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The Money Syndrome

Paths to an Economic Order Free from Crises

This is a preliminary translation accomplished by the non-native English translators Hans Eisenkolb, B.C., Ca. and Robert Mittelstaedt, Munich. With this work they hope to promote an English edition of THE MONEY SYNDROME, which in German has already become a standard work of reference.

Dear reader,

twelve years ago a reader of my School-Diary wrote to me that I had taken up important questions, but had not always found the right answer. He suggested to probe into the problems around our money.

I was not very much interested, because I could not imagine any problems with money. After all, I had more than 30 years of practical experience with financing, calculation and viability estimating. A few things in the letter made me curious though some of the dimensions seemed unbelievable. As a pragmatic person I wanted to disprove the writer, without knowing what can of worms I opened with that. There was not much statistical material available on the one side and on the other side I noticed so many contradictions in the sphere of money that I could not leave it alone any more.

The results of twelve years of analysis you hold now in your hands. Even though I was able to close most of the »white spots on the map«, the dealing with the problems of money will become more necessary and important with every day.

I presume you will agree with me after you have read this book.

»We should not behave as if the knowledge of economic relations is the sole right of the keepers of the grail, who on one side scientifically and on the other side demagogically stick to their hardened standpoints.
No, every citizen of our state must know about the economic relationships and be able to judge, because these are questions of our political order, the stability of which is the concern of all of us.«

Ludwig Erhard, 1962

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If not stated otherwise, all quoted data and figures have been taken from publications of the Bundesbank and the Statistisches Bundesamt. All of my own converted and progressional calculations as well as most of the graphics are based on this material.

Introduction

Money is a phantastic institution. Yet, while we have known and used it for centuries there is nothing in comparison about which we know less! Money is still hidden in a fog of mysticism. Even economists talk about the illusion and the magic of money.

In this book we try to explain the very idea and the functions of money and its role in the market and how it affects people. Above all we will trace the basic dysfunctional structures ingrained in the money as we know it and show the resulting consequences. In the end we will try to show a way out of the age-old dilemma. For, the knowledge of these dysfunctional structures and the possibilities to correct them is essential for our future, not only for the indebted Southamerican countries or the inflationary descent of the former East Block countries. It also applies to the industrial nations where the money related development of problems becomes more obvious day by day. Nobody can escape these monetary forces unless he flees like Robinson to an island.

The normal citizen hardly thinks about these matters. He gets money for his work and spends it on his living expenses. At the most he heard a few proverbs in his youth without giving them much thought. For instance: "Money destroys the character" or "The devil always throws money on the biggest heap". Or still better known in many languages: "Money rules the world".

Why does money destroy the character? Would you say that about a voucher or a theatre ticket, which, similar to money, documents the claim to a good or a service? And why do the ones who already have a "big heap" still get more? Is money not tied to work done? If yes, is income without work not against all basic and human rights? And how about the proverb that money rules the world? Are all governments, whether red, black or green, elected or not, only a farce and marionets of money? Can we speak of an enlightened and grown up world or, first of all, about democracy, if these questions remain unanswered? Or is the fog that covers the sphere of money intentional?

What is wrong with our money?

Whoever concerns himself unbiasedly with questions of money will soon find his hairs rising. Just to mention the contradictions, which you encounter if you try to logically comprehend, will have no end:

- Money is considered a public medium of exchange and at the same time is privately owned, too, although nothing in the world can serve two masters.
- The increase of the amount of money by forging bills or coins is prohibited and punishable by law while withdrawing and thus reducing the circulating amount of money is tolerated.
- Money is the sole legal tender and at the same time an object of speculation.
- Money is subject to compulsory acceptance but not to passing on as payment, although the first makes no sense without the second.
- Money is declared as a medium of exchange and at the same time as a store of value, although the second function makes the first impossible.
- No measurement on the market is used as frequently as money, but its value is not kept stable.
- Our money is connected with the effects of compound interest, although this is bound to self-destruction by mathematical laws.

These contradictions alone should explain the tribulations caused by money, particularily, if you realize what central role money plays in the economy of today.

What importance does money have?

If you ask the inhabitant of a house, which parts of the house were the most important ones, you would probably get the answer: the living quarters. Hardly anybody will mention the basement or the foundation, even though the foundation is a basic necessity for the stability of the house. Similarily, the storeys of our »political house« in which we live, the fields of social politics, are the most important ones, economy concerns us less and money or currency hardly at all. This does not only apply to the majority of the public, but it is also true for almost all politicians. A member of the Socialist Party in the German Bundestag, formerly banker at the National Bank and then expert for currency questions of his party once lamented: whenever social questions of the day are being dealt with, the plenum is full. If the discussion was about economics two thirds of the members would leave and if it concerned questions of money or currency at the most half a dozen members would stay. - In other parties it is probably hardly any better.

Everybody should see the real importance of money if we arrange the sections of currency, economy and society above each other just like in our example with the house: a stable society is only possible with a stable economy and the economy needs the foundation of a stable money and currency system. But similar to the foundation of buildings we hardly know anything about this fundamental role of currency. If cracks develop in the "societal living quarters" or if the whole building threatens to collapse, we try to fix the problems by patching the cracks. Yet, such solutions have no chance to succeed, where the causes for the disorder lay deeper. If we take the trouble to probe into the underlying causes for the cracks and the state of decay in our society, which means to follow the chain of cause and effect down to the lowest level, we will almost always find them in the foundation - the level of money and currency.

Before examining the fundamental dysfunctional structures it will be useful to clarify some definitions concerning money and economic functions.

Explanation of Monetary Terms and Processes

If concepts are not right, the words are wrong,
and if the words are wrong, works cannot be achieved.

Confuzius

Concepts should be an aid to conceive. Having clearly defined terms and concepts, even complicated relationships become comprehensible. Unclear definitions can even muddle simple facts and relationships.

Someone coming from other fields of endeavor and starts to learn about money matters will be amazed at the double talk which is prevailing in these circles.

Somewhere changes in the general level of prices get mixed up with the change of single prices and even get subsumed under the term inflation. Elsewhere profit, earnings, interest, yield and surplus value are used for the same as for different phenomena. And then checks and credit-cards are called »money« or bank notes and coins are put together with deposits and declared as »amount of money«. The stated reason is that the transfer from account to account can balance a claim, just as a change of hands with money.

What would we think of tradesmen, if they comprised nails, screws and fasteners within the term »glue« just because all of them can be used to fix two pieces of wood in a similar way as with glue? Even laymen would rightfully tell them that they are confusing everybody including themselves.

In the following we will try therefore to shed some clarity on the conceptions and functions around money, even though antiquated and deeply engraved thinking habits have to be challenged.

What Is Money?

The answer to this question alone could fill books! At first, money is quite a fantastic invention, comparable to the invention of the wheel. Just as with the help of the wheel the transport of goods was made easy in a previous unthinkable manner so made money the exchange of goods and even the production of goods for sale possible. Without money it was only possible to exchange service for service. The basket-maker, who needed new shoes, had first to find a shoe-maker, who needed a basket. This shows that without money a market for specialization and division of labor was impossible to achieve.

Looking at the exchange of services and goods, which made civilization and culture possible, money is the intermediary which frees the render of a service from being bound to one partner. Money makes it possible to sell a service to anyone interested in it and, with the received payment, unlimited by time and place, asking for a return service from anybody else. Before money came into existence these services were rendered by goods, which nearly everybody could use, such as salt, grains, tea-bricks or coca-beans. These goods could be used because of their relatively long »shelf-life« as medium of exchange but they were un-handy and lost value in time. Money, being countable and durable as well as facilitating to be carried, stored and to compare prices, brought about the development of a market economy without which the civilization of today would be unthinkable.

What Do People Believe Is Money?

This question is not difficult to answer for the common man. Money is, what he has in his wallet or at home in a drawer: coins and bank notes. On the market there are hardly any misunderstandings either: A bill is paid with money or with a transfer of deposits from an account. In practical life money is a neutral anonymous medium of exchange that circulates in economy.

With this idea of money students of economy get into difficulties after a few semesters. They are taught to count positive accounts in the banks for money, too. They talk about savings accounts, term accounts and giro accounts and comprise them within the term »book-money«. And this notion of money gets extended farther and farther. The former banker von Bethmann, whose critical analysis usually hits the target, even ›creates‹ money with every unpaid bill which will be ›destroyed‹ after the bill had been paid. »Basically nobody knows any more, where money ends«, an official of the National bank said in facing this situation. Note, these are the words of an official of the institution which is responsible for the amount of money in circulation.

How Can Money Be Defined?

The definition of money becomes more difficult if the conception of money will be extended to more and more phenomena. This difficulty is reflected in scientific statements, for which three samples should suffice:

- »Money is a general good of nominal validity« (F.Lütje),
- »Money is a creation of the money order« (F.G.Knapp) and
- »Money is what is valid« (G.Schmoelders).

In the view of such »precise« remarks the statement of a national banker (O.Issing) is almost reassuring: »Huge heaps of scientific literature show evidence that the definition of money is anything but indisputable.« But, if national bankers do not know »where money ends« it is more than doubtful that they have a concise notion of what money is. Trying to define money with its functions one can describe it as follows:

- Medium of exchange
- calculating base, price measurement or price comparer
- store of value and medium for transferring value.

Using judiciary or documentary aspects, then money is:

- a public service for the benefit of all citizens,
- an anonymous proof of service with acceptance compulsion,
- a transferable document of claim on the social product,
- sole legal tender.

And, if one considers the above mentioned faults of money, then it is:

- An institution, the function of which as a store of value works against the original purpose as a medium of exchange,

- an institution which stands on one leg because the compulsion to accept it is not counter-balanced by a compulsion to pass it on,
- the only public service which everybody can take out of service and can legally abuse for private gain.

Within these confinements we have answered the question what money is. It is the medium to which all the definitions above apply. And this is only the case with bank notes and coins, the medium of exchange, which the state issues.

For all other phenomena which economists call money, like accounts, checks, credit-cards and so on, the definitions apply only in a few points. Consequently we should not call them money, even though we can do similar things with them as with money. Logic as well as scientific integrity should call for distinct definitions.

Which Purposes Can Money Serve?

Just as one gets money as payment for services, so it will be given away for the services of others. Money cannot only be used for buying, one can also give it away or lend it out. Or, one can just let it sit.

If you pass it on, it is gone to other hands and the recipient can do with it what he wants. If you lend the money out you give up your rights on it for only a while. If somebody just lets it sit, he postpones his right to a counter-service at a later time.With that he causes a disruption of the circulation of money. This disruption is not a single occurrence. It is like a chain-reaction! Figuring that usually money changes hands two times a month on an average, then an idle 100 DM bill prevents demand for 2400 DM a year. While by giving away, buying or lending out, the money remains circulating, the keeping of money idle will lead to disruptions which in the course of time will accumulate.

In this uncontrollable timelag between the rendering of a service and collecting the pay for it and the acceptance of a counterservice and paying for it (which is the function of money as a store of value) lays the decisive fault of our money construction. We will later go into more details but let us state once more that one can use money for three different functions: medium of exchange, price measurement and store of value. And then one can use it as a capital good lending it out for interest.

Are Checks and Credit Cards Money?

Using checks, transfers, debit entries you can transfer credit balances from one account to another. With a check you can withdraw money from an account. For that reason you cannot call a check money. It is a paper allowing somebody to transfer a right on money to a third person or to withdraw ones own money from the bank.

Credit- and check-cards are even less money. They only guarantee the receiver that his claim will be covered by a transfer of money in due time. Magnetic cards which are either ›loaded‹ with a limited sum of money or can be used to access ones bank account are not money either. They are only technical aids to transfer money.

Money are only the bills and coins issued from the national bank, with which one can settle claims from hand to hand without bookkeeping and which after that, can instantly be given to a third party. Money is also the prerequisite of a bank balance.

Certainly, some things may be said in favour of the idea to comprise daily transferable accounts with the amount of money as is done with the M1 expression. Because of todays double function of these accounts as means of transfer or credit, this is highly problematic. We will go deeper into this later.

Why Do We Have to Distinguish Between Money and Other Means for Settling Claims?

Let's assume, for instance, that a plumber has performed some repairs for a baker and asks $ 100 for it. The baker can settle the bill

- either with a $ 100 bill or, if the plumber accepts it:
- with a check or transfer by using a credit card or
- with a trade of $ 100 worth of bread.

The first is the settling of a claim by payment, the second by a transfer und the third by a trade. If everything which can be used to settle a claim would be »money«, then not only the check would be money but the bread as well. If checks or bread are money, then money or checks are - bread!

Such equalizations are not only questionable in a conceptual sense, but also for practical reasons. Thus, the amount of bread can directly be multiplied by work and the amount of transferable assets increases. The amount of money (and this is the significant difference) can only be increased by the national bank (the Fed in the states).

The settling of claims by trading or transfer of assets thus depends on previous contributions of the buyer and therefore is always backed. Money itself, however, is the only medium of demand which can without backing by production be brought into circulation (by the issuing bank).

The difference between money, check and trade-goods becomes still more distinct, if you imagine that the plumber loses his payment: If he lost the bread, his claim would nevertheless remain settled. If he lost the check, his claim would still be unsettled and eventually he could ask the baker for a new one.

If he loses the $ 100 bill, all of his claims were for naught, even if witnesses would testify he once had owned the money. In the first case only he is hurt. In the second case, he has no loss

at all. In the third case, he not only hurts himself but also the public, because he started, even unwillingly, a chain reaction which disrupts the circulation of money.

Why Is Money Superior to Labor and Goods?

Imagine three hungry and tired hikers who, late in the evening, arrive at a village and would like to get a good meal. The first of the three has a 20 dollar bill in his pocket, the second a basket of fresh mushrooms, which are worth at least 20 dollars, and the third boasts of being able to split more than 20 dollars worth of wood in one hour.

The one with the money will have no problems at all to get a meal in the next inn. The one with the mushrooms will only get one if he can sell or trade them. Still harder it will be for the third, since it seems doubtful that somebody might look for a laborer to split wood this late in the evening.

One more example which may be even more drastic: imagine the doors of a safe with 10,000 dollars inside to be closed for two weeks, or a market-hall containing goods for 10,000 dollars, or a room with ten people who normally earn 10,000 dollars in two weeks.

After opening the doors two weeks later, the ten people will probably be dead, the goods in the market-hall for the largest part spoiled, but the bills in the safe would be as fresh as before. Hence, money is - in contrast to the understanding of Marx and other economists - in no way equal to goods and labor, but much superior to those. Because of this the professor for constitutional law, Dieter Suhr, called money the »joker« in economy, the playing card which trumps all others and which everybody keeps as long as possible in his hands because that makes it rare and therefore more precious.

What Are the Dimensions in Calculating with Money?

When we talk about money we can no longer avoid speaking of figures in the millions and billions and some figures have even crossed the boundary to the trillions.

We still have a concrete idea, when we think of one-, ten- or a hundred thousand Marks. However, a figure with six, nine or even more zeros behind the first number transcends our capacity of imagination and judgement. We might get excited to learn that someone earns 20'000 Marks per month and we may find it unjust and unbearable. But if we read about someone who gets 200'000, 2 million or even 20 million a month our critical faculty dissolves and gives way to amazed awe.

Though the numbers get extended just by zeros, those zeros bear a meaning: for instance, if someone sits in front of a heap of one million of 1-DM-coins (a »1« with six zeros) and starts counting them, he will need almost 35 days to remove the heap, if he counts one coin every second for eight hours a day. Three zeros more, that means 1 billion, and it will take him 96 years eight hours a day without interruption! To become rich is similarily toiling: for instance,

if you want to become a millionaire, you must for a period of 83 years put 1'000 Marks aside every month. In order to become a billionaire within the same span of time, you would have to save one million every month. And you could have been born as a billionaire, if your ancestors had started to put 1'000 Marks aside for you every month 83'000 years ago!

Since the money related billion figures of our national economy are now made up of four digits (by the end of 1993 money assets and debts amounted to around 6'000 billion DM) we should include trillions, too, in our calculation examples. However, in this book we drop that and - for easier comparison - stick to billion figures.

Where Does Money Get Its Value from?

At the times when gold or silver were used as money, the value of money was mainly determined by the value of the metal. This value in turn consisted of the desirability, the rarity and the difficulty to find the metal. Money made of gold or silver was like a good which was exchanged for another good. Today only cents might have some such value. The nominal worth of bigger coins and especially bills exceeds the cost of material and production by a wide margin.

Just as gold and silver coins derived their economic value from their scarcity, this is also the case with our paper money today. Our money gets its value from the fact that it is kept scarce compared to the goods and services offered on the market. This means that the value of money (or better: the purchasing power, because money itself has no considerable value anymore) depends on the relationship between supply and demand. In other words: the quantity of economic output divided by the amount of money determines the purchasing power.

Money which is itself actually worthless, is backed today by the products of the economy one can buy with it. It is a document of a claim to a service just as a received banknote is normally the proof of a previous service. If the national bank would double the amount of money tomorrow in the case of unchanged economic output, nobody would become any richer. The result of such a doubling of money would be a doubling of all prices and nobody could buy more than before. But on the other hand all the money accounts and the debts would be cut to half of the value. This means that the creditors would lose half of the purchasing power of their assets and the debtors could now pay their debts with half of the former real value.

How Much Money Does Exist?

When we look at Germany's long term figures for the amount of money in »circulation« (cash without the cash in the banks), it amounted up to 8 billion DM by the end of 1950 and to about 159 billion DM by the end of 1990. This means that the amount of money got multiplied by the factor 20 within 40 years. During the same time the real social product got multiplied by the factor of ›only‹ 5.4. This difference between economic output and the increase of money mainly shows the loss of purchasing power of money but also in parts the change of payment habits (more use of cashless transfers).

In 1990 the per head amount would have been 2,600 DM or 6,100 DM for an average household in the old Federal Republic. The whole amount is made up of about 8% coins and 92% bills and about 1/4 of the value fall to 1,000 DM notes. In converted figures these were one and a half 1,000 DM notes and one and a half 500 DM notes as well as 26 notes á 100 DM in each household, which would add up to the mentioned 6,100 including the smaller notes. Since in reality the average amount of money in a household was only 1,500 DM, this means, that four times as much money had been circulating in economy than had been used by consumer demand.

Of course, businesses also use cash. Compared to their turnover the sums are relatively small. And the large sums that get accumulated in retail stores, eventually end up in the banks, sometimes more than once daily.

By the way, each bank note runs through the tills of the central banks (branches of the ›Bundesbank‹ = national bank) about three times a year. This is around 2 billion Marks every banking day. At this opportunity all soiled or torn bills - about 2,5 million pieces a day valued at 100 million Marks - are taken out of circulation, burnt and replaced by new ones.

How Does Money Get in Circulation?

In 1948, with the so called monetary reform (which was no reform at all, but only a new start after the last bankruptcy of the state), every citizen received 40 new Marks for 40 old ones as a »starting capital« and late in fall another 20 Marks. The employers got the same amount in addition for each employee. All other old cash as well as bank-accounts and debts were exchanged 1 to 10. Half of the bank-accounts were frozen and a few weeks later again devalued by 70%, when the government found out that there still was too much money in circulation. This means, for 10 old Marks on the bank accounts one could only get 65 new Pfennig.

As this example shows, it is the state or from the state appointed issuing bank, which brings money into circulation. In 1948 this was the »Bank deutscher Laender« as it was still called then.

The issuing bank of today, the »Deutsche Bundesbank« in Frankfurt, exists since 1957. Since then it is the only bank which is entitled to issue money. In the frame of economic necessity this is its obligation as in a similar way, it has to care for keeping the money stable. This means that it has to issue more money when the economy grows, if possible, in a precisely adequate step, which is necessary to keep the price level stable, or rather, the purchasing power of money.

How Does Circulating Money Get Expanded?

Expanding the amount of money is not done anymore by head count (even though this might be a just way!), but mainly by credits to the commercial banks.

Besides the acceptance of promissory notes (to which the discount rate is related), the issuing bank can also give so-called Lombard credits in exchange to the deposit of certain security bonds. Today most of the provision with money is done by so-called »security-pension deals«, a variation of »open market deals«, with which the issuing bank can influence the amount of money in circulation. In these deals the »Bundesbank« buys a number of times per month different security bonds or similar assets from the banks with different values, expiry dates and interest levels.

It is important to keep in mind, that these are usually very short term credits and must be paid back or prolonged frequently. With this the Bundesbank has a tool of changing the terms and conditions of these credits at will.

The drawback of these ways of expanding the amount of money by credits is, that they are always connected with interest which the banks have to charge their customers. Part of the interest which the Bundesbank collects, is used for its huge administration with a total of almost 18,000 employees. The rest goes into the treasury of the state.

Another kind of putting money into circulation, for instance, is to take foreign currency in. An expansion of the money in circulation is primarily then connected with it, when export exceeds import as is the case in Germany most of the time. If the Bundesbank accepts the foreign currency as a result of surplus, it has to put German Marks in circulation for it even though the extent might surpass the necessities of the economic growth.

The same often not covered effect of expansion is given with all purchases of foreign currency for supporting the exchange rate. In this last mentioned way most of the surplus money was brought into circulation during the 70ties. By the end of the 70ties this occurred by accepting securities and during the 80ties it was done for the main part by profit transfer to the treasury, according to former Bundesbank President Poehl.

The only expansion of the amount of money that makes sense, is the expansion in context with a growing economy. If the commercial banks ask for more money, it is hard for the Bundesbank to decide, however, whether this results from expanding output of the economy or from changing habits of payment or from increased liquidity.

Of course, the Bundesbank could the necessary money for the economy give away, for instance, as a gift to the state, which nowadays receives most of its profits anyway. Or it could send every citizen 100 DM a year by mail which would approximately be the amount, that corresponds with the necessary expansion of the money amount every year. Even better and more just would it be to sponsor every newborn baby with 5,000 or 10,000 DM. This could be understood as a small compensation for the fact, that each newborn baby now finds an economic debt in his cradle of about 80,000 DM, of which 20,000 DM are from the state and for which he has to pay one of these days (1993 figures, now much higher).

Where Does the »Bundesbank« Get Its Money from?

Paper money is printed in special print-shops, which means that the Bundesbank gets its money for the cost of printing, which is near to nothing. All that is needed is paper and

printing-ink. A bill costs about 25 Pfennig and a 1,000 DM bill does not cost more than a bill with »10 DM« imprint.

Some people believe that the Bundesbank can pocket the difference between these costs and the nominal worth of the bills. This would be the case if it would put money into circulation by buying goods, but this is only done in case of buying security bonds or other currencies, which it, until they get sold again, just keeps on hold. Most of the newly issued money goes its way via bank credits. This means it is only lent out and brings nothing besides interest.

According to current law, the coins cannot be produced by the Bundesbank, only the state is entitled to do so. This is ancient law and when the Bundesbank needs coins, it buys them from the state with bank notes at their nominal worth produced by the Bundesbank. Because the cost of minting coins is (with the exception of the one Pfennig coins) much lower than that, the state makes a few hundred millions with this deal.

The yearly expansion of the amount of money is not all that great. Between 1975 and 1985 it amounted to only 5 billion DM or about 6%. Per head of the population it was 80 DM a year. In the following years it got increased. Between 1985 to 1988 it amounted to 200 DM . In 1989 it decreased to 72 DM. In 1990, by including the new states, it went up to 148 DM, 1991 to 163, 1992 to 355(!) and in 1993 to 140. The causes and the upshot of these fluctuations we will treat later.

To Whom Does Money Belong?

Whoever produces a thing is normally the owner, even when he gives others - with or without charge - the right to use it.

If for instance the railroad supplies their customers at the stations with carts to carry their luggage, they are still owned by the railroad and the travelers are at the most temporary users. One should think, that it would be the same with money which the Bundesbank leaves to the public for use. But here - although money is a public institution - it appears, as if everybody, who has a bank note in his hand, is its owner. This view might have been correct at times, when money was made of gold and silver and therefore was a good with its own value. But today it is outdated.

The problems that are associated with this idea of ownership we will examine later. Fact is, that today everybody can do with a bank note whatever he wants to do except duplicating it. Not only the claim for an economic good, documented by the bill, is his own according to today's understanding, but also the bill itself. And, since everybody can do with his possession, whatever he likes, everybody can deface a bill or can even destroy or burn it (which hardly anybody will do), although the state had provided this bill to the public as a medium of exchange and had expenses for it.

Above all, everybody can, without having to fear consequences, pull this bank note out of circulation thus preventing others from using it.

If we compare this with the carts of the railroad, it will become comprehensible that disfiguring them would hardly impede their usefulness. But if anybody could take these carts

out of circulation, it would not only hurt the traveler who would look for a cart in vain, but it would prevent a whole chain of transports. This example makes clear what negative consequences are associated with the right to hold money back.

Money and Credit

»I believe that we have to find a consensus about definitions. Naturally, one can constantly mix things up, so that one will call money what the next sees as an assets and the third as credit.«

Werner Ehrlicher
(Money theoretician at the University of Freiburg, in a panel discussion "What is money?", Wangen/Allgäu 1991)

What Are Monetary Assets and How Do They Grow?

When a housewife lends her neighbor a pound of salt, it is not in her possession any more. But she has a claim to a pound of salt and her neighbor owes a pound of salt. When her neigbor returns the salt, her claim will be cancelled and so the debt. Nothing had changed in the amount of salt, neither during the deal nor after.

In lending out money the procedure is not any different. When you lend 1'000 DM to another person, you don't have the money anymore. But instead you have a claim to get the 1'000 DM back which is a monetary asset, and the borrower has a debt about the same amount. If he wants to repay the amount, he has to earn it first and then take it from his income. This means that he has to save it, just as the creditor had to do before he lent it out.

These dealings do not affect the amount of money nor do they change the amount of demand on the market. There is only an interim change of the persons who have the money in hand to use it as demand .

If somebody has a leftover of 1000 DM every month which he lends to his neighbor then his claim will amount to 12,000 DM after one year and to 120,000 DM after ten years.

Correspondingly, the debt of his neighbor went up to the same amount. There didn't necessarily have to be a change of output, income or the total of expenses of the persons involved. The same applies to monetary assets and debts within the economy as a whole. Both figures can increase or accelerate in growth even though the level of economic output remains

the same. This means, that growing monetary assets and debts in a political economy have no influence on the amount of money and its purchasing power. They only mirror the size of the debts of some people and the monetary claims of others. The growing amount of these claims and the debts in exactly the same amounts depend alone on the participants in economy, the growing of the amount of money (and therefore the loss of purchasing power of the monetary unit) is solely the responsibility of the issuing banks.

Why Is It Wrong to Sum up Money and Monetary Assets?

An old saying tells us, that we cannot add up apples and pears. By no means can they be subsumed under one of their names. Somebody, who would mix a pound of apples with two pounds of pears and then pretend he had three pounds of apples, we would probably find a little bit beside normality

While apples and pears cannot be subsumed under the heading »apples«, even less can money and credit items be subsumed under the term »money«. Apples and pears are at least comparable real products, but with money and credit items we have on the one hand a concrete, on the other hand an abstract phenomenon. Money is something material which can be grasped and given away. A credit item is only some marks on a ledger, a proof of a claim to money. It is similar to a picture of apples, which one has given to somebody. These pictures have something to do with apples, but they are not apples even though you might call them »book-apples« - in analogy to »book-money«. A subsumption of apples and »book-apples« wouldn't make sense. Just as the assumption, that with every picture of an apple the amount of apples in the world would increase.

Nowaday's usage to subsume money and credit items under the term »money« or »amount of money« is contrary to logic as well as to actual facts. Hence, for the control of the actual amount of money, i.e. as a means and criterion for stabilizing the purchasing power, such a summing up would be irrelevant.

Is It Possible to Sum up Money and Monetary Assets?

Of course, one can put different things together under new names. One can add apples and pears under the heading of fruits, or fruits and vegetables as garden products and so on.

In this way you can also sum up money and credit items, namely, under the heading of monetary asset. Someone who has 1000 DM in his pocket and 8,000 DM in the bank has 9,000 DM worth of monetary assets. To talk about 9,000 DM »money« would be wrong. Moreover, such incorrect usage confuses the discussion about money, the consequences of which become immeasurable. This is especially the case when one uses the name of a primary phenomenon for the primary phenomenon as well as from there derived secondary phenomena.

The example of language and writing - as shown in the following table - makes it clear that it is necessary to keep primary and secondary phenomena apart .

The example can of course be extended by the corresponding technical mediums of transfer. Writing could comprise letters, newspapers and books and as for credit items checks, credit cards and transfer forms.

A. Arrangement of terms in language and writing

	subterms	**main term**	**superimposed concept**
primary phenomenon	sounds words	language	communication
secondary phenomenon	signs letters numbers	writing	

B. Arrangement of terms with money and monetary assets

	subterms	**main term**	**superimposed concept**
primary phenomenon	coins bills	money	monetary asset
secondary phenomenon	deposits savings time-accounts	credit items	

What Are Checking Accounts and How Are They Created?

Bank accounts have different terms for the availability of cash as well as different time frames and interest rates. Normally the interest is lower when the time, the money is locked up, is shorter. There are some where the time is already fixed when money gets deposited. Others are open end but need a notice of withdrawal. Normal savings accounts in Germany are subject to a three months notice. Without notice, one can only withdraw 3000 DM within a 30 day period . Checking accounts have no such limits. Checking accounts - also called giro accounts or book-money - not only differ by lower interest rates and no withdrawal limits.

They have (besides the credit to the bank) a second function. With their help one can transfer monetary assets. These accounts were even installed for this very reason. Of course, on can transfer assets like bank-books or other accounts also, but the transfer of any part sum is much easier with a checking account and the banks offer different easy ways to do so, such as checks, standing orders and transfers. The installing and the raising of those checking accounts by the public happens the same way as with all other bank accounts, namely by depositing money, and they can, overall, only be diminished by the withdrawal of money. Transfers from one account to another have no influence on the size of the total of all accounts and they only lead to changes between accounts. This means that when one account gets bigger another must get smaller by the same amount. How often the assets get transferred from one account to another does not make a difference in the overall amount just as the daily back and forth of cash does not make any difference in the amount of cash that was issued.

Can One Increase His Demand with the Help of a Checking Account?

Everybody can spend his income only once. Nobody could break this rule, unless he has a counterfeit printing press in his basement. It does not matter whether he gets his income as cash or as transfer to his account or whether he pays with cash or with checks and transfers - more demand as his income allows is impossible. If he overdraws his income with a bank credit some body else must have used less and must have given the surplus to the bank.
With a change from cash to cashless transfer nobody can increase his demand. Let us make this clear on an example: if somebody always got his income as cash and now wants to make half of his payments cashless, he has to open a checking account and deposit half of his cash there. On the other hand, if somebody got his income by transfer and always cashed it out to pay his expenses with cash, he then simply leaves half of his income on the account. In both cases he now needs only half the amount of cash while he needs the other half in form of a monetary asset on his account for purposes of transfer. If all market participants would change their payment habits in this way half of the cash would not be needed any more. And let us imagine that all people would pay only with check, credit card or transfer, the whole active cash would end up in the banks and would disappear. All the incomes and expenditures in the economy would not be changed by that as well as they would not be changed if everybody would go back to cash. The only thing changed would be the amounts of cash or assets on the accounts.

With those today used transfers there is only a change to a second way of demand, which can be used instead of cash. The advantage seems to be clear: the payer saves the work of getting cash from the bank and brings it to the recipient and the recipient saves the work of bringing the cash to the bank.

What Are the Results of Increased Transfers in the Banking System?

The banks gain in different ways by increased transfers. First, they can reduce their interest costing debts to the central banks. Second, they also have lower costs for moving cash which usually are not paid by their customers. The usually even higher costs for transfers are easily covered by fees or interest differences and also through time-lags between transfers (which they cannot do with cash). Third - and this is the biggest advantage - it is possible for them to extend more credit based on bigger assets of customers, sitting in the accounts and they have therefore more interest income.

Although the use of transfer instead of cash does not give the recipient of income more purchasing power, yet in the total economy it results in a higher demand potential through credits. A bank note cannot be used between receiving and spending, but the bank can lend out the held assets. This means that these assets can be used more effectively than cash. A comparative use of cash would be, if every owner of a bank note would lend it out between receiving and spending it.

Because of these different grades of utilizing cash or cashless assets, this will also result in changes of the overall demand.

Let us imagine that everybody would reduce his cash by half. The total sum of cash now in the economy (200 billion DM) would be reduced by 100 billion DM and the deposits in the banks would be raised by the same amount. Compared to the total deposits of around 3500 billion DM, this would be only 3%. Compared to the total demand potential, it would be 15% against which the issuing bank could only counteract with difficulties.

Since the payment habits are pretty stable and change only slowly, the size of the changes are relatively minor, but they can lead to a loss of stability, especially if it comes to big speculative shifts though the asset owners. (Remark from the translator: here Creutz does not take into consideration the different speed of turnover for cash and for asset transfers)

What Was First - Assets or Debts, Money or Credit?

You can argue about this question just as you can argue about the question whether the hen war first or the egg. Yet, with monetary assets or debts the answer is simple: both are born at the same time whenever somebody borrows something and they disappear both from this world the same time the debt is paid. Assets are neither a precondition for a debt nor the other way around. But something has to happen before any of these two phenomena can come into being. Namely, the saving of the lender and his willingness to lend the saved money to someone else. And for the dissolving of these asset-debt-relations, too, something must be done beforehand. This is the saving of the debtor. He must be willing and able to save the money from his income in order to repay the debt.

This answers the second question about the priority of money or credit: you can only lend out what is there already. It goes for the lending out of a bicycle or a bag of salt as well as for money. That most of the money is put into circulation by the national banks through credits to the commercial banks makes no difference. The national bank must first print the money. But these credits only have the purpose to put money in circulation. The credits which the commercial banks grant to their customers do not come from the national bank but from the

savings of other customers. This is also shown by the fact that in Germany the bank credits grow 20 times as much as the Bundesbank expands the amount of money.

The belief of some economists and historians, who see the origin of money not as a medium of exchange but as a debit mark born in the places of worship or temples does not change these facts. This theory might historically or sociologically be of high interest. For the function as medium of exchange and credit of our money and the problem which arise out of them, it is without significance.

What Is the Meaning of Saving, Lending or Paying?

Saving means: less consuming, using or employing. Saved money can be put under the mattress or in the safe behind the picture of aunt Nelly. One can also bring it to a bank which might even be called savings bank. Many people believe that their money is kept there like at home, only safer in a big safe, from which the money is taken again when somebody wants some back. Professional terminology enforces this belief by talking about depositing money in banks and in insurance companies. In reality these deposits do not exist. The banks are not depositories for money. They are intermediaries that hand the credit they have received from a saver over to a third person.

Principally nothing else happens in the banks as in the case, when somebody gives his money directly to a neighbor which he does not need himself. Because this is not called »saving«, one should not call that person a »saver« who brings his spare cash to the bank. Saving is only always the *prerequisite*, that one can lend money to the bank or to somebody else or keep (hoard) it at home.

Having concrete procedures in mind, the term »to pay« [in the German language to pay - ›bezahlen‹ is associated with ›zählen‹ - to count] should only be used in context with money. For cashless performed acts are not payments but transfers, i.e. accounted credit items from one account to another. These transfers, which the Bundesbank calls ›endorsed disposals‹ [girale Verfügungen], in general lead only to delayed settlement of claims, which anyone can see on his statements of account. Besides that they are done in several accounting steps and always depend on the help of a bank.

Surely is it possible to call a movement from one checking account to another a movement of »money«, but this would only make sense if these deposits on checking accounts were equal to money and their use as a credit item was not allowed. As long as this is not the case, the relation of terms like »money« and »payment« to procedures between checking accounts can only create confusion and complicates the understanding of money related procedures.

One should differentiate between the only real money, legal tender, and »book-money« which is only an entree on a ledger, the essential characteristics of which are once again made clear in the following table:

	Money	Deposits (»Book-Money«)
Functions	legal tender	means of transfer

Devices	coins, bank bills	checks, transfers
Specific differences	emitted by the state immediate settlement help of third parties not needed no documentation only expanded by the state	private savings delayed settlement help of third parties and technical aids needed documentation of transaction expanded by anyone

It is essential to note that everyone who accepts a check or other asset transfer will only do so as long as he can be sure to get cash for it whenever he wants.

Money Movements - Money Circulation

»Money plays the same role in the body economic
as blood does in the human body. Is the body to fulfill its
various life functions the blood must circulate unrestricted.
Just as necessary is it that money circulates to make full
employment a reality.«

Edouard Daladier
Former French Prime Minister, at the London Conference 1934

The Enigma of the 5 DM Coin

The following story I found on the entertainment page of a magazine:
In the saw-dust of the circus-ring the clown found a shiny 5 DM coin. He went to the stableboy and said: "I owe you ten Marks, here you have 5 DM for the time being, then I owe you only five more."
The stableboy thanked him, went to his foreman and said: "I am owing you ten Marks; here are five and then I owe you only five more."
The foreman thanked him and went to the horse trainer and said: "I owe you ten Marks, here are five Marks and then I owe you only five more." The horse trainer thanked him and went to the director and said: "Mr. Director, I owe you ten Marks, if you please, here are five Marks and then I owe you only five more."
The director thanked him and took the clown aside and told him: " Here I give you five

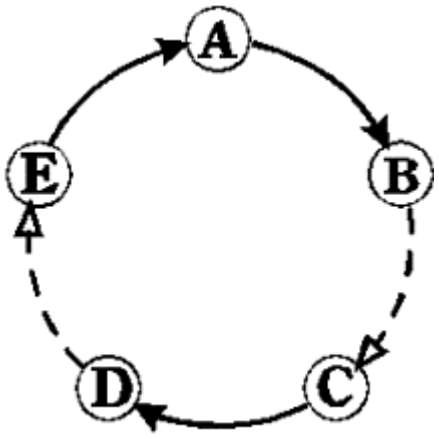
Marks, the other five you will get later."
The clown thanked, gave 5 Marks to the stableboy and said: "Now we are quits."
The stableboy repaid his remaining debts to the foreman, the foreman to the horse trainer and the horse trainer to the director. The director took the clown aside and said: "Here, clown, are the 5 Marks, which are still due to you."
In this way the clown got his 5 DM coin back and everybody else got rid of his debts...
Even though the story might look confusing at first glance, it describes nothing but a series of repayment acts with a circulating 5 Mark coin. That the story starts off with a coin that had been found, is only meant to increase irritation. The clown might have earned those 5 Marks just as well as stolen them or received as a gift. After the second rotation all the debts would have vanished even with a forged 5 Mark coin.

Yet the story is not only about the disappearance of the debts of the five persons involved, but also the disappearance of credits of the same amount. For the debt of the clown to the stableboy was countered by a reciprocal credit of the stableboy to the clown a.s.o.

By this story, we can realize that circulating money can not only countlessly be used for purchasing but countless times for lending and repayments, too. But just as little as the amount of money had changed in the described chain of repayments, so little is its change in a chain of granted credits. Only the funds of credits and debts change which arise from the lending of money and dissolve with their repayment.

How to Understand Circulation?

In a circle there is no beginning and no end. Once a bill has been put into circulation it can run around with no end, no matter what purpose it is being used for. Let's clarify this in simple models with five participants:

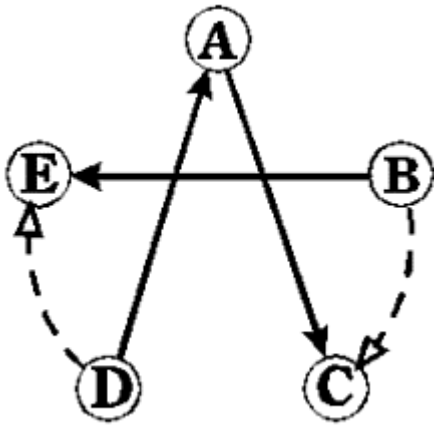


Turnover of Money with Acts of Payment and Lending

Fig. 2

A purchases from B.- B doesn't need the received money and lends it to C. - C purchases from D. - D lends it to E, who in turn pays a service he receives from A. Thus, the rotating bill was used three times for purchases and twice for lending. If B had not lent out his surplus, then the following acts would not have been possible. This simple example shows again the risks, which result from holding money back.

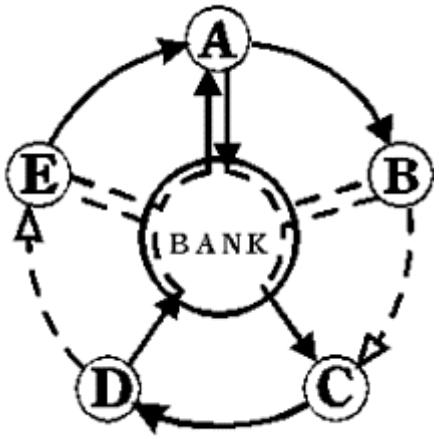
In the next model of circulation the debts get repaid:
A buys from C, who repays his debt to B. - B purchases from E, who repays his debt to D, who in turn purchases from A. Again the circle is closed and can start anew at random sequence.



Turnover of Money with Acts of Payment and Repayment

Fig. 3

Nothing in principle changes in these acts even though loans and repayments are performed by mediation of a bank. Not even when payments in cash and transfers of deposits would alternate:



Turnover of Money by Mediation of a Bank

Fig. 4

A deposits the bill on a bank account and buys by check from B. - B purchases from C and pays by transferring the credit item he had received from A. - C withdraws this credit item and buys from D with cash. - D deposits the money at the bank again and purchases from E by bank transfer. E demands a service from A and in exchange transfers the credit item he had received from D. Since A is momentarily short of cash, he withdraws the amount from his account.

In this case the money was deposited twice at the bank and withdrawn twice, once a charge got balanced by cash and four times a credit item was transferred. The bank can use the funds which result from deposits for granting loans ensuing in an interim extension of the credit potential which will be dealt with more closely in Part V.

Which Consequences May Arise from Savings?

The consequences of savings are also to be considered within a limited frame and with comprehensible figures. Imagine an island with ten inhabitants, each of whom brings work into the market of 2'000 Marks worth every month and whose demands also amount to 2'000 Marks. If you further assume that the money turns over twice a month, then for making all the business on the island 10'000 Marks will be necessary. If this is regularily spent, then the circulation on the island will be stable, just as the business prospects. Everyone can sell services up to the same amount as his demands are. With a saturated demand a growth of the economy is not necessary.

Let us now survey the case of an inhabitant of the island who, just like everybody else, receives 2'000 Marks per month for his work, but only demands services for 1'800 Marks, thus withholding 200 Marks every month. Which consequences may arise from these savings?

Case 1 - The saver gives his surplus of 200 Marks regularily away as a gift:
If the receiver of the gift spends the money just as regularly, then the market on the island will remain fully balanced. The receiver, so to speak, demands the services which the saver has brought in beyond his own demand. In the long run the wealth of the receiving one will increase compared to all others, the wealth of the giving one decreases.

Case 2 - The saver gives his surplus of 200 Marks regularily away as a loan:
The situation of the market on the island and also the shifting of wealth is the same as in Case 1. Yet, because of the open demand of repayment the lender's asset will grow from month to month while the borrower's debt will reciprocally grow. After one year both figures have risen to 2'400 Marks, after ten years to 24'000 Marks. That means, after ten years money assets and debts amount to 2.4 times as much as all the circulating money on the island which doesn't exceed, as we know, 10'000 Marks.

Case 3 - The saver gives his surplus away as a loan and collects interest:
At first (!) nothing changes in the market on the isle, the circulation of money and the business prospects. But the borrower of money is not only obliged to promise the repayment of the loan but in addition to that must pay a »loan tax« every month. He can only subtract this from his monthly income. With an interest rate of 10% this loan tax will sum up to 20 Marks after one year and to 200 Marks after ten years. These permanently increasing interest charges are countered by permanently increasing interest revenues of the lender. If he continues to live a frugal life, he can in addition to the monthly savings of 200 Marks lend out a permanently increasing amount from his interest revenues.

Case 4 - The saver accumulates the surplus at home:
By this the money circulation on the island will be deprived of 200 Marks every month. After ten months the saver has already accumulated 2'000 Marks, one fifth of all the circulating money. After 50 months, i.e. little more than four years, theoretically all the money of the island would be in the hands of the saver.
Of course, things will not develop that far, because the monthly increasing lack of money would long before that result in a crash of the economy on the island.

What Can We Learn from the Examples of the Island?

Like the examples 1, 2 and 3 show, in an economy money *can* not only be saved, given away or lent out, but it *must* be done and the money *must* be put back into circulation or the economy - as shown in example 4 - will collapse.

As examples 1, 2 and 3 also show, does the temporary lending out of money not increase the amount of money, only the size of assets and debts. Those could theoretically grow to infinity without an influence on the amount of money. In examples 2 and 3 with mounting debts the debtor becomes less and less able to pay them back. He will become more and more dependant on the money-lender. He must mortgage more and more assets to the money-lender and the end of this progression is, that all the debtor's property, including his house and land, now belongs to the money-lender. In former times he ended then in the »debtor's prison« or as »chattel« of his creditor. Today it is ›only‹ bankruptcy and attachment of further income.

To borrow money *without* interest will hardly ever lead to such problems. Normally, nobody will save money all the time and nobody will borrow it likewise. These processes end and get turned around and in any case they ›only‹ increase in a linear fashion, i.e. with steady pace. In example 3, however, by compound interest the debts grow with increasing speed. If the interest paying debtor doesn't want to starve, he must try to produce more and also be able to sell his increased output. If a third does not want to have his service unsold, there must be a common growth of demand and consumption on the island, which, if prices ought to remain stable, must be accompanied with an increased issuing of money by the bank of the island. Lending money and asking for interest has a built-in self-feeding effect which leads to a steadily growing difference between poor and rich. And when the debtor is at a stage where he must, only in order to pay the interest on his debts, make new debts, the process cannot be turned around anymore. We do not only observe this in Latin-America today, but in uncountable companies, private households, too, and above all, in the indebtments of most states.

To borrow money with interest is only useful for a debtor, when he can invest the money into something which brings an added profit on top of the interest. Macro-economically it depends on steady economic growth which has to be at least as high as the interest fed growth of monetary assets, that have to be pulled back into circulation by debts. Borrowing with interest is only without problems, if creditor and debtor - at shifting times - are the same person. This means that they get as much interest as they pay. This is the case with building societies and their banks, where the level of interest rates therefore is irrelevant.

Is There Any Difference in the Circulation of Money When Applied to a Bigger Economy?

All the examples which we have been playing through with small amounts of money and a limited number of persons also applies to every national economy. The number of bank notes, participants, payments or credit transfers may be in the millions: the basic workings are the same, they only get more obscure.

The following model shows such a cycle including output, income and demand. The best way is to imagine such a cycle with a turnover of 100 billions in a month. When the income resulting from production is fully spent, the market will be emptied. Everybody keeps his labor and therefore his income.

We will assume in this model, that everybody who collects income will save 10% of this income. This means, that only 90% of the total income is spent directly and in this way will become demand. If the savers give their surplus to the banks and the banks are able to give these deposits to others as credit the full demand is secured. If this money had not been given away as credit 10% of the output would stay unsold on the market. The result would be a downturn of the economy with unemployment and business failures.

As the lower part of the graphic shows, after the first month there are 10 billions in the banking sector. Not considering the small amount of remaining cash in the banks, there are also 10 billions of outstanding credit. Assuming the same level of savings (10%) the deposits will grow every month by 10 billions and after five months will already have reached half the size of all income and demand.

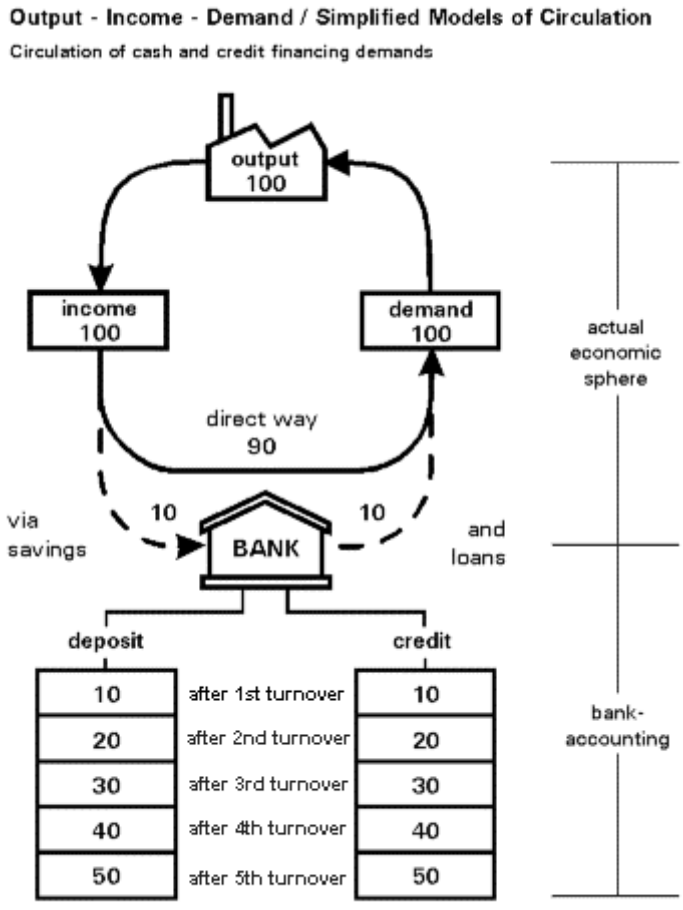


Fig. 5

Here also it becomes clear that even with the same output, income and demand levels the monetary assets and debts can grow ever bigger without influencing the amount of money and its circulation. But »under the surface« the tension grows stronger and stronger, especially if credit is connected with interest payments as the example on the island has already shown. With a steadily growing economy these tensions can be softened for a while but not indefinitely. Considering the dangers to the environment through steady economic growth the end is already in sight.

Commercial Banks, Central Banks, Non-Banks

»Money and banking are so mysterious for the average person, that it consists only of a ›taboo‹ as the sole popular concept..... The popular concepts including those of average banking experts are as primitive as the superstitious beliefs of Russian farmers before the World War.«

Irving Fisher
(US-economist and money theoretician
in "The Illusion of Money", 1934)

What Is the Main Task of Banks?

Market participants usually receive their income only by bringing in work and are therefore capable to demand the service of others. A demand beyond this income is only possible through loans. Loans in turn require the savings of another person as a prerequisite.

For the steady movement of the economic circulation, no one is compelled to spend all his earnings. Nonetheless is it necessary to leave all income surplus to others for satisfying their demands. With the mediation between saver and debtor the banks fulfill an important task in political economy. The mediation of credits does not only serve the debtor but also the economy as a whole. For the debtor closes a demand gap which would be created by the saver's non-demand. The clearing of the market by the debtor is particularily in favor of the saver, whose output is bigger than his demand. Without the replacement of demand by the debtor, his output surplus would remain in the market.

Of course, it is not the only task of the banks to fill the money boxes or accounts of market participants by loans. Another important task is the cashless settlement of accounts in the economy. If you consider that in 1993 about 3'260 billion DM had been moved between deposit accounts every month, that is nearly 50'000 DM per capita, then the dimensions of this service will be conceivable. In addition to that comes the circulation of cash money, the dimensions and turnover of which, however, is much smaller. But it would be wrong to regard the circulation of cash as a negligible factor. According to a research of the Bundesbank from 1985, 87% of all payments of ›non-banks‹ (= market participants without banks) had been settled with cash and only 13% by transfer of credit items. Even though single amounts of these surpass cash settlements by far, the role of cash becomes clear. Moreover it must be noted, that the majority of the shifting of assets and speculative business are being settled via deposit accounts as well as the multitudinous payments immediately before investments and consumption. All the latter settlements immediately before consumption can only be performed as long as there is a consumer at the end of the chain who takes his money bill and goes shopping.

What About the Power of Banks?

Generally, the power in the land can be told from the size of buildings. In former times these were temples, castles, cathedrals, palaces or city halls. In our times these seem to be banks. This is not only true for the bank-towers in Frankfurt, but even in the remotest village the popular bank is often the most representative building.

The numbers, too, are impressing: a total of almost 4'000 banks with 40'000 branch banks and 600'000 employees have shown a volume of business of 6'597 billion DM in 1993, more than double the national product of Western Germany. The volume of credits with 4'090 billion DM by the end of 1993 was almost eight times as big as the budget of the Federal Government.

Despite these facts a conclusion about proportions of power would be somewhat doubtful. Because the size of bank buildings and the growth of banks only reflect the size and the growth of money assets that the banks are entrusted with by their clients. For the most part their power is just a borrowed one. The banks' own funds rarely exceed the six percent of the volume of credits specified by the supervisory board of banks. And two thirds of all banks organize their own capital under public law or in co-operatives. The three well-known biggest banks in Germany only hold 12.5% shares of the total volume of their business and the liable capital is put together by hundreds of thousands of shareholders. Genuine private banks like those of Rothschild or Rockefeller, where individuals or families hold the capital, rarely exist anymore. In the Federal Republic their portion of the total volume of banking business doesn't exceed 1.3%. Power, that means influence on economy and through that on politics, can only be wielded by banks which possess large stocks of single firms. But much more serious is the fact that in stockholder's assemblies banks can act as representatives of their clients who delegate their voting right to them. But this wielding of power is not a specific question of the banks but one of stock laws, which can easily be amended.

Does the Power of Banks Grow with Their Turnover?

The assumption seems obvious that banks grow more powerful and influential with the over-development of money deposits and credits. But in reality, as in all processes of over-growth, finally countercurrent effects occur. For the bigger the money assets and debts in political economy, the greater become the risks for granting loans because of decreasing real securities. And if it comes to a massive insolvency of debtors, then the market price of credited objects fall below the open bank claims.

In the beginning of the eigthies a series of breakdowns of banks in the countryside occured in the USA when ten thousands of highly endebted farmers had to sell their properties at auctions and the returns couldn't cover the credits. The same happened at the end of the eighties to savings banks and a number of regional big banks. It was caused by Reagan's extended limits for credits on real estate meant as a stimulus for the economy. Consequently their value shot up and enabled further grantings of loans. When the speculative balloon burst, many of the outstanding claims could not be called in. According to a report in the Frankfurter Allgemeinen Zeitung (FAZ) from Oct. 21/92, »1'492 (=12%) of almost 12'000 business banks were close to bankruptcy and another 1'179 actually insolvent«. In the beginning of 1993 Prof. Udo Reifner reported in ›Bank Watch‹, an information service of the Institut für Finanzdienstleistungen, that the breakdown of those banks »will cost the American taxpayer depending on different estimations between 500 to 1'200 billion DM until the end of the nineties.« But as he further writes, problems also heap up in our country, for instance »the crooked position of German big banks like the Bank fuer Gemeinwirtschaft (BfG), the DG-Bank and the BRZ which can only with pains be covered by payments of billions of DM from third parties interested in the German market... or from the funds of small co-operative banks«. The security funds have already been reduced by 2.6 billion DM, and since the contribution to these funds are only 0.03 to 0.06 DM per 100 DM deposit, the securing of depositors is here limited, too.

The increasing number of bank fusions or the fusion of banks with assurance companies is therefore not always a sign of growing strength but more often a sign of the very opposite.

What Are the Tasks of Issuing Banks?

The tasks of issuing banks are mainly related to supplying the economy with money and to assure the stability of the purchasing power.

The realization of this task depends on the instruments and rights which are granted to them. Beyond that it depends on the proficiency of the persons in charge and last not least on the right of veto of third parties, i.e. primarily governments. Concerning the right of veto it is of course essential who is the holder or owner of the issuing banks. According to researches of longer date four fifth of all issuing banks are completely in possession of the state, the rest at least for the major part. Only few issuing banks (like for instance in Switzerland) are organized according to private law. However, for the success of issuing banks the question of private law matters less than their independence. If, for instance, the state has the right to call for loans then any effort of the issuing bank for the stability of the currency gets corrupted.

As the description of tasks already shows, issuing banks - also called central banks - are in reality no banks but institutions for fulfilling a task of public law, namely, the provision of the economy with money. Here, too, by using the term »bank« for banks and issuing banks, which have completely different tasks and are acting in totally different fields, unnecessary confusion is provoked and misunderstandings can be anticipated.

The Federal German Issuing Bank, How Is It Organized?

Our issuing bank, the Deutsche Bundesbank, is owned by the Federation, but it is an autonomous institution of public law, comparable, say, to the Constitutional Court (Verfassungsgericht). The president of the Bundesbank and all the other members of the board get appointed by the government, but in their decisions they are extensively independent and bound to the fixations in the »Gesetz über die Deutsche Bundesbank« (Law Concerning the Federal German Issuing Bank). The most important statements are found in § 3 BBG: »With its authority for currency policy the Deutsche Bundesbank regulates... the circulation of money and the provision of the economy with credits in order to secure the currency...«And § 12, in which the relation of the bank to the Federal Government is laid down, it says: »The Deutsche Bundesbank while preserving its task is obliged to support the general economic policy of the Federal Government.«If you unbiasedly read these two paragraphs, then you can only shake your head upon such vague declarations. These uncertain formulations might have resulted from the poor monetary knowledge of the politicians and their counselors who have formulated this law in 1957. So you might well argue about the practical consequences which can be derived from the obligation »to support the general economic policy of the Federal Government.« This raises the question, whether this obligation weighs heavier than the task of regulating the circulation of money and the securing of the currency.

What Does »Securing the Currency« Mean?

An unprejudiced person might guess that these words refer to the backing of the money's value by gold, to the prevention of counterfeiting or the safe deposition of money bills in treasuries. In fact for a long time it was debatable, what the authors of this version of the text had in mind: fixed exchange rates or stable purchasing power of money. In the meantime - primarily since the desaster with fixed exchange rates at the beginning of the 70ties - the authorities have agreed on the aim of a stable purchasing power even though with little practical success. For, if you consider that the German Mark of 1950 is not even worth 30 Pfennig today (= 0.30 DM) and that it had to deplore its biggest loss during the last two decades, then you can hardly pretend the Bundesbank had fulfilled its task according to § 3. The main cause for this inefficacy is the inadequate securing of money circulation, which is its expressed task according to the same paragraph.

How Does the ›Bundesbank‹ Control the Circulation of Money, and Why Is this Task so Important?

Starting from the provision of the economy with money, we think at first of controlling the amount. The amount is but one factor of the efficiency, the second one is the frequency of its active use in economy as a medium of exchange. For, if issued money remains sitting somewhere, it is just as inefficient as not issued money. An issuing bank therefore has not only the task of putting money into circulation, it also must care for its steady circulation. Only with a circulation speed that is free from disturbances can the trade cycles be free from interferences and the purchasing power be stable.

If you compare money with a horse and economy with a carriage pulled by horses, then the issuing banks could be taken as the coachmen, who have to care for the horses and their steady pace. If the coachman wants to achieve the optimum, he will lead the horses on short bridle, so that the carriage maintains a smooth movement. Above all, he will ensure that the horses will not run off the track as they like or even come to a halt.

But the issuing banks are satisfied with harnessing the »number of horses« to the economic carriage, which they consider to be just about appropriate. They control the pace of the horses - if at all - with a very long bridle, hoping, that the horses will do it on their own. Only when they realize that the carriage runs too fast or too slow, they start getting active. But they don't do this by handling the bridle. They rather try to influence the movement of the »horses« by either reducing or increasing the »portion of oats« they offer to them. In terms of reality: if the issuing banks realize, that the issued money does not circulate steadily, they try to stimulate the owners of money by more or less »oats of interest« instead of leading the money on a »short bridle« in order to make it circulate more smoothly. And in contrary to their oaths for stability, they keep it running with the whip of a little inflation. Since they only recognize changes in the speed of the economic carriage with delay and since their efforts to correct via interest rates and inflation are associated with even greater and incalculabe delays, the outcome is more than arbitrary. In their despair they eventually fight the self-induced inflation with too much issued money and high interest rates, which is like exorcising the devil with old Nick. No wonder, the success of this procedure is the same everywhere in the world.

There is a clear prerequisite for the velocity of circulation, namely, the speed of the currents of income. The issuing banks need only to care for all incomes to become expenses again by introducing a well working circulation assurance. They wouldn't have to care for the level of interest rates anymore, the »appropriate amount of money« and the stability of purchasing power would adjust automatically.

What Does That Mean: »Regulates... the Provision of the Economy with Credits«?

Even today most minds get confused by that formulation. Even experts conclude from this, that the Bundesbank does provide the economy with credits. But in our economy credits - if not from private sources - stem from bank deposits of savers, i.e. from income surplus of the participants of the economy and not from the Bundesbank. Only until 1994 the Bundesbank

could grant short-termed cash loans to the state, however, with restrictions and relatively small amounts only.

Besides that, only the business banks are granted credits which they can call from the Bundesbank only in cash money. That means, those credits alone serve for the provision of the economy with money. By the amount and the granting conditions of these credits the issuing banks try to control the »amount of money« in aiming at a stable purchasing power. Since today the circulation is not assured (because every money owner has the right to withdraw [hoard] money as he likes), this is the only attempt up to now.

Credits to Banks - How Does It Work?

Since business banks can only call cash money from the issuing bank, they only take loans to such an extent as they need for settlements at the bank counter. That means, neither the issuing banks nor the business banks determine the amount of money in economy, but the participants in economy who withdraw money from their bank accounts. Do they withdraw more money than the bank has in its cash box, the bank extends its debts at the issuing bank in order to get additional money. Does the bank have too much money in its cash box, it immediately returns it to the issuing bank. For all money in the cash box is »dead capital« for the bank and it has to pay interest for it to the issuing bank. That means, that the German business banks are all indebted to the Bundesbank over the amount of money they have put into circulation. For the main part of the money they have given out (nearly 197 billion DM by the end of 1993), they have to pay interest without being able to charge the withdrawers and users of money with these costs. This even applies to bank notes which maybe since years lie dormant in some treasuries, are current in foreign countries or have even been destroyed by fire or whatever. That means, the banks have to charge the debtors with the costs for all current as well as non-current cash money, who maybe don't call for cash at all in requiring a loan. Beyond these necessary credits for the supply with cash money, the business banks only get indebted up to the amount of ›minimal reserves‹ they have to keep (nearly 60 billion DM by the end of 1993).

These minimal reserves originally were compulsory deposits for assuring the deposits of clients. In the 60ties and in the beginning of the 70ties these had been used by the Bundesbank in order to withdraw over-issued money from circulation (mainly as a consequence of purchases in support of the dollar). Today they only serve the purpose to tie the banks tighter to the »bridle of interest« by compulsory indebtedness, however questionable this may be. That means, even though this may still be differently presented in manuals: from all the savings that are deposited in a bank, not a single Mark goes as minimal reserve to the Bundesbank. Hence, the granting of loans by a bank is not restricted by these ›reserves‹. The Bundesbank rather grants »central bank assets« to the business banks up to the amount of the minimal reserve as specified by the Bundesbank itself.

When Do Issuing Banks Have to Multiply Money? How Can They Do This?

A banker of the Swiss issuing bank once said, that one needs just a printing-press and a stove in order to regulate the amount of money - the press for printing more money if needed and the stove for burning the surplus. Yet, a little more difficult than printing and burning is the putting money into circulation and withdrawing it again.

The issuing banks can put money into circulation in various ways. For instance by purchasing other currencies from export surplus, by »support purchases« in order to assure the exchange rate and by credits or distribution of profits to the state. The most frequently used method is - as described - the provision of banks with »fresh money«. If they want to control the amount, they have to specify the contingencies for distribution in the same way as they nowadays do with accepting promissory notes. However, in this way they can only get rid of money if the bank clients ask for more. In order to make this attractive to the participants of the economy, they must in a given case make it »cheaper«, i.e. lower the interest rates. This most frequently used method of regulating the amount via the interest rates is already quite doubtful, when precise results are required.

A simpler method would be if the state put additionally required money into circulation. As long as the issuing banks alone decide upon whether and how much money they distribute to the public, this way via the state would be without problems - at any rate less troublesome than nowadays distributed fluctuating profits to the state.

The necessary withdrawal of money, as recognized by the mounting price level, could most simply be done by the state. For the state can be forced to return money or to hold it back, not so the citizens. And since these regulations would have to deal with relatively small amounts, much smaller than all other revenues of the state, this method would be associated with no problems.

With such a regulation of the amount of money by the state it would also become clear, that the issuing of money as well as the stability of its purchasing power are public affairs. On the other hand it would become distinct, that bank deposits and granted loans from there are the responsibilities of the business banks only. A reckoning on the issuing banks as »lender of last resort«, i.e. as an emergency service providing freshly printed money, wouldn't be needed any more.

What About the »Money Amount Aim« of Issuing Banks?

At the end of the year most of the issuing banks inform the public to what extent they plan to increase the amount of money in the following year. That these announcements have little to do with reality and if at all have only psychological effects is being proved not only by the results but by actual facts: the issuing bank's task is not the determination of an »amount of money« for the economy to find a position, but in contrary the issuing banks have to smoothly adjust to developments of the economy. But since they let the harnessed »horses« go as it pleases them instead of leading them on short bridle, which in other words reads: since they cannot control the amount of money, they hang the »interest-oats-bag« higher or lower instead and take resort to doubtful »money amount aims« as a reinforcement for themselves.

One could compare this method of the issuing banks with a railway administration, which, while keeping wagons in readiness, doesn't care about the actual needs for the traffic of transportation, but plans the volume of traffic for the year ahead. If then the number of wagons does not comply with the actual needs for transportation, and if it tries to regulate the »stability« of the traffic by increasing or decreasing the prices for renting a wagon instead of adjusting the necessary number of wagons, then it acts like our issuing banks.

The determination of the aim by issuing banks can even more simply be compared to parents, who determine the size of the shoes for their children in the forthcoming year to which the children's feet are to adjust their growth.

Which »Amount of Money« Do the Issuing Banks Try to Regulate?

One should think that the issuing banks in their attempts of regulation are concerned with that amount of money about which only they can decide, i.e. the amount of cash money, which is the sole real money. Instead, they theorize about various »aggregates of money amounts« which for the most part are made up of figures that are no money at all but only money assets. In that they are not at all content with bank deposits, which by force of their transferability could still be considered as demand potential, but they also include savings and term assets into the »money amount aim«.

Thus, the issuing banks try to maintain the stability of purchasing power not by watching the price level and corresponding corrections of the amount, but by preliminary calculations about the additional amount of money in a year. This method likens to someone in charge of keeping the amount of water in a reservoir stable who doesn't watch the water-mark, but tries to achieve this aim by calculating the influx of water per year. If he left out of consideration that a part of the influx wouldn't show at the water-mark because more or less of the water evaporates, then this method of regulation would be more than doubtful. But even more doubtful would it be, if the person in charge included in his calculation the amount of water in the clouds besides the influx.

But exactly this is what the issuing banks are doing. In their preliminary calculations they do not consider, that some part of the additional money does not affect the price level, because it disappears from the circulating amount. They also comprise with the »money amount« the money which is bound in bank assets. But just as the water in the clouds isn't contained in the reservoir, so is the purchasing power delegated to the banks contained in the circulating money. In both cases the summary must lead to double counts and therefore to false figures in the calculation.

Where Do the Profits of the Bundesbank Come from?

Like any enterprise and any authority, the Bundesbank has revenues and expenses, too. In no institution, however, there is such a big and extremely fluctuating gap between those figures as in the currency authority in Frankfurt.

If we have a look at the numbers of the year 1991, then the revenues of the Bundesbank amounted to 25 billion DM. Almost 99 percent of these revenues came from interest returns. 17 billions of it had been withdrawn by the banks from the German national economy, 7.5 billion were returns from investing currency reserves (mainly dollars) in foreign countries. From the expenses of the Bundesbank of nearly 10 billion DM a part of 1.4 billion falls to the costs for the personnel of around 18'000 employees and 330 million DM to the printing costs of bank notes. The biggest items were the expenditures for interest with an amount of 4.3 billion and for the deduction of currency reserves amounting to 2.9 billion DM.

The profit after the reduction of the legally prescribed reserve flows - as is well known - to the owner of the Bundesbank, that is the Federation. In 1991 these were almost 14.5 billion DM and in the preceding year 8.3 billion. That means, in 1991 the Federal Government took high profits from the policy of high interest rates of the Bundesbank. The distribution of the profits of the Bundesbank is for the state as well as for the economy nothing else but an additional tax, the precise amount of which, however, cannot be calculated. This item of revenues fluctuated since 1980 between 240 million DM (1987) and the foregoing 14.5 billion (1991). The average was about 9 billion DM.

If we relate this profit of 14.5 billion to the 34 million employees in the united Federal Republic, then everyone got 430 Marks pulled out of his pocket by this hidden tax collection. In relation to the 7'500 DM wage and income taxes that every occupied person had to earn in 1991, these 430 DM are just a minor amount. Yet the question arises, whether this indirect seizure of the state on citizens by way of Bundesbank profits is compatible with a democratic constitutional state.