service Recipients		Welfare Unemployed (2)	Total of Unemployed (3)
		Unemployment Insurance	Crisis Assistance		

#### IN THOUSANDS

March	1931	14,092	2,317	923	1,027	4,744
June	1931	15,253	1,412	941	1,098	3,954
Dec.	1931	12,440	1,542	1,506	1,697	5,668
Jan.	1932	12,085	1,885	1,596	1,858	6,042
Feb.	1932	11,928	1,852	1,674	1,994	6,128
Sep.	1932	12,834	618	1,231	2,550	5,103

Dec.	1932	11,983	722	1,281	2,800	5,103
Jan.	1933	11,487	953	1,419	2,860	6,014
Feb.	1933	11,533	942	1,513	2,880	6,001
June	1933	13,307	416	1,310	2,430 (4)	4,857
Oct.	1933	14,063	317	1,072	1,487	3,745
Nov.	1933	14,020	345	1,058	1,434	3,715
Dec.	1933	13,020	554	1,175	1,410	4,058
Jan.	1934	13,518	549	1,166	1,317	4,058
Feb.	1934	13,690	419	1,087	1,188	3,374
March	1934	14,687	249	911	984	2,798
April	1934	15,362	219	841	884	2,609

- (1) According to the (purged) statistics of the health insurance companies.
- (2) According to the local welfare associations. The number of the welfare recipients simultaneously recognized by the employment offices is always lower.
- (3) At the employment offices.
- (4) The number of the welfare-unemployed for April to June has afterwards been corrected by the German "Gemeindetag". Since June it does no longer include welfare and emergency programme workers.

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Of the trade union members finally more than 45% were unemployed. (They kept their wages above the market level! - J.Z., 26.12.02.)

The causal and simultaneous connection with the degeneration of credit could be shown in details. But we will now continue listing the phenomena in the decline of the turnover credit which caused these terrible disasters.

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## 9. THE FATEFUL COMPENSATION OF AN INFLATION OF FINANCIAL BILL MONEY BY A DEFLATION OF COMMERCIAL BILL MONEY

**If one had issued as much financial bill money in normal times, then an inflation would have resulted. That, at that time, no inflation followed, is explained by the fact that a corresponding amount of sound commercial bill money was displaced.**

In order to be able to maintain the numerous rotten credits, one organized AN ABNORMAL AND DEFLATIONARY RESTRICTION OF THE COMMERCIAL BILL MONEY. Since turnover credit is as indispensable for the marketing of goods as their dispatch by railway and trucks, the goods turnover of the economy was thereby most seriously disturbed. ONE HAD PARALYSED ABOUT ONE THIRD OF THE TOTAL GOODS TURNOVER IN THE COUNTRY in order to be able to fulfil the categorical demands of rotten institutions whose interests were separate from those of the whole community, and in order to save their managers, whose debit balances one could not examine because some of these personalities called themselves experts and even resorted to scientific arguments.

Through the thus enforced unsaleability of goods, at a time of greatest unemployment, so many even of the solid enterprises were brought to the edge of the abyss that the whole of the assets of the banks were in jeopardy. The remedy commonly recommended by egoistic, naive and scientifically untrained "experts" proved to be a DESTRUCTIVE MEASURE OF THE FIRST ORDER for the banks. It could not even safeguard the private fortunes of the bank directors as the disaster assumed unexpected proportions and spread like wild fire.

It was assumed, when the financial bill money was issued, that a high interest rate would soon achieve its reflux. Accordingly, an increase of the discount rate to 30% was demanded. In this one forgot that with FINANCIAL BILL MONEY, which was the ultimate cause of all inflations yet experienced, the effective reflux of the commercial bill is entirely absent since the underlying credits are economically long term ones.

The PERNICIOUS CONSEQUENCE of this false theory of the advantage of a high interest rate was that THIS ENORMOUS DISCOUNT RATE of, at times, 15% and, later, still 10 and 7%, was ALSO applied TO THE COMMERCIAL BILL MONEY whereby the deflationary paralysis of the goods exchange was carried still further.

Thus, by 1932, WE WERE CONFRONTED WITH THE ALTERNATIVE OF EITHER A PRIMITIVE BARTER EXCHANGE OF GOODS or a radical break with the present system, combined with a return to proven credit principles.

#### 10. THE FALSE SUPPORT OF THE BANKS INCREASES UNEMPLOYMENT

The Reichsbank thus supported sick banks and gave the impression that they were backed by the Reich. This "virtual State guaranty" led the population to withdraw, in the middle of the crisis, their balances from the healthy banks that were actively concerned with turnover and the provision of employment. Furthermore, the healthy enterprises were saddled with the cost of this assistance to the banks, of over 1.5 milliard Reichsmark, through taxation, whilst the sick banks paid almost no taxes or were altogether exempted. This penalising of good economic conduct and of the ACTIVE PROVISION OF EMPLOYMENT WAS FOLLOWED, IN THE SUCCEEDING YEARS, BY THE WORST CONSEQUENCES:

A large proportion, especially of the best entrepreneurs, of the medium and small scale industries, upon whom Germany's wealth in manpower and jobs and its strength, especially in exports, had rested, were wiped out while speculative corporations, built by economically inexpert persons, remained in operation, with greater and greater losses, until Dr. Schacht, here also, came to the rescue in the Spring of 1933.

Dr. LUTHER had taken over from his predecessor, Reichsbank President Dr. Hjalmar SCHACHT, in Spring 1930, a sound Reichsbank, holding almost 3 milliards in gold and foreign exchange and ample reserves. According to its balance sheet it disposed on 31/12/1931 still over the following imposing holdings in gold and foreign exchange:

#### A S S E T S

1. Gold holdings, unencumbered (bars, domestic & foreign coins):	
a) in the bank safes .....	1 993 550 688.00 RM
b) with foreign central banks .....	222 230 965.00 RM
2. Holdings in foreign bills and cheques .....	290 733 661.00 RM
<hr/>	
Gold and foreign exchange total:	<u>2 506 515 314.00 RM</u>

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These assets were taken over by Dr. Luther. When he departed and handed back the management to Dr. Schacht, he left him a seriously sick institution, over-loaded with financial bills and bad credits, deprived of its reserves, with only about 200 million RM in gold and foreign exchange left, an institution which was quite incapable to finance the goods turnover of Germany as was its duty according to the Bank Act. Thus it was surrounded by the greatest unemployment and numerous collapsing firms.

The Reichsbank itself, at the beginning of the bank crisis of 1931, had almost no debts and liabilities abroad, as little as the four small banks of issue in Germany. Hence the withdrawal of credits from Germany could not affect it at all. The majority of the 800 private German bankers, the independent large banks of Southern Germany with their branches (15), two large-scale Berlin banks without branches, the 2,100 co-operative banks and a large section of the 3,200 Savings and Municipal Banks, in numbers over 90% of the German banks, were equally well prepared to meet the foreign exchange problem arising from the sudden recall of 10,000 million Reichsmarks in foreign bank credits.

The three large-scale Berlin banks with their 1,323 branches, a few mismanaged municipal banks and a comparatively small number of less important institutions, had taken up foreign short-term credits on a vast scale and had lent out these funds, against all rules, on long terms. Thus the Reichsbank and the government, in July 1931, were faced with the problem whether they should preserve the more than 35,000 sound banks and bank branches, which regulated the exchange of goods among 20 million working people, leaving the over-indebted and illiquid large-scale Berlin Banks with their branches to the settlement procedures of the courts, or the reverse. (16)

- See below:

According to the information published by the economic and statistical section of the Reichsbank for the Bank Enquiry of 1933, the number of German banks and their branches was made up as follows, at the end of 1931:

T A B L E    I I

Number of the German Banks and their branches	No. of the Institutions	No. of the branches, agencies etc.	Total of existing bank centres	Grand Total at the end of 1931
I. Private credit banks in form of joint stock companies:				
1. Berlin large-scale banks				
a) without branches (sound)	2	-	2	
b) with branches	3	1,323	1,326	
2. Other joint stock banks, among them 50 with branches				
	170	1,707	1,877	
3. Overseas branches (3) and special banks (62)				
	65	151	216	
II. Private Banks, about				
	800	180	980	
		Sub-total,	I & II :	4,401
III. Cooperative banks (6.8 million members)				
1. Workers' banks				
	82	781	863	
2. Industrial credit coops				
	1,328	-	1,328	
3. Agricultural credit cooperatives				
	19,910	-	19,910	
4. Consumer cooperatives with savings facilities				
	1,229	-	1,229	23,330
IV. Public credit institutions				
1. State banks & giro centres				
27 with a branch network	39	396	445	
2. District banks				
	8	61	69	
3. Municipal banks (& Saxon Giro centres)				
	584	65	649	
4. Savings banks				
	2,570	10,510	13,080	14,233
Grand Total of Table II, sum of columns I - IV, at the end of 1931:				
				<u>41,964 banks &amp; branches</u>

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According to the amounts of the balances, the about 35,000 banks and bank branches embraced approximately two thirds and the sick three large banks etc. about one third of all banking. The big banks had their interests predominantly with the big firms of industry - of which there were, according to the official count of 1925, only 66, each with more than 5,000 workers. Between them they employed only 559,000 workers whilst the total number of those gainfully employed in Germany at that time was between 25 and 30 million.

**The German Bank Act, based on the experiences gathered in crises during more than 150 years, had obliged the Reichsbank, by its provisions and penal clauses, to grant credit only to sound banks and this only for the turnover of goods and the provision of employment through the exchange of goods and services - and to leave the unsound banks to their fate. However, Reichsbank and the Reich Government decided upon the reverse: They broke the Bank Act, a protective law of the first order against such abuses. They supported the unsound banks with almost 2,000 million Reichsmark in subsidies, out of tax funds. They thereby offered a camouflaged government guaranty to unsound banks and thus deprived the sound banks of their customers.**

They declared that "Germany's" credit was at stake, that "Germany" had contracted these debts, that a "run" upon "Germany" had broken out, whilst, in reality, only the credit of some badly conducted banks was in doubt, banks which had bank debts abroad. These, as was only right and proper, were called on by their careless creditors in England, Holland, the U.S.A. etc. to repay their debts. While government and people rightly fought against the Reparations - whose goods equivalents, moreover, the creditors refused to accept - some of those interested only joined this fight with the separate motive to conceal their state of affairs. **Thus thousands of banks and bank branches were sacrificed in order to save the few who had their hands on the rudder of the State.** During the decisive discussions the other, the healthy banks, were not consulted at all. Instead, the three sick banks were identified with the "German banking system".

#### 11. UNNECESSARY SACRIFICE OF THE GOLD AND FOREIGN EXCHANGE RESERVES INTENSIFIED THE UNEMPLOYMENT

The sacrifice of the gold and foreign exchange holdings of the Reichsbank proved soon to have been a serious blunder. Dr. Schacht will have to work for years, with extraordinary energy and expertise, to make good this mistake. As the few large deposit banks which were overloaded with short term foreign debts, no longer possessed good commercial bill material in considerable quantities - which the Reichsbank, perhaps, in a liberal interpretation of its duties, might have been morally obliged to discount, there was no reason for the Reichsbank to take over the dubious assets of these banks and to hand over to them, in exchange, gold and foreign exchange by the milliards, in cash, amounts which were later urgently needed by the sound economy.

After the gold and foreign exchange reserves of the Reichsbank were in this way aimlessly squandered, it turned out that only a portion of the debts had been repaid.

Thus the calamity continued and turned into an emergency for all German banks, into a threat for the Reichsbank and for the stability of the currency. One cannot link the fate of a bank of issue with an unsound banking group and failing industrial corporations without jeopardising the currency and foreign exchange position.

(I hold that such reserves are not needed for a sound currency. They represent unused and wasted capital reserves. - J.Z., 26.12.02.)

The bank of issue thus took over the debts of third parties. Without reason, it took up the obligations of others - and had to surrender for them its gold holdings. The subsequent shortage of gold and foreign exchange is not a consequence of an unfavourable balance of trade but of the existence of matured foreign debts which one has, so to speak, declared to be one's own, without any good reason. **WITH THIS FOREIGN EXCHANGE SHORTAGE AND FOREIGN EXCHANGE DIFFICULTIES ONE HAS THEN EXCUSED, FOR YEARS, THE FAILURE TO ADOPT ANY MEASURE TO PROVIDE EMPLOYMENT.** In these mistakes lies thus one of the so far neglected major causes of the worsening of unemployment.

(Foreign exchange is not necessary for trading with foreign countries. One can pay with assignments upon their own goods and services. - J.Z., 26.12.02.)

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#### 12. WHERE DOES THE INFLATION DANGER LIE TODAY?

**Against the inflation argument, which is constantly used to fight the natural provision of employment by turnover credit, one can simply say that the cart is put before the horse when the private financing of new and additional turnovers is stigmatised as dangerous while, at the same time, the OLD credit grant system by means of the creation of prohibited financial bill money, through prolongations, is uncritically passed over. In this situation the only right thing to do can only be to promote the payment transactions concerned with turnover and to proceed against the old, frozen and inflationary mass of means of payment, which is hoarded to a threatening degree, by abolishing their compulsory market rate (legal tender) and by withdrawing them.** Prof. Lexis, then advisor of the Reichsbank, and others, had made similar observations during the crisis of 1907.

No one should be permitted to assert here (uncontradicted) that a small inflation is the unavoidable medicine and that the proposal represented here would also amount to a minor inflation and that this should be frankly admitted. On the contrary, inflation is a means of destruction. The applause it finds in certain business circles is due to the fact that it makes the prolongation of bad credits possible, at the expense of the healthy requirements of turnover credit and that it prevents clear understanding of the true causes of the disease.

### 13. THE AGGRAVATION OF THE SITUATION BY THE FALSE CURE OF DEVALUATION

From this general unemployment, foreign exchange crisis, illiquidity and fictitiousness of values and prices, one should have boldly returned to the simple and solid principles of banks of issue. However, this return would have revealed grave abuses, especially in highly respected firms. Hence, in England, the U.S.A. and in many other States, one decided to follow the road to disaster and artificiality one step further and, thereby, to reach **ROCK BOTTOM IN THE DEGENERATION OF THE BANKNOTE ISSUE SYSTEM: DEVALUATION**. The rate of foreign exchange on foreign markets was left **FREE** and thus one seemingly responded to the healthy demand for the restoration of the market. But, simultaneously, one played a trick which annulled the favourable effect of the free market rate. This method, of a single or continuous alteration of the gold purchase rate of the central bank, has been revived by **IRVING FISHER** and, unfortunately, also by **J. M. KEYNES**, who have therefore, apart from their very great scientific renown, the doubtful merit of having added another link to the chain of degenerative phenomena of the present banknote system. This method was formerly known only from the legal proceedings taken against insolvent banks of issue.

Devaluation and free market rate are completely different. Under a pure gold currency and a free market rate for means of payment, when a free gold market exists and the foreign exchange control is repealed, then e.g. Reichsbank notes could be freely exported and valued. Under this system, Reichsbank notes could suffer a considerable discount for a few days. Their only value would consist - as the redemption obligation is abolished - in their usefulness for purchases in Germany. That would be a strong stimulus for German exports. The tariff barriers encircling the country concerned could be partly or wholly surmounted. The market rate of the banknotes would, to some extent, be a function of the height of tariffs of **THAT** country in which the banknotes are. When tariffs are low, then one would value the notes in foreign countries, presumably, at par, under prohibitive tariffs, theoretically, at zero. It would then be **ENTIRELY A PROBLEM OF THE FOREIGNERS AND THEIR GOVERNMENTS** to give or destroy the value of the German notes held by them. Presumably, one would make **EFFORTS TO REDUCE TARIFFS**, particularly in those countries which so far had prohibitive tariffs against German goods and, at the same time, a favourable balance of payments against Germany, i.e. in countries where one claimed payment without being prepared to accept goods.

The same applies to all debtor countries, hence, especially, to most of the South American States. Their creditors would then, presumably, endeavour to induce their own governments to reduce the tariffs so that South American goods could enter, in payment.

An **ABUSE FOR DUMPING PURPOSES** need **NOT** be feared for only the export of the **DEBTOR COUNTRIES** to the extent of the so far unpaid **DEBT BALANCE** becomes possible and nothing more.

Thus the par value of the German banknotes on foreign markets would, presumably, be soon restored.

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Nor could a foreign exchange shortage happen for, e.g. in the case of Germany, the "misfortune" would consist in the fact that the foreigners could continuously raise **MORE** payment claims against us than we could against them. In the foreign portfolios German banknotes, commercial bills etc. would accumulate which have value only when something is **PURCHASED** with them. Thus **MORE** export is enforced - unless one proceeds, in the foreign countries, to burn or hoard the German notes. Thus the free market rate turns the Reichsbank notes into Milhaud's "purchasing certificates" (17). They help to adjust the balance of payments without the Reichsbank having to worry about it.

**HOW MUCH THIS SYSTEM OF THE FREE MARKET RATE**, that prevailed before the war in almost all countries, **IS IN CONTRAST TO TODAY'S DEVALUATION**, we can gather from the following considerations. When the bank of issue grants long-term credits, "internally" and especially "externally", then there are no immediate payments due from abroad. Little comes in but much goes out. This is called a foreign exchange shortage. The redemption in gold is then mostly abolished. Under the legal tender regime, the foreign exchange control system is then, usually, introduced. But if a free market rate for banknotes exists - and outside a country's borders it always exists - **THEN A DISCOUNT OF THE NOTES OCCURS**. In this case the bank can choose one of two roads:

1. EITHER THE BANK KEEPS TO ITS TRADITIONAL AND LEGAL PURCHASE PRICE FOR GOLD. Then it neither receives additional gold nor can it increase its shrunken holdings of gold because gold is at a premium, i.e., it is too expensive. It does not grant any further new credits than those necessary for short goods turnover. THEN SOMETHING AMAZING HAPPENS: The "run" of consumers on the goods in shops, of the debtors on creditors, especially on the bank as creditor of bills, and on the taxation offices if, as in Germany, the tax offices have still to take these notes at par value. For only at three places can the holders of such notes, depreciated for a few days, pass their paper notes on at par value - while all other places reckon in stable values (in gold) and demand a premium when payment is in these banknotes:

in debt payments to the BANK,

in tax payments to the TAXATION OFFICES and

in the SHOPS, because lastly, all turnover credits of the bank of issue are represented in the shops which offer goods in return for them.

**This "terrible" run is not evil at all for it happens in the economically desirable direction: In the end and for some milliards, goods are sold, taxes paid and warehouse stocks reduced and the bank of issue is again liquid because it has received a torrential reflux of notes.**

This reflux of notes also happens from abroad, for we assume that the export of notes is again free and that note holders will hurry to purchase with them in Germany - which is excellent for the balance of trade.

By means of this salutary crisis the equilibrium in internal and external credit operations is thus restored within a few days. The surfeit of notes and the foreign exchange shortage, as well as the discount, have disappeared: THROUGH STIMULATING PURCHASES WHILE MAINTAINING THE PURCHASE PRICE FOR GOLD.

This road has been prescribed as the only permissible one by the provisions of at least the continental banks of issue - which are based on the identical experience during the crises of centuries. (For instance: Par. 22 of the Bank Act.)

2. THE OTHER ROAD is the following: The note-issuing bank acts like a mismanaged mortgage bank on the day before it closes its doors. It does not care about the losses of the holders of its mortgage bonds. Instead, it attempts even now TO FORCE GREAT QUANTITIES OF ITS SICK NOTES (MORTGAGE BONDS) INTO CIRCULATION, BELOW PAR AND AT FALLING MARKET RATES, THUS IMPUDENTLY AGGRAVATING ITS ABUSES. As it is not interested in the credit business but solely in gold and a profit margin on gold and as no one will accept its depreciated papers at par, IT HAS TO INCREASE THE LEGAL PURCHASE PRICE OF GOLD FOR THIS PURPOSE! It can now buy masses of gold, that is, offer notes at the expense of the speculative losses of the note holders, who are cheated out of the automatic restoration of the par value. Then the bank asserts, boastingly, that it has done much for the (depreciated) currency!

All embarrassed bank managers have acted thus during the older period of free note issuing banks in Europe (until about 1850 or 1900).

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Exchange and employment opportunities were thus harmed IN THE LONG RUN. The penal laws have counteracted such abuses. (Compare the Bank Acts.)

THIS SECOND WAY IS NOWADAYS CALLED DEVALUATION. If the central banks or treasuries of the devaluation countries since 1931 would not have increased their gold purchase price, then the notes of the Bank of England etc. could have shown a strong discount only for a few days. After that the above indicated recovery tendencies would have triumphed. It required enormous gold purchases at increased prices, in other words, COLOSSAL SALES OF ENGLISH ETC. CURRENCIES, AT RIDICULOUSLY LOW PRICES, TO NULLIFY THESE TENDENCIES. As everyone knows, one tried, repeatedly, during the first months, to enforce a return to the old par value. (The Bank of England, for instance, and the TREASURY, had to purchase gold stocks amounting probably to 100 to 200 million gold Pounds!)

**We seek (in this paper) to combine the advantages of the free market rate and of the pure gold standard, an elastic balancing and export incentives with the safeguarding of contracts and capital investments. The system of 1909 contains them. With such a German tradition it is not surprising that it was Dr. SCHACHT**

**who, in April 1924, in the midst of the greatest foreign exchange shortage, and a command economy, ended speculation and restored freedom in German foreign trade and foreign exchange transactions, and enforced the strongest reflux of notes., with one stroke - by freeing the market rate and HOLDING FAST TO THE OLD GOLD PURCHASE PRICE. This procedure was, unfortunately, not understood by a false monetary theory so that public opinion is today unaware of this experience. Probably this is the only example in the history of modern crises where such a huge central note issuing bank acted quite correctly during the crisis.**

Regarding the GOLD PURCHASE PRICE of the central bank there are only two systems: the RETENTION of a fixed rate at which the bank of issue purchases gold or ABOLITION and deliberate alteration of this rate.

The former is the successfully tested PRE-WAR SYSTEM of the well-administered countries (a pure gold currency with a free market rate for notes but fixed purchase price for gold at the bank of issue).

The other is inflation or devaluation which are both only different aspects of the same reality (compulsory acceptance or legal tender within and alteration of the purchase price for gold by the bank of issue).

That one can solve the problem of unemployment with inflation, TEMPORARILY, at the price of extraordinary sacrifices and with the greatest destructive effects, is known. The contribution of J. Fisher and Keynes does, therefore, not mean anything new, especially not a lasting recovery, but a FURTHER DESTRUCTION OF CREDIT.

We are here not confronted with an INCREASE IN THE VALUE OF GOLD, which makes a devaluation necessary, as it is only the PRICES OF GOODS which have been driven downwards by a destruction of turnover credits and markets which continued for years. Gold had nothing to do with that.

The justification of devaluation with an alleged inability to compete abroad and with the fall of exports because of excessive inland prices is also untenable. The OVER-PRICING OF GOODS in certain countries finds its cause in the growing price control by large trusts whose price policy knows no bounds and who thereby ruin the provision of employment and the currency.

(Note by JZ: I would deny the latter - unless one takes into consideration the indirect effect: the readiness of most governments to devalue the currency in order to enforce, temporarily, exports of the overpriced goods of these influential trusts.)

**A RESTRICTION OF THE ACTIVITY OF TRUSTS WOULD, WITHOUT A TRUE DEFLATION, LEAD TO AN EFFECTIVE REDUCTION OF PRICES.**

(Note by JZ: I do not think Prof. Rittershausen had in mind trust-busting through special legislation and court actions of the present type. I believe that he would favour, instead, a repeal of all their legal privileges, their tariff protection, their tax concessions and subsidies, their preferred treatment in credits given by a monopolised system and the repeal of the regulatory and licensing system restricting their competitors. In a truly competitive economy they would hardly constitute a threat.)

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All savers together would then no longer have to pay the costs of this selfishness, which has been pursued too far. The producers must make efforts regarding quality and prices. Artificial means should not deceive us on this.

**14. IS THE CENTRAL BANK SYSTEM OR FREE BANKING MORE SUITABLE TO PROVIDE EMPLOYMENT AND END THE CRISIS?**

**Already Hock uttered prophetic words on this subject, sounding like a judgement on today's banking and currency crises in all countries. (Quoted here from Leopold Lasker's "Bankfreiheit" (Free Banking ), 1871, page 66.):**

**"For a monopoly bank the State must step in, in times of a crisis, granting advances, standing guarantor for it, infringing the law in its favour, permitting a moratorium, authorising its notes to circulate further, although it can no longer redeem them, perhaps conferring a forced rate (legal tender) on them, all this because, otherwise, the whole trade of the country, which is dependent on this bank, would be, forcefully, brought to a standstill.**

**Under a system of free banks the failure of a bank passes as unnoticed and is so completely dealt with by the law as the insolvency of any other business.**

**Many banks of North America have often and repeatedly suspended payment during the great trade crises of 1837 and 1857, but the effects of these events barely lasted a year. New banks were established or the old ones rehabilitated themselves and trade became brisk again.**

**In Austria, on the other hand, the cessation of redemption led to most deplorable interferences by the State with private rights and caused a paralysing fluctuation of the currencies and the rate of foreign exchange" (foreign exchange shortage! - the author.) "lasting until today."**

Who would deny that this is a pregnant description of today's conditions and that most countries in the world repeated the policy of the Austria of that time and have, thereby, either retarded the cure of the crisis and of unemployment or made them impossible?

#### **15. DECLINE OF THE CREDIT SYSTEM AND AGGRAVATION OF THE UNEMPLOYMENT PROBLEM - AS THE OUTCOME OF AN UNHEALTHY DEVELOPMENT OVER SEVERAL DECADES**

**Thus it was not transitory errors of economic policy or faults in the organisation of the world economy that have caused the long-continued worsening of the crisis - but they were basic misconceptions which had been growing over decades and were, by custom, almost legalized:**

**a) THE SEPARATION OF NOTE ISSUES FROM THE GOODS TURNOVER THROUGH THE SEPARATION**

**OF FUNCTIONS between banks of issue and deposit banks,**

**b) the MONOPOLISATION of the note issue by a central bank, which is always restrictive and deflationary,**

**c) the transition from the BANKNOTE which is serving turnovers and which remains, with its free market rate, under the control of the market, to an irredeemable PAPER MONEY WITH COMPULSORY ACCEPTANCE (legal tender),**

**d) the inflation and devaluation tendencies which are inherent in the SEMI-OFFICIAL CENTRAL BANK and in the rule of COMPULSORY ACCEPTANCE (legal tender) for notes, (and COMPULSORY VALUE! - J.Z.)**

**e) the NEGLECT OF THE TURNOVER AND EXCHANGE PRINCIPLE in favour of the lombard- and mortgage-type security principle in granting credits -**

**These are the developments which have turned our banks to a large extent away from their original purpose - to promote the wealth of the community and to provide employment. They have, temporarily, left our country, as well as many other countries, in spite of its enormous national wealth, WITHOUT A PROPER ORGANIZATION FOR THE MUTUAL PROVISION OF EMPLOYMENT THROUGH CREDITS.**

If the two most important measures to fight unemployment are the re-integration of the unemployed in the so-called regular economic process and the investment out of latent capital formation -

(On the latter see the author's work: "Arbeitslosigkeit und Kapitalbildung - zugleich ein bankpolitisches Programm zur Bekaempfung der Wirtschaftskrise" - ["UNEMPLOYMENT AND CAPITAL FORMATION, at the same time a programme for a banking policy to fight the economic crisis"], Fischer, Jena, 1930.)

- then serious defects in turnover credit had to result in the impossibility to achieve this re-integration.

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#### **C) THE CLEARING PRINCIPLE AND THE "VIER GESETZENTWUERFE" (FOUR LAW DRAFTS) TO-RE-INTEGRATE THE UNEMPLOYED IN THE ECONOMIC PROCESS**

##### **I. FROM PAYMENT TO CLEARING (18)**

1. Our analysis has clarified what mistakes have to be avoided in the construction of a well functioning system of turnover credit. But the guiding principle is still absent with whose help this construction can be achieved. To find this principle, a further analytical step is necessary:

For the question is whether the agreement that all contracts expressed in money should be fulfilled by PAYMENT (in cash or real money), can be retained at all. If it can NOT be continued, then one will have to discard the thought of a NOTE ISSUING BANK and of the banknote, which stood so far in the foreground, or one will have to DEVELOP THEM MUCH FURTHER to achieve an ideal EXCHANGE ORGANISATION.

This criticism of the principle of payment (in cash or ready money) on which so far all credits and banknotes rested, and this perfection of the banks of issue system beyond the classical scheme, was attempted in Germany, in a scientific way, through the "Vier Gesetzentwürfe zur Bekämpfung der Deflation, zur Verhinderung der Inflation und zur Senkung des Zinses" (Four Law Drafts to Fight Deflation, to Prevent Inflation and to Lower the Interest Rate), Berlin, 1932. (19)

(See also the texts of the drafts and the two commentaries reproduced in Peace Plans No. 40. - J.Z.)

2. The purchases and sales, credits, deliveries and services on terms do establish, in every country, a system of short-term obligations which must be continuously met in order to make room for new purchases, new deliveries and services, thus for a never renewed goods exchange. The SOLUTION of such a system of short-term obligations can be conceived in different ways.

One is by PAYMENT pursuant to Roman Law, *i.e.*, by physical delivery of coins or paper money with compulsory acceptance.

Another, is the confrontation of two reciprocal claims, followed by their CLEARING (compensation, off-setting, mutual cancellation), *i.e.*, juridically speaking, by some kind of mutual renunciation.

Furthermore, there is payment through private BANKNOTES, CHEQUES OR GIRO TRANSFERS, which lead in most cases to compensation on an account etc., and, lastly, by means of

DEVALUATION, BANKRUPTCY, LAPSE (cancellation through the statute of limitations) OR OTHER FORFEITURES OF THE CLAIMS.

If we discard the last possibility, which is the result of complete helplessness and lack of ideas, then we will, first of all, consider PAYMENT. This constitutes, according to the old-style Roman legal principles, the RULE for the solution. It means the DELIVERY OF PHYSICAL MEANS OF PAYMENT, of material objects and hence the delivery of goods.

According to this, a loan contract is a contract which puts the debtor in the same position as one who sells GOODS on forward terms on the Exchange. Through the principle of payment all monetary obligations in a country become converted into OBLIGATIONS FOR THE FORWARD DELIVERY OF GOODS (goods delivery obligations at a future date).

With the GOLD STANDARD this means GOLD DELIVERY OBLIGATIONS AT CERTAIN FUTURE DATES. (20) With the today mostly customary so-called GOLD CORE CURRENCIES (gold exchange standards), they turn into FUTURES OBLIGATIONS TO SUPPLY MONOPOLISED PAPER CERTIFICATES, the notes of the central bank.

In dealings in futures (forward dealings) with goods at the Exchange, it is customary to protect oneself against the heavy risks of such transactions by means of withdrawal premiums and other protective transactions. (E.g. "hedging". - J.Z.) In money and payment transactions one has, so far and unfortunately, not advanced to such

safeguards. The lack of such precautions has not been without consequences. Moreover, the concentration of most of all such futures obligations of a country within a few banks has further increased the problem.

The crisis of 1931-1933, like the previous crises, has shown that such future (forward) delivery contracts, when concluded on a massive scale, cannot be fulfilled in a serious situation. Indeed, they result, then, in a paralysis of the entire economic life for months, in the unemployment of millions of people and, particularly, in the seeming impossibility to solve the problem of unemployment.

**3. The only way to avoid such a faulty procedure, shown by our whole banking system so far, is probably the REPLACEMENT OF PAYMENT BY CLEARING, as far as this is possible. This way has already been opened up by the natural development, in most countries. For the use of cheques and clearing has grown so much that in most countries today already 80-90% and more of all solutions (settlements) take place without using PAYMENTS.**

Formally, it is true, most, even of the cash-less transactions, imply still the delivery of the physical means of payment of the central bank - but use of this possibility is made only in case of a crisis.

(Note by JZ: Precisely then it can turn a minor crisis into a disaster: Cash is already short, for one or the other reason, and then, suddenly, everybody claims the cash he is still legally entitled to, in cases where otherwise he would be satisfied with clearing. Thus many of the previously cash-less transactions are now turned into cash demands. Thus the need for cash may increase tenfold - while already less cash is available than before. There is no hope for prices and contracts to adapt AS fast to as sudden deflationary money shortages, no matter what economists like Murray N. Rothbard believed on this subject. Moreover, the different results of FALLEN and of FALLING prices have to be taken into consideration. FALLEN prices encourage buying while FALLING prices lead to the postponement of many purchases.)

**4. To declare all banknotes or even the whole of all cash-less means to be LEGAL TENDER, as already envisioned by Ricardo, would not signify any PROGRESS - for these means of payment, given legal tender, would enjoy some kind of State guaranty. They would thus have to be issued by the authorities or other monopoly organisations and CONTROLLED AND KEPT SCARCE. This would make the achievement of full employment impossible and lead to a further and intolerable growth of fiscal activity.**

Under such a monopolistic system, lastly, no business in the country could be any longer concluded without the previous consent to pay by the central bank. To make such promises is usually not within the authority of the bank. Moreover, as has been mentioned before, no monopolistic system of monetary control can be conceived that is not, in effect, deflationary.

In this connection it is remarkable that Karl MARX had demanded this centralisation and monopolisation of credit, already in 1848, in his "Communist Manifesto", in point 5 of its programme.

**5. The solution by means of CLEARING is completely different. (20 a) Nobody can refuse it WHO IS HIMSELF IN DEBT - which today applies generally, to every participant in the economy. Hence clearing is today, apart from gold and from the banknotes which were given legal tender, a THIRD MEANS OF PAYMENT WHICH MAY BE FORCED UPON A CREDITOR. As such it has so far been overlooked by monetary theory.**

**Towards any vendor of goods or any other creditor, clearing is thus as useful as a solution means as if it had legal tender but, indeed, ONLY TO THE AMOUNT OF THE DEBT OF THE PAYEE.**

**It has the further ADVANTAGE of not being monopolised, not being "managed" by the State, and not being kept artificially scarce but, instead, it is freely accessible for everyone.**

**It is also readily available for everyone during a crisis, i.e. precisely during the then customary credit restrictions. This is of decisive importance.**

**6. A credit system which aims to achieve the re-absorption of the unemployed in the regular economic process, even during a crisis, will thus not only have to REVERSE the above indicated historical SEPARATION from the goods circulation but will, moreover have to employ a SOLUTION PROCEDURE that avoids the dealing in futures of monopolised and "kept scarce" means of payment (in the sense so far employed).**

Apart from leading turnover credit back to its original and proper function, it must be the AIM to make the clearing principle THE GENERAL MONETARY SOLUTION PROCEDURE IN THE WHOLE COUNTRY because it is superior to the Roman juridical payment principle with regard to providing employment.

In working towards this aim one must take note that the existing legislation on clearing, in the civil codes, is much too narrow. It will have to be developed further. Decisive is not the accidental current version of it but the underlying PRINCIPLE and its development.

Furthermore, it is important that, especially in Germany, new forms have been developed which go BEYOND the cheque and giro operations:

- a) CLEARING not only of cheques but ALSO OF TRANSFER ORDERS in special "clearing offices" of the Reichsbank.
- b) The REVERSE TRANSFER (or so-called "withdrawal business") developed by Schoele in Berlin and
- c) the "skontration".

The aim of this great development of the technique of cash-less transactions is, figuratively speaking, neither to move physical objects (means of payment) from the debtor to the creditor (compulsory acceptance!) nor to shift balances in this direction, but instead, to rid the creditor of his debts, to make him debt-free, whereby the problem of legal tender, of the compulsory acceptance, is altogether avoided!

This newer development in German payment transactions receives its strength not from theoretical considerations of currency questions but simply from the fact that **these new methods operate much more efficiently and cause less costs than cheques and giro-transfers, which is of the greatest importance for the banks.**

The effect of the new principle upon the diverse branches of cash-less giro transactions could only be hinted at here.

Next to the above-mentioned giro and cheque transactions are those involving cash in which, up to now, the PAYMENT PRINCIPLE completely DOMINATES. Seemingly, it cannot be ousted here. But, surprisingly, HERE ALSO compensation is possible. For such CLEARING IN CASH DEALINGS under simultaneous abolition of the note issue monopoly, a new kind of note issuing bank would serve which would have to have the following characteristics (22) :

#### C / II.) DRAFT OF A "LAW" ON CLEARING BANKS

##### 1. THE FIRST "LAW DRAFT" DEMANDED BY MONETARY THEORY RUNS THUS:

###### Par. 1

- (1) Clearing banks are enterprises whose object is to clear claims and debts.
- (2) They may only acquire or grant credit on good commercial bills and good other claims arising out of sales of goods and services. The due date of the bills and claims must not exceed 4 months. Their obligors must be known as solvent.
- (3) They may not undertake any other classes of banking operations.

###### Par. 3

- (1) Clearing banks are entitled to accept clearing cheques drawn on them, by means of a note on these cheques.
- (2) By this acceptance the clearing banks bind themselves to credit the bearer of a clearing cheque on a clearing account. They are not obliged to pay cash.
- (3) The clearing bank can free itself from the obligation to clear by satisfying the claims of the creditor with the surrender of Reich banknotes, Reich treasury notes or coins.

Par. 4

(1) Clearing cheques, within the meaning of this Act, shall be payable to the bearer and shall carry on the front the notification : "For clearing only".

They may only be made out in denominations of 1, 2, 5, 10, 20 and 50 marks. Moreover, they must be in accordance with the requirements of par. 1 of the Cheque Act of 11. 3. 1908.

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(2) Clearing cheques must be printed, apart from the signatures of the bank drawn, the drawer and the date of issue. The issue date may be printed. The signatures may be mechanically duplicated.

Par.5

Clearing banks may only issue printed forms for clearing cheques which carry already the bank's notification of acceptance.

Par.6

The clearing banks are obliged to accept at full nominal value and at any time all clearing cheques which already carry their acceptance note.

Par.7

(1) Clearing banks may only issue printed forms for clearing cheques and acquire, or lend on, bills or other claims (par. 1, sec. 2), if in the course of the preceding calendar month one fifth of the bills and other claims, outstanding at the beginning of that month, have been repaid ( reflux).

(2) Prolongations of an existing indebtedness, in whatever form, do not count as re-payments.

Par.8

**(1) To the extent that the credits granted by a clearing bank are not repaid by the handing over of clearing cheques of this bank, but by other means, more particularly, by transfers or delivery of Reich banknotes, Reich treasury notes, or coins, these means of payment are to be used or to be kept ready, for the purchase of clearing cheques of that bank.**

(2) A clearing bank can demand a premium from its debtors to the extent that they do not repay their debt by the surrender of clearing cheques of this bank.

This surcharge may not exceed 1% of the amount repaid in this way.

Par. 9

The total amount of the circulating clearing cheques accepted by a clearing bank must be covered at this bank up to its nominal amount and at any time by bills and other claims (par. 1, sect. 2) of at least the same total amount or through cash.

Par. 10

There is no time limit for presenting a clearing cheque to the drawee clearing bank.

Par. 11

(1) The clearing banks shall be attached to an audit centre determined by the Reich Minister for Economic Affairs.

(2) The audit centre is entitled to examine the business papers, books and other documents of the clearing banks.

Par. 12

By the 10th. of each month, the clearing banks must submit to the audit centre statements on the development of the business during the preceding month. This report must set out:

1. the aggregate amount of the bills and claims acquired and those lent on, each separately,
2. the total amount of the issue and not yet returned printed clearing cheque forms,
3. the amount involved in the bills and other claims paid off during the month reported on,
4. the aggregate amount of the printed forms issued as clearing cheques during the month under review,
5. the amount of the means of payment held ready pursuant to par. 8, sec. 1,
6. the prolongations of existing debt obligations.

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2. The special purpose of the clearing banks is to close the incomplete circuit of commercial bills and of giro money THERE where WAGES are paid, i.e. where so far scarce monopolised means of payment were indispensable. The notes of these banks are crossed ("for clearing only" CHEQUES drawn by the account holder on the clearing bank. They are expressed in round (typified) amounts made out to the bearer and are already accepted by the bank. In some countries this is not permissible with ordinary cheques. It would have been MORE SIMPLE to choose the banknote with a new legal contents. But the method of the typified and accepted cheques avoids the collision with the monopoly of the central bank.

To loosen up the fettered goods circulation, the clearing banks should make the required PURE TURNOVER CREDIT available, in abundance and cheaply. Contrary to the proposals of the inflationists, the primary service shall not be the additional NOTE CIRCULATION but the credit business, the PROVISION OF TURNOVER CREDIT, to the extent of the sale of new goods.

Then the customer would obtain credits and banknotes (forms of typified and accepted cheques) from the banks - only when he has good short-term commercial bills and similar claims available for discounting. The limitation to the genuine proceeds from SOLD goods is very important. Advances must never be given on UNSOLD goods nor must bills be accepted which are not based on goods turnovers. This "cutting up" of genuine goods claims into means of payment can (as is well known) HAVE NO INFLATIONARY EFFECT as the thereby increased issue of means of payment is only possible when the goods offer increases to the same extent.

(Note by JZ: Moreover, the standard of value is the same for both sides: The means of exchange have a free market rate against it and are kept at par with their nominal value, in the interest of issuer and acceptor, and the goods are priced out in e.g., gold weight units, which serve as the standard of value. Thus, at most, badly managed means of exchange might depreciate themselves but they could never inflate the general price level which continues to be expressed in stable gold weight units. The bad means of exchange will then be driven out by the good ones.)

**The competition between several such private note-issuing banks achieves, nevertheless, an ample supply of such credits and the lowest interest rate - so that deflation is also excluded.**

The example of the Bank of France, which is today the only healthy central bank in the world, as well as that of the four small provincial banks in Germany and of the Bank of Danzig - all of which remained sound despite the crisis, preserved their gold stock and saved their economic spheres any restrictions, proves how efficient this principle is.

(Note by J.Z.: I wish he had not mentioned the gold stocks in this connection. For the clearing principle involved in these issues and their reflux a gold cover, gold reserve and gold redemption are superfluous. Nevertheless, these clearing cheques and all the prices and wages, rents and fees, subscriptions and credit contracts, which they mediate, could be expressed in gold weight units. - It's too easy to slip back into ancient "memes" when writing or talking. - J.Z., 27.12.02.)

**3. In Austria (in the town Woergl\*), in Germany and in the USA some kind of "Ausgleichs-kassen" (Compensation Pay Offices) were established since 1931 which pretend to operate according to the above principle. However, most of them have been prohibited again in the meantime. Their aim, regardless of the**

**promises they made, was NOT the compensation of short-term and due claims and the bridging of slightly different due dates. No, they attempted to foist upon their customers LONG TERM and non-interest-bearing claims in exchange for SHORT TERM ones - by financing not the proceeds of sold consumer goods but, instead, of long-term or capital goods like street constructions, houses etc. For papers thus issued, the storekeepers were supposed to surrender their consumer goods. These attempts have nothing in common with proper clearing banks.**

They merely make the hopeless attempt to sell, at 100%, long term LOAN CERTIFICATES, in small pieces and non-interest bearing, which should, perhaps, stand at 50% below par, seeing that even the large pieces of INTEREST BEARING issues of the same debtors were often priced at under 80% at the Exchange. The shopkeepers who sold against such money substitutes suffered heavy losses as nobody was prepared to accept these certificates from them. Their market value HAD to be low because the DEMAND for such certificates is too low.

(\* - In case of the "Schwundgeld" of Woergl, and largely unappreciated by its initiator and fans and objectors alike, tax foundation for these notes played a large role in their success, as Ulrich von Beckerath pointed out in his writings. - J.Z., 27.12.02.)

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4. CONTRARILY, THE SECRET OF THE CLEARING BANKS as well as that of the sound note-issuing banks, lies essentially in the fact that they arrange for an ESPECIALLY STRONG DEMAND FOR THEIR OWN ISSUES, which keeps their rate at par. The holders of the clearing cheques can clear, by surrendering cheques, ONLY when they have not only CLAIMS but when at least some of them have also due DEBT obligations towards the clearing banks. If the bank lends out its money on LONG TERMS, as the Austrian and American "Ausgleichskassen" (Clearing Banks) did, THEN IT HOLDS NO DUE CLAIMS AGAINST ANYBODY. Thus one cannot clear for ONLY DUE claims can be cleared. The cheques are then almost worthless.

**If, on the other hand, the bank lends its means on decidedly short-term conditions, then every day many claims will mature and the clearing, i.e. the utilisation of the cheques at 100% becomes possible.**

Certainly, not all cheque holders owe something to the clearing bank but only the few manufacturers and shopkeepers who received credit from it. But this does no mean that the cheques are valueless, e.g. for public servants and clerks. On the contrary, exactly the same applies to these cheques in the hands of such private people as applies to the monopolised banknotes now customary in most countries: they can be used for purchases in the shops and factories, because **the shopkeepers and manufacturers exert a LIVELY DEMAND for them in order to be able to repay with such slips their debts, when they fall due.** Thus three fourths of the national income finds its way to the shops and returns from these to the banks. The value of the cheques stands then at par.

**It must be the aim of the bank management to achieve this continuously. It can best achieve this objective if it considers the circle of its customers as a private "payment community" ("Zahlungsgemeinschaft" - Knapp). Within this community any creditor must undertake to accept HIS OWN matured debt obligations as means of payment against himself, i.e. to accept clearing. Then the following happens:**

**The shopkeepers will mostly have received credit from their suppliers, the manufacturers, and the latter, in turn, from the clearing bank. Instead of in banknotes, they have received these credits IN SUCH CHEQUES. The recipients have been obliged by the bank to repay their credits from the clearing bank not in legal tender means BUT IN THE SAME TYPE OF CHEQUES.**

The bank can enforce this by imposing a fine in case of payments with State money. Accordingly, the manufacturers will eagerly accept from their customers, the shopkeepers, payment in typified cheques and will express a direct demand for them. Likewise with the retailers. They will post this readiness to accept in notices and signs at their counters.

**For the manufacturers these cheques represent, so to speak, their own liabilities, as the pieces received by them are almost completely like those they received in their credit from the bank. The same applies to the shopkeepers. Both are bound to accept the cheques as means of payment since they are both in debt. They have obliged themselves towards the Bank to let their own debt certificates be counted against themselves,**

**i.e. to accept clearing up to the amount of their debts. Thereby and because their credits become soon due, a continuous DEMAND for such cheques and a permanent 100% usability for them is assured.**

This clearing is a multiple one. The customer in the shop, who received his wages in such cheques, buys goods. At the cash register of the shop he owes the amount. He hands the cheque in - which, in mobilised (liquid) form embodies the bank debt of the shopkeeper - and now he clears and thereby settles his purchase debt.

The shopkeeper, on his part, is indebted to the same bank in the same type of cheques. To reduce his debt he surrenders such cheques, which represent his own indebtedness to the bank. He compensates debt against credit and becomes thus debt-free.

The manufacturer is likewise indebted to the bank in such cheques. To repay his debt, he delivers the cheques and likewise clears them. Cheque credit and bank debt have disappeared.

The short run of the credits as well as their confinement to financing the turnover of saleable ("gangbaren" or "consumer goods", goods already produced and sold, at least to wholesalers! - J.Z., 27.12.02.) goods, create in this way a continuous DEMAND, an uninterrupted REFLUX of cheques. This demand achieves the par value of the cheques, although they do not yield interest, because these cheques are usable, at any time, for purchases in the shops and are in this equal to the best banknotes. **They represent, in a way, the prototype from which the banknotes were developed and from which the monopolised banknotes with legal tender powers have, taken their road to degeneration.**

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The difficulties of the variety of means of payment can be overcome by instituting clearing centres as one can find in Scotland and Canada, where the notes of 9 note-issuing banks still circulate successfully, side by side, unfortunately, since the war, likewise with legal tender. Even in Germany there are, apart from the Reichsbank notes with legal tender, still small change coins in circulation which are legal tender only up to 20 marks, as well as 5 kinds of certificates WITHOUT legal tender - and this does not lead to any difficulties. (Rentenbank notes and the banknotes of the private note-issuing banks of Bavaria, Baden, Saxonia and Wuerttemberg, in 1933.)

**5. From our historical description, we could draw the conclusion that deflation is only possible under the note issue monopoly because a monopoly excludes competition and no alternative institutions exist. We could, furthermore, conclude from it that inflations are possible only under compulsory acceptance (legal tender).**

**(Legal tender embraces also compulsory value! See his following sentence. - J.Z.)**

**The notes of the clearing banks have neither a legal exchange rate (legal tender) nor are they redeemable in gold. They can only be used for purchases in the shops ("shop foundation") like the notes of those of today's central banks which have suspended gold redemption. (Note by JZ : Naturally, the latter have ALSO legal tender and TAX FOUNDATION.)**

**With the clearing banks one has to take care that the equivalent for the clearing certificates really lies in readiness in the shops IN FORM OF GOODS. (Compare paragraphs 7 and 9.)**

**If financial bills had been discounted then the paper certificates received by the wage earners, which they carry to the stores, would not be confronted by consumer goods but by houses and the like. (Note by JZ: ... of the long-term debtors of the bank.) They could not purchase anything with them. They would have valueless papers in their hands.**

(Note by JZ: While they could not purchase or clear anything with them immediately, apart from the use of some of these certificates in instalment repayments of the long term loans they represent, they could be utilised in the long-run, over a period of 10-40 years, e.g., as mortgage claims against the houses etc. which they economically represent. Naturally, few consumer & shopkeepers are interested in these, while they need to pay their daily living expenses & other debts with suitable or "current" or "liquid" means of exchange, which e.g., shops are obliged or only too ready to accept, and for this these "mortgage bonds" etc., are totally unsuitable.)

If they were legal tender then their immediate depreciation would, indeed, be avoided, but prices would begin to soar (inflation).

**Thus, with the clearing banks, institutions are established which avoid the four scourges of modern economic life:**

**DEFLATION** - because the monopoly is abolished,

**INFLATION** - as there is no legal tender,

**FORWARD RISK** with bank balances and bank debts - as there is no redemption obligation and

**UNEMPLOYMENT**, as a result of a shortage of means of payment - as the establishment and cancellation

of credit exactly corresponds to the production and consumption of goods so that, from that side, the employment of labour is no longer limited.

**In a credit system built according to the principle of the clearing banks, the goods themselves create their own purchasing power (the means by which they are purchased).**

(Alas, the goods etc. do not and cannot print clearing cheques themselves, and their owners are usually neither legally free to do so nor do they appreciate this kind of monetary freedom. - Compare Say's Law, which does not operate as he and others imagined it would, in the absence of full monetary and clearing freedom and the sufficient use of these liberties. - If, for instance, gold or silver coins are the exclusive means of exchange, then their value or purchasing power will not automatically, instantly and fast enough rise to make up for any increase in the goods, labour and services offered for sale. Thus sales difficulties will arise for producers, shopkeepers, workers and providers of other services. Even the population might grow faster than the total rare metal stocks. When goods, services and labour are competitively supplied, then exchange media and clearing options for them must likewise be competitively supplied - to keep the balance between the goods side and the money side. Furthermore, alternative value standards must also be competitively offered and subject to free choice. Neither exchange media nor value standards must be monopolised and compulsorily integrated and unified via central banking privileges and legal tender laws. - J.Z., 27.12.02.)

**The goods turnover thus becomes INDEPENDENT of the availability of gold or of monopolised paper means of payment and of the current situation of gold mines and of the central bank of issue.**

Under exact adherence to the Quantity Theory, a safe solution of the problem of unemployment and of the re-integration of the unemployed into the normal economic process does then become possible.

Every increase in goods sales, during the re-integration of the unemployed, does then lead not to a new deflation, due to a shortage of means of payment, but to an increase in the means of payment. The newly issued means of payment begin their reflux to the bank at the very moment that the purchased goods are handed over the counter - and thereby disappear from the process of financing turnover.

The new money certificates issued in the process of re-integrating the unemployed in the economy, are, during their retention in the households, a loan raised by the banks in these homes.

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(Note by JZ: These households grant this "loan" in their otherwise unemployed labour. They are repaid on payday and then shop with these loan certificates, exchanging them into goods or services, and thereby set these loan certificates onto their return journey. Thus, quite clearly and in a monetary way, services and goods are exchanged for goods and services. Workers, until payday, are the CREDITORS of their employers and until they redeem the notes received in goods or services, they are the creditors of the note-issuing bank and of its debtors.)

These additional means are the source out of which the increased goods turnovers are financed - until the goods are sold and the notes or the typified cheques have returned.

C/ III) DRAFT OF A "LAW" ON THE ISSUE OF REICH TREASURY NOTES

**1. In the above the principle for private trading between producers, merchants and workers, i.e., for a PRIVATE payment community, was given and carried out in a draft. But with this only A PART of the economy would be freed of the shortage in means of payment. For, aside the private circuit of the economy there stands, so to speak, a second and PUBLIC CIRCUIT which suffers equally from deflationary effects. This is the money circuit between the taxpayers, the pay offices of the State and the municipalities, the public servants, the public bodies and the suppliers of the State.**

During the crisis it was precisely the frightful money shortage of the State, the breaking up of the public debt system and the floating debt of the State which, increasingly, aggravated the crisis on the Stock Exchange, in credit matters and on the interest market and increased, more and more, the unemployment among the white and blue collar workers of the State, as well as among the industries supplying the State, and in the economy as a whole.

According to the laws provided for in the Dawes Plan, the German Reichsbank was, exclusively, a bank of the private economy. Consequently, as long as the Reichsbank was healthy, it could only somewhat supply THIS sector of the economy with means of payment. But the other, the STATE'S circuit, remained without means of payment.

The means for it had first to be extracted from the other circuit - by means of taxation and forced liquidation. The tax laws, of course, take care of the tax demands of the State but NOT of the solution means required for paying taxes.

Here a special means of payment was necessary: the State paper money which, contrary to the inflationary "proper" paper money, must not be given compulsory acceptance (& compulsory value! - J.Z.) (legal tender). **Such treasury notes, with a free market rate, are indispensable for a healthy public finance system whose intention is not to disturb the regular course of the economy.**

(Note by JZ: No more so than it does anyhow, by its mere existence. See, especially, Murray N. Rothbard's 'Power and Market', Institute for Humane Studies, Menlo Park, California, chapter 4, on the harm done by all compulsory taxation. Apart from damaging a free exchange economy, it is, by its coercive and exploitative nature, i.e., morally, an abomination, one much is more clearly expressed by the term "tribute", better still by "blackmail - under benevolent pretences".)

**Whilst the State paper money with legal tender is an UNCOVERED floating DEBT of the State, the State paper money subject to a free market rate represents the mobilisation of matured TAX CLAIMS and thus a debt that is fully covered by due claims. Such certificates do also rest on the principle of clearing. They are, so to speak, liquidified taxation claims or typified taxation cheques, similar to the typified clearing cheques which are covered by commercial goods claims: The population has, continuously, to pay large amounts of taxes. The treasury and its public servants pay, continuously, large amounts to the population. Between these claims and debts a clearing is as practicable as between the claims and debts of the private economy through the cheque and giro system. It is arranged through treasury notes, which are really clearing certificates. They do not contain a promise to pay but merely the assurance that the State will ACCEPT them at all its pay offices in payment of taxes and custom duties, at any time and at their nominal value, like gold (tax foundation).(23)**

(Note by J.Z., 27.12.02: Alas, governments usually do NOT or no longer combine sound value reckoning, e.g. via gold weight units, with tax foundation but, rather, abstract and frequently depreciated "paper value standard" reckoning. They do not accept their tax foundation money, as when used with sound value standard, at par with that nominal value, even when in other transactions it has suffered a discount. Thus there is no inbuilt deterrence against over-issues. Under free market rating the State could issue tax foundation money beyond a sound quantity only at a discount and would have accepted these certificates at par from the tax payers.)

## 2. THE MOST IMPORTANT CLAUSES OF THIS LAW DRAFT FOLLOW HERE:

### Par. 1

The Government of the Reich is hereby empowered to issue Reich treasury notes in denominations of 5, 10, 20, 50 and 100 marks.

Par. 2

- (1) The Reich treasury notes shall be produced by the Debts Administration of the Reich.
- (2) The Debts Administration of the Reich has to note on the Reich treasury notes the date of their handing over to the Chief Pay Office of the Reich.
- (3) It shall replace notes that have been damaged or become useless and charge these to the Reich when the submitted piece is part of a genuine Reich treasury note and consists of more than half of such a note. In other cases, the Reich Debts Administration shall replace notes at its dutiful discretion.
- (4) The Reich Chief Pay Office shall cancel the Reich treasury notes flowing back to it and return them to the Reich Debts Administration for destruction.

Par. 3

- (1) The officially approved German Stock Exchanges shall daily determine and publish a rate in Reich marks for the Reich treasury notes.**
- (2) Until a free gold market has been established in Germany, the rate shall be fixed by conversion of the London gold rate on the basis of the average rate of Reich treasury notes for settlement in London.

Par. 4

If for more than two days the average rate quoted stands below 95% of the nominal value, then new Reich treasury notes may not be produced by the Reich Debts Administration or circulated by the Reich Chief Pay Office, until the price quoted reaches at least 95%.

Par. 5

- (1) The Reich Gazette and the State Gazette shall publish daily statements on the Reich treasury notes. These statements shall report, separately, by denominations,
  1. the total amount of Reich treasury notes,
  2. the stock of Reich treasury notes at the Reich Chief Pay Office,
  3. the resulting number of Reich treasury notes circulating,
  4. the incomings and outgoings of Reich treasury notes at the Reich Debts Administration and the Reich Chief Pay Office.
- (2) The Audit Office of the German Reich shall control the accuracy of the statements and vouch for them in public announcements.

Par. 6

**There is no legal obligation to accept Reich treasury notes in payments which are to be made in currency, neither at their face value nor at any other value.**

Par. 7

- (1) Compulsory acceptance for these notes applies only to the pay offices of
  1. the Reich,
  2. the German States,
  3. the municipalities and municipal federations,
  4. the social insurance authorities,
  5. the Reich Post Office,
  6. the Reich Railway Company.
- (2) The compulsory acceptance does not apply to deposits in postal cheque and savings accounts and in general bank transactions, especially not to payments made to pay offices mentioned in section 1 which only serve the passing on or the bank-like administration of the amounts paid in.

Par. 8

**The pay offices named in par. 7 must accept the Reich treasury notes at their face value at all times.**

Par. 9

(1) If the average rate quoted at a Stock Exchange stands below 95% of the nominal value for more than 6 days, then the Reich Minister of Finance shall decree the payment of certain or of all taxes in parts or wholly in Reich treasury notes.

(2) When any payee fails to comply with this obligation then he must pay a surcharge of 1%.

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Par. 10

If a debt payment is offered in Reich treasury notes then the debt relationship ends with their acceptance.

Par. 11 ...

Par. 12

The Reich Minister of Finance shall adopt measures to facilitate - particularly through establishing exchange centres - the exchange of Reich treasury notes paid in at banks, between the Reich Chief Pay Office, the Reichsbank, and the banks, savings banks, and other credit institutions.

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**3. At a time when one quarter to one third of the national income is claimed by the State, one has to provide special means of payment for the movement of these enormous quantities of goods - if the whole economy is not to suffer.**

During a crisis the tax sources tend to dry up. Thus we have here a means to avoid a deflationary interruption in the State's goods circuit and to make the tax sources flow once more.

(Note by JZ: This tax stoppage is not the equivalent to a well thought-out and well organized TAX STRIKE. - Compare Peace Plans Nos. 13 & 14. - Instead, it leaves the tax system untouched and brings it to the extreme of numerous forced expropriations and sales for overdue taxes, to a large-scale depression and unemployment. The intention here is merely to avoid this ADDITIONAL evil of taxation. It amounts, as someone once said, to "the torture of a deaf and dumb person in order to extract a confession from him".)

At the same time, the central bank of issue is relieved of the leaden weight of the floating State credit for, with the means then obtained, the State can repay its credit from the central bank. The central bank of issue, now overburdened and crushed by State credits, can once more and better pursue its task to promote the private economy. Even without a monopoly, it would retain, in the financing of large industries and of external trade, a function which the more localised clearing banks could hardly take over for the time being.

4. The SAFEGUARDS of the Reich treasury notes against abuse consist, comparable to the old Prussian tradition of the "Tresorscheine" (Treasury notes of 1810) and down to the Rentenbank certificates of 1923, in the following aspects:

a) In their free market rate and daily quotation at the Exchanges. In case of over-issues, they depreciate and receive a discount - without affecting the country's prices calculated in gold units. But such a depreciation, because of the vigorously enforced reflux, would practically be confined to a case of the greatest fiscal mismanagement. For THIS case no other system can offer a security, either.

(Note by JZ: The security would then lie in the right of the people and of individuals to REFUSE ACCEPTANCE and in the losses the government would suffer when issuing its notes below par while it has to accept these same notes immediately at par in payment of taxes etc. The government would thus provide an effective tax reduction and would thus render itself still more insolvent. Naturally, the people would have to take several precautions against the reintroduction of legal tender and the note issue monopoly. For instance, the government of Switzerland could not reintroduce them AGAINST the will of its citizens, who have referendum powers and constitute an ARMED CITIZENRY.)

b) In their tax foundation: Everyone can pay with them his tax debts at par so that a discount of these certificates would lead to a run upon the tax offices.

(Note by J.Z.: A "run" not in order to WITHDRAW, as with gold redemption banks, but in order to PAY taxes! This tax relief will not be welcomed by the government since it suffers losses or has to spend more when issuing treasury notes below par, which it has then to accept, immediately and at par in payment. It would also risk losing suppliers who refuse to accept the treasury notes altogether. This sounds harmless only when one has only certain goods suppliers in mind. But, for instance, in Athens after WW II almost all public servants walked off their jobs and turned into day labourers at the harbour etc., because they could no longer support themselves on their fixed salaries, which were paid in greatly inflated State paper money. History has several times shown that these refusals to accept inflated paper money in payment can become very dangerous when the "suppliers" are e.g. suppliers of police and military services.

Today, the powerful unions of public servants would probably be among the first to refuse to accept the payment of their salaries in depreciated treasury notes - if the free market rate is allowed to reveal their depreciation, i.e. legal tender does no longer exist, helping to conceal this depreciation, misdirect the anger on "price increases" and keeping them monetarily ignorant.)

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c) In the provision that the issue of treasury notes must be suspended when a marked discount appears. The reflux, due to the tax foundation, will then immediately reduce the total circulation. The remaining demand re-establishes parity.

d) In the provision that the Minister of Finance HAS to order the payment of some or all taxes EXCLUSIVELY IN TREASURY NOTES in order to speed up their reflux. Thereby an especially strong demand is created in case of an emergency.

e) In the possibility to pay the treasury notes at any time into frozen gold accounts at the tax offices, as advance payments of future taxes. Such "tax-assets" are not reclaimable but only useful for paying taxes. They bear interest, are transferable and, moreover, exempt from taxes. They thus constitute SOME KIND OF SEMI-LONG-TERM LOAN TAKEN UP BY THE REICH. (24)

They are expressed in gold marks so that the bearer of treasury notes, in the quite improbable case of their depreciation, can obtain for them at any time a kind of gold loan of the Reich guaranteed by a kind of lien on tax revenues. Thereby, THE STATE BECOMES AN INSURER OF THE PEOPLE AGAINST INFLATION. It becomes a tax bank. It receives, especially during a time of loss of confidence, a semi-long-term loan (25) and, at the same time, abides by the requirements of honesty.

(Note by J.Z.: I would not use the term "honesty" in connection with compulsory taxation. But one has to remember that Rittershausen wrote this under the severe censorship of the Hitler regime, which would certainly have prosecuted the advocacy of a tax strike and of voluntary taxation.)

5. How securely the price of such State paper money would remain at par follows from the fact that in case of an issue of 1 milliard marks, the total issue would annually be re-purchased about 12 times, as the tax receipts of the Reich, its component States and the municipalities amounted to about 12 milliard marks. Twelve times p.a. it would have come to clearing. Such a great demand would, undoubtedly, have kept the rate at par.

The excellent experiences which PRUSSIA had with such treasury notes, during the Napoleonic Wars, speak in their favour. It was the well known Freiherr VOM STEIN who, from 1812-1815, financed the war of RUSSIA - after SPAIN'S famous advances - and, later, that of all allies, against Napoleon I, in this way, successfully, and without inflation. In most other countries similar traditions exist.

Compare Lorenz von Stein: "Finanzwissenschaft" (Science of Finance), Vol. II, 1886 and De Viti de Marco, "Financial Science", in several languages. about 1928, in its major part on State paper money. (Here and there, this theory is represented in details.)

These historical experiences ought to be utilised today for the fight against the economic emergency.

C /IV.) DRAFT OF A "LAW" ON RAISING THE PRICE OF SECURITIES  
AND LOWERING THE EFFECTIVE INTEREST RATE  
BY THE INTRODUCTION OF CLEARING IN THE SPHERE OF LOANS

1. The principle of clearing is useful also for a third sphere, where a shortage of means of payment is felt: the long-term State credits. Since 1931 the Reich, its component States and the municipalities could no longer pay their due debts or only with the greatest difficulties. The same applied soon to many of the issuers of private loan certificates, since the very large enterprises, as main users of the capital market, fell as first victims of the crisis.

The loan system and the annuity market practically collapsed. Their prices fell sometimes to below 50% and even 30% so that the effective interest rate rose, temporarily to over 25%. These enormous interest rates and the destruction of the capital market made any provision of employment completely impossible.

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They also disturbed the short-term turnover credit and the short-term State credit which were discussed above. The latter could not be reorganised without providing aid for the long-term State credit and the loan market.

The aim was to make the debtors of loans solvent again. The further aim was to achieve such an intensive DEMAND for loan certificates at the exchanges that their price would rise to 100% and a conversion would become possible, of the loans bearing nominally 6-8% interest, into series with lower interest rates. Otherwise, the issue of cheap loans to convert the large floating indebtedness and to finance employment, would not be feasible. These questions of lowering the interest rate cannot be discussed here in detail. The author, officially commissioned, has submitted detailed reports on this which were partly published in the "Bankarchiv" of 15.6.1933.

2. The solution suggested by the clearing principle for the here occurring PROBLEM OF MEANS OF PAYMENT, consisted in removing the difficulties, as far as they were caused by the impossibility to obtain monopolised means of payment, by the USAGE OF THE LOAN CERTIFICATES THEMSELVES AS SOLUTION MEANS.

In Germany, as the result of the above-mentioned publications, this procedure was developed in practical application. Many large cities had lent out hundreds of millions in mortgages, loans, unpaid purchase instalments etc. The debtors, although mostly financially weak, embraced, nevertheless, a great number of small real estate owners, of members of the middle stand and of healthy medium sized enterprises, who could very well make repayments, even in advance, if only they had a special incentive.

Thus at first some, and later more and more cities, declared that they were prepared to accept their own debt certificates at their face value as means of payment and thus to accept the amortisation of their long term debts, in natura, in their own loan bonds instead of in monopolised legal tender money, that is, **to permit the CLEARING of such long-term loans of the towns with the long-term debts of the towns**. Essentially, this is nothing but a self-evident realisation of the concept of honesty.

Thereby SUCH A GREAT DEMAND FOR SUCH COMMUNAL LOANS AROSE that their PRICES ROSE by no less than 10% of their nominal value, precisely at the moment when two of the most important cities had to suspend payments, in September of 1932.

A new possibility for utilising loans was established. The holders of the loan certificates had no longer to view with despair the worsening financial situation of their debtors, for they could open up compensation possibilities and thereby mutually extinguish progressively larger parts of the long term debts. In this they received 100%.

Some German towns own very large electricity, gas and water works etc., which often could be placed at the disposal of their creditors in form of joint stock companies, thereby opening up very large clearing opportunities. Thus the LIQUIDATION OF THE MAJOR PART OF THE LONG-TERM INDEBTEDNESS OF THE TOWNS BECAME POSSIBLE. (The question of the different due dates will not be discussed here. Consult on this my article in "Bankarchiv" of 15/6/1933.)

3. In one law draft this principle was also extended to the loan credit of the REICH and its component STATES. In this connection a large number of constructive measures were proposed. This principle was even made useful for the issue of MORTGAGE BANKS, which, therefore, experienced a considerable price increase. No less than 400 million RM out of a total of 6,300 million RM were thus compensated during 17 months. They served to relieve the market by purchases at a time when any other rate support was missing as nobody bought. The principle even

penetrated into legislation. **The Fourth Emergency Decree of Dr. BRUENING authorised mortgage debtors to repay their mortgages in mortgage bonds, at their nominal value, instead of in cash. The debtors thus purchased mortgage bonds cheaply. They stood, sometimes, at only 65 % while loans of the Reich, States and municipalities had fallen down to 30-40% of their nominal value.**

Thereby a DEMAND was developed for mortgage bonds. They remitted these bonds to the banks for the amortisation of their debts, "in natura", at their nominal value. (26)

Finally, the principle was proposed even for INDUSTRIAL BONDS, whereby often a debt reduction through clearing became possible by the sale of old stocks of goods against loan certificates which had become almost worthless. The rate increases were large.

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4. The strong rate increases of loans and the revival of the confidence of loan holders, were later the starting point for the "organic lowering of the interest rate", which was systematically begun by the Reich Government and the Reichsbank, i.e. for an interest reduction not by a renewed legal robbery of the creditors, as had been conducted by Bruening, but by a rise in the market rates. As Dr. Otto Christian FISCHER, the leader of the German bank system and president of the Central Federation of the German Banking Industry, once explained, the demand for a lower interest rate means only a demand for HIGHER MARKET PRICES, since the effective and not the nominal interest rate is decisive. Only a low actual interest rate, at which credits are really obtainable, can lead to the re-integration of the unemployed, not an artificial lowering of the nominal interest rate, at which no credits are obtainable. (27)

#### C / V.) DRAFT OF A "LAW" ON STABLE VALUE RECKONING

The general realisation of the clearing principle, the abolition of the money monopoly, of inflation, of deflation and of legal tender, call for a return to principles in currency legislation which prevailed in most countries up to the end of the previous century. **THE CONCEPTS OF THE VALUE STANDARD AND THE MEANS OF PAYMENT MUST BE SEPARATED ONCE MORE.**

Under a pure gold weight currency and with a free gold market, this separation was necessary and realized. For freedom of the gold price can mean nothing else than the possibility for fluctuations in the value of paper means of exchange. We have seen that this separation was also abolished in Germany, in the course of the last decades, which led to the appearance of various forms of paper currency, among them the so-called gold-core-currency (gold exchange standard), under which compulsory acceptance (legal tender) existed for the notes of the central bank. Thus concepts of inflation penetrated the population which were disastrous from the viewpoint of re-integrating the unemployed in the economic process:

Any kind of increase of the circulating media was supposed to endanger the stability of the currency. According to the theoreticians of legal tender, one had **ONLY THE CHOICE BETWEEN MASS UNEMPLOYMENT AND INFLATION.** It was left to politics to choose between these two forms of economic disasters.

(Compare my 16 page and highly condensed essay on this: The Soft Option: Monetary Freedom to Stop Inflation without Causing Unemployment, in PEACE PLANS 19 b, which is now offered on my main website. - J.Z., 27.12.02.)

**ACCORDING TO THE HERE REPRESENTED VIEW, THESE DISASTROUS ALTERNATIVES APPLY ONLY TO THE REGIME OF LEGAL TENDER.** To liberate ourselves from it and to achieve an abundant supply of means of payment, until the unemployed have been re-employed (28), **WITHOUT** running the risk of inflating prices, the legislation on currency, coins, means of payment and compulsory acceptance, which applies in Germany, must be amended and reduced to the older and sounder principles on the subject. The fourth "law draft" serves this aim. It falls into two parts, one on a new currency act, the other on the rehabilitation of the then seriously sick German central note-issuing bank (the "Reichsbank").

Here is the text of this Draft Law:

In all payment and credit transactions, regardless of the market rate of the means of exchange, calculations are to be made in stable value units.

#### Par. 2

- (1) Gold is the standard of value.
- (2) The reckoning unit is the mark which is divided into 100 pfennigs.
- (3) The value of the mark is equal to 1/2790 kilogram of fine gold.
- (4) By agreement other value standards than gold may be determined.

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#### Par. 3

Gold coins of the Reich are the only means of payment that have to be accepted in all transactions without limits and at their face value.

An obligation to remit gold or coins in settlement of liabilities valued in marks does not exist. (29)

#### Par. 3 a

The creditor, whenever the debtor offers them, has to accept in settlement and at their nominal value his own due bonds and goods warrants which are expressed in marks, and also those of his creditors.

The creditor has to facilitate the possibility of clearing by making his goods and services available ("shop foundation") as is practice in his profession, and by naming his bank.

Clearing is the only means of settlement which must be accepted by the creditor in trading, at nominal value and up to the amount of his debt. The clauses of the Civil Code on clearing do not apply.

The restrictions on clearing by debtors of public bodies are repealed.

#### Par. 4

- (1) There is no obligation to accept banknotes in payments which are legally to be paid in money.
- (2) Par. 3, sec. 2 of the Bank Act of 30/8/24 (RGBl. II, p. 253, compulsory acceptance for Reichsbanknotes, Dawes Act) is hereby repealed.
- (3) In par. 5, sec. 1, sentence 1 a of the Coinage Act of 30/8/24 (RGBl. II, p. 254) the following words shall be deleted: "and the notes issued by the Reichsbank and payable in Reichsmark".

#### Par. 5

- (1) The officially approved German Stock Exchanges shall daily determine and publish the rate, in Reichsmark, for the Reich banknotes.
- (2) Until a free gold market has been established in Germany, the rate shall be fixed by conversion of the official London gold rate on the basis of the average rate of the Reich banknotes for settlement in London.

#### Par. 6

In cases of doubt, rate variations of the customary means of payment of 1% of the nominal value, upwards or downwards, shall be ignored.

#### Par. 7

Should the determination or publication of the market rate for a means of payment not take place or should only a restricted allotment of gold and foreign exchange occur for a period of more than 6 Exchange days, then the creditor is entitled to refuse to accept what is offered - as long as the determination or publication of the rate remain suspended or the restricted allotment continues.

#### Par. 8

Should a settlement be effected by a remittance of Reich banknotes, then their acceptance terminates the debt obligation.

#### Par. 9

The debt relationships existing when this Act comes into force, are considered as stable value relationships.

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We have reprinted this "law draft" because it represents the most conclusive refutation of the argument of inflationism and because it attempts to outline in a short and radical form, the pure gold currency without its previous mistake: the obligation to tender physical means of payment.

At the same time it attempts to clarify the clearing principle.

Although these law drafts possess only scientific value and can only be the basis for the decisions to be taken by the deciding authorities, nevertheless, the thorough elaboration of the scientifically correct principles, not in general terms but in a practically conceivable way, has had great effect upon the practice.

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Whilst other reform proposals want to copy certain American and English precedents, which must be considered as mere makeshifts and thus required the further expansion of paper money issued upon illiquid claims and assets, as well as the extension of legal tender to giro money, here, for the purpose of re-integrating the unemployed, exactly the contrary has been demanded.

## D CONCLUSION

### 1. FUNDAMENTAL CONCLUSION: NECESSITY OF A SATURATION WITH MEANS OF PAYMENT

We have seen the cardinal objective in the re-integration of the unemployed in the regular economic process. Our starting point was the goods and money circulation in a small payment community. We recognize that the COSTS AND EXPENSES involved in the production of goods, turn, in the hands of the workers, the clerks, the recipients of interest and dividends, into INCOME. We also recognize that the goods production either serves the direct supply of the population with CONSUMER GOODS or the MAKING OF LONG-TERM CAPITAL GOODS. In both instances credit plays an important role.

The supply of the population with consumer goods in the "regular economic process" is not possible without a solution of the PROBLEM OF TURNOVER CREDIT. We had recognised that the turnover credit in its present organization is far REMOVED from its ORIGINAL PURPOSE to promote the turnover and sale of goods. We have, moreover, recognised that in this separation of the money circulation from the goods circulation **the following play a significant role: bank organisation, value standard and means of payment and especially the problems of the note issue monopoly of the central bank and the compulsory acceptance (and enforced and fictitious value! - J.Z.) (legal tender) for paper money.**

The positive section, in which we gave as example some law drafts, showed us that merely with the removal of the lava which, in the course of historical development, has covered the system of turnover credit in most countries of the world, an adequate solution of the problem of re-integrating the unemployed is not yet possible. **Therefore, the PRINCIPLE OF CLEARING was developed which, as a new solution principle, promises to solve a great part of the so far insoluble problem of turnover credit and of unemployment.**

(Note by JZ : It is "new", in its explicit clearing form, only in the wage payment & consumer-spending sphere.)

As the FUNDAMENTAL CONCLUSION of our examination of turnover credit and unemployment, we can now state the DEMAND THAT ALL TRADE MUST BE AS ABUNDANTLY AS POSSIBLE SUPPLIED WITH MEANS OF PAYMENT.

**If any issuing centre should issue too many means of payment then, under the system of a free market rate, these means of payment depreciate by suffering a discount. In case of compulsory acceptance an inflation would occur.**

Both extremes should be avoided: the artificial scarcity and the over-issue of means of payment. In the middle between them lies, so to speak, the SATURATION POINT, which would offer the best guaranty that, as far as turnover credit is concerned, no worker is prevented from producing and exchanging whatever he and people like him want to consume.

## 2. PRACTICAL PART SOLUTIONS: THE CENTRAL BANKING SYSTEM AND THE FUTURE OF OUR BANK AND PAYMENT SYSTEM

Certain practical PART SOLUTIONS ARE SUBORDINATED to the above described fundamental conclusion:

RELATIVELY TOLERABLE CONDITIONS FOR THE RE-INTEGRATION OF THE UNEMPLOYED can also be achieved under the monopolistic regime of the central bank by the following measures

- a) Keeping the central bank healthy.
- b) Restricting the bank to the granting of turnover credit.
- c) Re-linking of credit with the exchange of goods.
- d) Preservation or restoration of the State's short-term and long-term credit.
- e) Refusal to support unsound banks and industrial enterprises, since the means required for this would have to be withdrawn from the sound portions of the economy and because such a policy is followed by either credit restriction or inflation.
- f) Cover of banknotes not by industrial bonds or state securities and similarly frozen stocks but by self-liquidating commercial bills and similar claims.

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That one will fare much better with these time-honoured policies, abandoned by most countries today, than with the untested methods of the conjunctural and the open-market policies of the last years, which remind so much of the time of bank restrictions in England before 1844, is quite certain. Nevertheless, under today's changed circumstances, one will remain in great difficulties with these, as the next decades will show. Thus these measures will require further measures.

Far BETTER CONDITIONS for the re-integration of the unemployed are given when one can resolve upon the ABOLITION OF THE ENFORCED MONOPOLY AND THE COMPULSORY ACCEPTANCE (AND COMPULSORY VALUE! - J.Z.) and a return to the more free and efficient bank and money policy of the last century, which, by the way, also developed a stronger and more independent type of man. This was a system under which Europe once before flourished extraordinarily, both intellectually and economically.

STILL BETTER conditions for the re-integration of the unemployed and avoidance of economic crises and collapses, will be established if one removes redemption in specie and the cash-repayability of banknotes and bank deposits and if, instead, one changes over, by means of internal and external purchasing certificates (goods warrants etc.) to **the NEW SOLUTION PRINCIPLE OF CLEARING which has also a proud history**. All conceivable precautionary measures are to be used in this. Only few of them could be discussed here. (30)

## 3. THE LIMITS OF THE IMPORTANCE OF TURNOVER CREDIT FOR THE SOLUTION OF THE-UNEMPLOYMENT PROBLEM

No matter how great the importance of an advantageous organization of turnover credit may be for the solution of the unemployment problem, however optimistic our practical conclusions may make us, yet we must not overestimate the part solutions so far offered.

Firstly, unemployment is by no means caused exclusively by monetary factors. Only this present paper has confined itself to the treatment of the monetary and credit causes.

Moreover, at least until a short time ago, the turnover credit in Europe was still by far the best developed of all credit branches, leaving aside mortgage credit in some countries. Despite this and already from 1929 onwards, unemployment was very large in most countries of the world. This is a phenomenon which cannot be traced back to disturbances in turnover credit alone. Only after the breakdown of the turnover credit system (a collapse which was latently prepared in various ways), in Germany, in the year 1931 and in other countries shortly before or after, has the question of turnover credit become especially acute.

Nor should it be forgotten that the achievements of machines in the production of today's consumer goods are so great that ALL unemployed could not be employed (in the production of consumer goods) even once all of them begin to consume fully.

There is an excess of productive capacity. The existing consumer goods production and sales organization could, if it newly employed merely ONE million workers, produce, perhaps, the consumer goods for TWO million additional consumers. **THUS, TODAY, PART OF THE UNEMPLOYED WOULD NO LONGER BE NEEDED FOR THEIR OWN SUPPLY WITH CONSUMER GOODS, IF THE ECONOMY IS WORKING AT FULL CAPACITY.**

If one wants to employ this portion of the unemployed also, then one must let them produce not consumer goods but long-term capital goods and pay their wages with the consumer goods remaining within the productive capacity of the consumer goods industry. As is known, this has been done especially by the German Government in the year 1933/34 with great success.

(Note by JZ: The reader ought to keep in mind here that this work was written under Nazi censorship. The least criticism would either have prevented its publication or led to great difficulties for the author. Thus, as an insurance, he inserted some praise. Actually, Prof. Rittershausen was a member of the resistance and

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survived the Nazi regime only by a fluke. Later, when he could speak freely, he pointed out that under the Nazi's economic rule no miraculous recovery was achieved. The worst of the crisis was already over, anyhow and further recovery, under Nazi rule, was slower in Germany than in many other European countries. But the myth of economic successes of this regime persists even until today. Just compare the unemployment statistic in the above table, page 16. Large scale unemployment still persisted under the Nazi regime for years, in spite of natural recovery trends. From 1935 onwards, at least, the statistics were shamelessly forged. They were not faultless before, either, nor are they now, in "democratic" countries.)

Thus one has to beware, to speak with Karl Diehl (31), of an over-estimation of the "sphere of circulation" as probably an as large number of the causal factors of the boom and bust cycle is not to be found here but in the "sphere of production". But this kind of problem need not be discussed here. (32) The difficulties in consolidating the floating debts contracted in these investments, due to lack of liquidity in the Banking and Exchange apparatus, make this road impassable (in the near future) as State Secretary F. Reinhardt has rightly pointed out. The reorganisation of the machinery of turnover credit, which was to be the introductory subject of the Bank Enquiry, should now find general attention.

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## FOOTNOTES

By Dr. Heinrich Rittershausen, for easier typing here collected at the end of the text instead of, as in the original, at the bottom of the corresponding pages.

Additional notes by the translator, John Zube, have been inserted in the text, in brackets.

1. Compare my book: "Der Neubau des Deutschen Kreditsystems" (The Reconstruction of the German Credit System), Stilke, Berlin, Feb. 1932, 184 pp. (Microfilmed by LMP, with comments by Ulrich von Beckerath and John Zube, in PEACE PLANS 315.)
2. Compare: Dr. H. Rittershausen, "Mutual Marketing as a Remedy for Unemployment", in the INSURANCE AND FINANCE REVIEW, Calcutta, 1930 (8).
3. Simplified from the classical equation. Compare also the production/income equation in my book: "Arbeitslosigkeit und Kapitalbildung" (Unemployment and Capital Formation), Fischer, Jena, 1930, ch. 1. (Reproduced in PEACE PLANS 393.)
4. See Elster, Ad. Wagner, Lexis, Bendixen, Schacht and others.

5. Bendixen, in particular, has, unfortunately, associated this theory with legal tender and with a fight against the Quantity Theory, although we have here only a refinement of the Quantity Theory. Thus he, unnecessarily, exposed a so rightful basic concept to the most serious objections.
6. Apart from Scotland and Canada, where the system of free note issue of all banks has been successfully continued until today - in the framework of normative Acts. Unfortunately, since the World War, their system has also been falsified by the forced currency. (Their notes have become legal tender.)
7. Expression by Prof. L. Ab. Hahn, "Aufgaben und Grenzen der Waehrungspolitik" (Tasks and Limits of Currency Policy), Jena, 1928.
8. 4th. edition, pp. 126 & 129. Besides, Knapp is not at all an enemy of legal tender, which curiously, is today as much considered as self-evident as it was unanimously condemned until 1909. The stress has been put in by the author.
9. Hence Carl Rosch in his book on credit inflation (Jena, 1927), rightly declares that banknotes which are accepted at public pay offices and are legal tender, are no longer banknotes but simply state paper money. (p. 24.)
10. Georg Friedrich Knapp: "Staatliche Theorie des Geldes" (State Theory of Money), 4th. ed., Muenchen and Leipzig, 1923, P. 125.
11. Compare on this especially the German Bank Enquiry of 1908.
12. For instance, France had preceded Germany in this. Compare the authoritative work of Prof. Rist.
13. Mises is of the same opinion. (The Theory of Money and Credit, here quoted from H. E. Batson's translation in the FEE, Irvington-on-Hudson, New York, edition of 1971, P.398.) Rittershausen quoted the same passage in the German edition of 1924, p. 408. - J.Z.): "Apart from the question of financial preparation for war, the arguments used in favour of the centralisation, monopolisation, and State control of banks-of-issue in general and of credit-issuing banks in particular, are thoroughly unsound. During the past twenty or thirty years, the literature of banking has got so thoroughly lost among the details of commercial technique, has so entirely abandoned the economic point of view and so completely surrendered itself to the influence of the most undisguised kinds of etatistic arguments, that in order to discover what the considerations are

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that are supposed to militate against the freedom of the banks, it is necessary to go back to the ideas that dominated the banking literature and policy of two or three generations ago. The bank-of-issue system was then supposed to be regulated in the interests of the poor and ignorant man in the street, so that bank failures might not inflict loss upon those who were unskilled and unpractised in business matters - the labourer, the salaried employee, the civil servant, the farmer. The argument was that such private persons should not be obliged to accept notes whose value they were unable to test, an argument which only needs to be stated for its utter invalidity to be apparent. No banking policy could have been more injurious to the small man than recent statism has been."

14. See the excellent report of the German Festmark Bank in Berlin of January 1932; also Francois-Marsal, Encyclopédie de banque et de Bourse, Fol. I, S. 33.
15. For instance the "Bayrische Hypotheken- und Wechselbank" (Bavarian Mortgage and Bill Bank) with 130 branches.
16. This note is already inserted in the text, above table 11 on page 18.
17. See: Prof. Edgar Milhaud: "Goldburgfriede und internationales Clearing", Annalen der Gemeinwirtschaft, Jan. - May 1933, Geneva, also in English and French, and the two monographs by Zander and Beckerath in the same volume. The English edition was published under the title: A GOLD TRUCE, a constructive plan for the revival of international trade, by Williams and Norgate, London, 1933.

18. See also the three papers by von Beckerath and Zander in this volume of the Annals and the two volumes by Prof. Edgar Milhaud, Geneva, on purchasing certificates.
19. "Das andere System" (The Other System), an economic and financial proposal in four law drafts, Georg Stilke, Berlin, 1932, 135 S. (This was reproduced in PEACE PLANS 315. - A 1948 re-writing of this book, which, due to the timing of the German currency reform of 1948 never saw print, was microfiched in PEACE PLANS 394.)
20. Compare Henry Meulen: Industrial Justice through Banking Reform, London, 1917, page 16 and Greene. (William B. Greene's famous: "Mutual Banking", 1849, republished e.g. by Modern Publishers, Indore, 1945.)
- 20a. German Civil Code par. 387 - 396. In the Civil Codes of other countries: Argentina, 818 - 831, Austria, 1438 - 1442; Belgium, 1289 - 1299; Bolivia, 1297 - 1309; Brazil, 1009 - 1024; Chile, 1655 - 1664; China, 334 - 342; Columbia, 1714 - 1723; Costa Rica, 806 - 813; France, 1289 - 1299; Guatemala, 2326 - 2336; Honduras, 1473 - 1480; Italy, 1285 - 1298, Japan, 505 - 512; Livonian, Esthonian, and Courland private law, 3545 - 3564, Mexico, 2185 - 2205; Netherlands, 1461 - 1471; Panama, 1081 - 1088; Peru, 2252 - 2263; Portugal, 765 - 777; Rumania, 1143 - 1153; Russia, 129b; San Salvador, 1525 - 1534; Spain, 1595 - 1602; Switzerland, 120 - 126; Uruguay, 1497 - 1514; Venezuela, 1353 - 1363. In Great Britain and in Anglo-Saxon countries generally, only the "set-off" and clearing exist, whilst compensation proper is not provided for legislatively.
21. Compare my article "Die Bankenequete von 1908 und die Entwicklung des bargeldlosen Zahlungsverkehrs" (The Banking Enquiry of 1908 and the Development of Non-Cash Payments) in "Zahlungsverkehr und Bankbetrieb" (Payment transactions and bank Organization) part 10, 1933, p. 236 ff, as well as my leading article in "Deutsche Bergwerkszeitung" (German Mining News) of 6/10/1933.
22. On this subject, see Prof. Milhaud's statements regarding purchasing certificates in the "Annals of Collective Economy" for 1933, as well as the papers by Zander and v. Beckerath previously referred to and published in the same volume IX, 1.
23. On the basis of these scientific pioneer works, during the years 1932 and 1933 in Germany, the "Steuergutscheine" (tax warrants) were constructed. These, naturally, were not means of payment. Of these, 1,800 million worth were issued, making them the largest German State security issue. (Note by JZ: The bureaucrats managed to neglect all requirements for sound State paper money AND managed to turn this into just another State subsidy scheme.)

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24. The Rentenbank Act of 1923 also recognized the possibility of a stable value loan by means of such payments.
25. The special draft law on this subject has not been reprinted here. Compare Footnote 19 or consult the reproduction in Peace Plans No. 40.
26. Compare my Bank Enquiry submission: "Lage und Gesundungsmoeglichkeiten der Hypothekenbanken" (Situation and Recovery Possibility of Mortgage Banks), Reichsbank, Berlin, 1934, pp. 32-40 and 57 ff.
27. In April 1933, the author was commissioned to prepare a detailed report on the problem of an "organic interest rate lowering". Compare the article in "Bankarchiv" of 1 May and 15 June, 1933.
28. The author is aware that unemployment has many roots besides that of credit shortage. But here only an attempt can be made to remove the credit obstacles to the provision of employment.
29. Paragraph 3, sentence 2 and paragraph 3 a have here been newly introduced by the author.
30. Note especially the method of four safeguards for the holders of private bank-notes in Canada, among others by means of a central banknotes insurance fund. The latter has been operating successfully for 70 years and has saved the note-holders any losses. Holders also have precedence in liquidation etc.
31. See Karl Diehl, "Weber neuere Kredittheorien im Lichte der Lehre von MacLeod" (Concerning Recent Credit

32. Compare the author's work: "Arbeitslosigkeit und Kapitalbildung" (Unemployment and Capital Formation, Jena, 1930, appearing in Spanish in Barcelona in 1934, as well as the work of von Beckerath in this volume. (This latter essay: "The Realization of Milhaud's Proposals" - a fundamental introduction to free banking principles and practices, appeared in Peace Plans No. 9. J.Z.)

(For some more writings by Prof. Heinrich Rittershausen and Ulrich von Beckerath see especially the main literature list of LMP.)

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"Under free competition in the supply of exchange media, everyone who offers them must endeavour, in his own interest, to keep them stable. Otherwise, he will be pushed out of the market by his competitors, particularly through the public itself." - K.H.Z. Solneman: "Drei Kernfragen (Three Core Questions)

"And it doesn't take a genius to figure how to exploit a money monopoly: just print bogus warehouse receipts and declare them to be legal tender; then pass laws to penalise suppliers of goods or services, who refuse to accept the bogus receipts at face value..."  
Leonard E. Read, FREEMAN 1/75.

"As money and credit constitute the most abstract and important features of free market trading, it is no wonder that they are even less understood than other, more simple, market phenomena. They involve all and are thus understood by hardly any." - J.Z., 24/2/79.

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#### AN EDITORIAL NOTE ON OTHER WORKS BY PROFESSOR RITTERSHAUSEN

##### AND ON CURRENT MONETARY FREEDOM THEORIES

*Some of the other relevant works of Prof. Heinrich Rittershausen, which were not mentioned in the above text or footnotes are:*

1. *"Die Reform der Muendelsicherheitsbestimmungen und der Industrielle Anlagekredit, Zugleich ein Beitrag zum Erwerbslosenproblem!" (The Reform of the Trustee Acts and the Industrial Investment Credits, at the Same Time a Contribution to the Problem of Unemployment), Fischer, Jena, 1929, 90 S.  
(This, too, is a real pioneer work on a fundamental problem existing still today in most countries. That a great problem does lie in this sphere has so far been re-cognised by hardly anyone else. For a long time I was unable to get a copy. Then I microfiched it in PEACE PLANS 532. Therein too, it remains largely ignored. - J.Z., 27.12.02.)*
2. *"Am Tage nach dem Zusammenbruch" (On the Day after the Breakdown), Stilke, Berlin, 1931, 77 S., reproduced in PEACE PLANS 394.*
3. *"Hypothekenbankwesen" (Mortgage Bank System), Verlag der Bankwissenschaft, Berlin. This work was being printed in 1932 and I have still not succeeded in getting a copy. (J.Z., 2002.)*
4. *"Internationale Handels- und Devisenpolitik" (International Trade and Foreign Exchange Policy), Fritz Knapp, Frankfurt/M., 1955, a modern and thorough defence of Free Trade in 528 pages.*
5. *"Bankpolitik" (Bank Policy), Knapp, Frankfurt/M., 1956.*
6. *"Die Zentralnotenbank" (The Central Note-issuing Bank), Knapp, 1962, 820 pp.*
7. *"Wirtschaft" (The Economy), a volume in the Fischer Encyclopaedia, Fischer, Frankfurt/M., 1958.*

*Especially Nos. 5 and 6 of the above do not openly advocate free banking. They are rather typically professorial works, "objective" and "descriptive", to serve as acceptable handbooks or reference works. Prof. Rittershausen*

*had, after all, to make a living - and he did so by teaching his opposition how to run their show! Naturally, his free banking sympathies do leak through and are expressed sometimes. But one should not mistake these books for handbooks on free banking. R. intended to write such a work but advancing age and failing health prevented this. His free banking views ran so much against current "thinking" on the subject that he did not succeed in spreading them widely in Germany. It may be the tragedy of his life, so far, that he succeeded better in teaching the details of the present system, with all its flaws, rather than the sound alternatives. It's hard to swim against the stream! Compared with Rittershausen's, Beckerath's and Zander's writings, the writings of Ludwig von Mises on monetary theory and practice are full of errors, omissions and misunderstandings, as I hope to show in one of the future issues of this series.*

*But they and the likewise faulty theories of Henry Meulen were, usually, the only free banking writings easily accessible to the few libertarians interested in monetary theory. Thus their theories are still accepted in these circles. Mises became even relatively popular among them, not only because of his other excellent writings, but, as I am convinced, after a recent reading of his major work on monetary theory, because he shared many of the popular fallacies on this subject.*

*Thus libertarian monetary theory is, generally, still at a deplorable stage. Not even a comprehensive bibliography has been compiled, far less abstracts, and most of the comparative critical essays for the integration of the existing theories and observations and experiences have still to be written.*

*Libertarian Microfiche Publishing intends to do its share of this work and has already done much in this direction. The Research Centre for Monetary and Financial Freedom was established for this purpose and still needs many collaborators.*

*An ideal money system may indeed provide the Archimedean leverage required. John Zube, 3/79.*

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