Letter from Ulrich von Beckerath, Berlin, to Dr. E. Foerster, Vienna from 1933/08/28, with notes on the railway money

Dear Dr. Förster,

I believe the possibility that the railway vouchers will at times not pass at par is not entirely theoretical, but will actually occur. This event will even occur from time to time in spite of careful and proper issuing; in addition to the fact that, as you write, carelessness, ignorance and even fraud can never be completely ruled out. The system **must** take this into account and, moreover, be arranged in such a way that possible damage to the public will remain minimal.

If I myself had to draw up terms of issue, I would introduce two main protections:

1.) I would make sure that in as many places as possible the bills will have a free market and thus a free market rate. No tendency to offer the bills cheaper than face value should be inhibited, to the contrary, if anything, such a tendency should be encouraged.
2.) the railway would have to be obligated to spend a certain part of their gross revenue to purchase its own vouchers, as long as the amount of its normal reflux is smaller than this part.

The free market rate is the major additional insurance of the people against inflation. Great statesmen have always been aware of that and have therefore turned against the legal tender of paper money, Frederick the Great, Baron von Stein, Bismarck, Metternich, who has certainly influenced the Imperial Patent of 1816/6/1. Even Napoleon considered it right to assure from time to time that under his government the paper money will not have legal tender status.

Suppose the railroad **did** recklessly mismanage and it issued too many vouchers; then - in case of a free market rate of the vouchers - punishment follows immediately. A voucher that is now 95 and tomorrow 94, is not accepted in any store where things get somewhat busy. The salespersons simply cannot manage currency translation into full-value money. At most, art shops, antique shops and jewelers will take the lower value vouchers, because they have the time to calculate and later have time to use the certificates.

But once the food stores no longer accept the vouchers, the wage earners, too, will not take them any longer, nor will the employees of the railway. So the railway company can no longer circulate the vouchers and is forced to stop issuing even if it had the most evil intentions to make further mischief.

The question is how far over-issuing can be driven before the vouchers are rejected. The Austrian Federal Railways in 1930 had a gross income of 665 million Schilling. This is a daily average of 665 : 365.20 = 1.822 million Schilling. I guess that the railway, on a good day, is collecting about 10 million Schilling. When suddenly for some reason railway travel is particularly cheap, for example, because you can buy railway money cheap and can enforce payment at face value, the revenues of the railway will also rise up to this amount.

Now, it further needs to be investigated how many vouchers have to circulate, so that a reduction of the amount outstanding of 10 million in **one** day would not cause a substantial change of the market rate. For this investigation we have no <u>experience</u>. At best one can judge on the basis of analogies.

The private note issuing banks in Germany seemed to have been predisposed, in case they were forced to suddenly abandon the issuing business, that the entire stock of issued vouchers would have returned to them within about 20 days on average. (Die Bewegung der neun preußischen Zettelbanken von 1857 - 1863, von C. Röpell, Danzig 1864. [Movement of the nine Prussian note issuing banks from 1857 to 1863, by C. Röpell, Gdansk 1864.]) So in that time, about 1/20 of all notes seems to have returned daily to the banks, and thereby par value was maintained. Recent statistics on the ratio of reflux to total circulation appear to be missing.

Accepting the number 1/20, the twenty times shillings, that is 200 million shillings for the Austrian Federal Railways would be a safe volume of vouchers, with which nothing could "happen", that is, this amount would immediately - by reflux - be reduced down to the correct amount, if it once should be exceeded by a blunder. That reasonably fits to the old rule in state economy that a State may issue paper money that has no legal tender up to about 1/3 of its annual revenues, without having to fear a discount. One third of 665 million would be about 222 million; this correspondence seems good enough to me.

But what if the railway company does not stick to the rule and issues an entire annual revenue's amount of paper money ????
I suspect that even assuming the worst intent, this will not be possible.
The free market rate builds a barrier at a particular limit, which is not totally exact but pretty much exact, and then the reflux puts everything in order within a few days.

However, one might think about a particularly unfavorable case, which, by the way, in the case of the Leipzig-Dresden Railway about 90 years ago actually happened. The railway had the right to issue paper money, and it seems they really issued more in the early years than the circulation could handle by reflux. The old business reports say that the railway sometimes had to ask banks for loans to effect the redemption of the bills in silver. Perhaps the railway had not issued too many bills in the first place, but the obligation to redeem, which the railway had accepted (although the Saxon government apparently had not required that), of course disturbed the normal reflux, and today, after so many years, we cannot determine if the redemption was at that time only claimed because the bills would otherwise get discounted, or just because some merchant who had a lot of bills, really needed silver taler. The railway management didn't bother about such questions, the less so because it had no difficulty in acquiring the silver.

Suppose the Austrian Federal Railways had issued paper money in the amount of an entire year of income, and suddenly for some reason it turns out that it was too much, and just as suddenly the certificates start being discounted, then the total revenue for weeks only consists of discounted notes, the railway does not have any means of payment to pay wages, coal, etc.. What then???

Yes - then the railway would see itself in just the same situation as it would be in today, if for example it had paid new-built railway stations from short-term loans, hoping of being able to cover the costs from current revenue, but realizing that hope is wrong. The railway in such a case would have to get money from somewhere, and if it cannot, then it is bankrupt. It seems to me that the railway is much more likely to get such financial difficulties through **such** blunders than by issuing paper money with a free market rate.

The value of a free market rate can be improved considerably.

First, experience shows, that large bills and small ones do not have the same market rate oscillations. That is why for decades the rate lists of all major stock exchanges show separate rates of large and small notes. Devaluation - - if there is one - - inevitably appears in the **major** denominations first and can be quite large, before small denominations are affected. It seems Adolf Wagner in his standard work about note issuing banks has been the last to thoroughly describe this phenomenon, later authors did not bother any more. Therefore, when the railway issues not only small denominations but large ones, too - in Austria about 500 shillings - substantial protection is already achieved for the owners of small denominations; on the other hand, the railway cannot help but to announce what it intends to do to fight the discount of its bills.

In any case maximum publicity is a simple and very effective barrier against abuse of the right to issue.

Daily notification of the amount of outstanding vouchers is technically easy and a great reassurance to the public, and also, at the same time, indispensable for the railway itself, if it is to act properly. The Prussian Bank used to publish not daily, but monthly, and later on weekly, accurate overviews of the notes outstanding and even of their denominations. What was easy decades ago, can today not be difficult, when we have accounting machines and Hollerith-statistics.

Usually the railway considers a certain discretion to be necessary; however, in money issuing matters, not discretion, but the opposite is required.

Here, I would like to quote the old Kant:

> “All maxims which require publicity, in order that they may not fail to attain their end, are in agreement both with right and politics.”

In summary: Through great ineptitude and fraud the <u>railway</u> **can** suffer damage in issuing paper money, but ineptitude and fraud **here** are more difficult to carry out than in any other management branch!! Overissuing of railway money can indeed cause <u>inconveniences</u> to <u>the public</u>, when the certificates cannot **immediately** be used; however, the public cannot suffer from heavy <u>losses</u>, because the <u>redemption objects</u>, namely the trains, are not destroyed by overissuing.

Dr. Zander in his pamphlet intended that every bill that returns to the railway, be immediately destroyed, similar to the Bank of England (in some recent writings it is alleged that happened for reasons of **hygiene**, a proof of how thoroughly the principles of reflux have been forgotten). I want to go one step further and apply a provision that the railway shall use a certain proportion of their gross revenue to buy back their vouchers, when this proportion is not reached by their natural reflux. As long as experience does not show a better percentage, I would suggest the railway shall use every day at least 1/20 of its gross revenue for purchasing, unless such a forced buying-up would obviously cause a premium.

One might think that it is a matter of indifference whether the railway had constantly about 200 million Schilling outstanding, the amount of which is occasionally reduced by a discount and on another occasion again replenished to 200 million, or whether it daily generated an additional reflux of 5 million Schilling and newly issued 5 million daily. The example of the old issuing banks, however, shows that a mass of paper money must constantly be on the move to be on par. I am convinced that there exists a very similar relationship between paper money amount and reflux, like there is between an aircraft and the minimum speed by which it remains in the air.

I do not suggest the additional reflux is imperatively necessary, but I think it is very useful.

One might think to still incorporate another safeguard. There should be a bond of about 3% interest constantly ready for subscription, which can be drawn only with railway vouchers irrespective of whether they are on par or not. Thus some people will - in case of a discount - not try to place their vouchers at the counter window, but buy bonds instead.

Such safeguard through a bond was initially foreseen in the old Prussian exchequer bills, however, it was not carried out. Also Par. 15 of the German law, which then established the Rentenbank notes, provided for a safeguard by a 5% bond. 500 Rentenmark was the price of a bond of 500 Goldmark regardless of the actual rate of the Rentenmark.

(The Law of 1923/10/15 about the German Rentenbank was not bad at all. **Land** only ostensibly was the foundation of the RM, in order to make a concession to people's prejudices. It was envisaged that the landowner must pay an additional tax, namely in Renten notes. In addition, by Par. 14, the bills were equipped with general tax foundation. The amount issued was almost 1/6 of the annual income of those pay offices, which had to accept the bills at face value. Therefore, the Renten bills were technically sound state paper money, with rather correct foundation, except that the nomenclature adopted allowed for the insanity of the year 1923.)

Dr. Zander and I completely agree in assessing the free market rate as a sufficient protection of the parity of the railway bills; we might not agree 100% in terms of the daily buying up the bills and the issuing of bonds. But these two points are not primary.

In Austria there is deflation. As long as in rural markets, the farmers have to **exchange** tobacco against piglets and rutabaga (as in the Congo), the lack of means of payment is proven, even if such cases may not be commonplace and if the note circulation of the **State Bank** may be such that an extension of **this** note circulation would have to lead to a devaluation. But the opinion that a **state bank** could supply any country with sufficient means of payment, should **today** be abandoned, after decades of experience with state and central banks have so evidently proved the opposite. The supply of a country with means of payment **must** derive from several institutions. This is readily apparent when one considers the - under the present social conditions - natural cycle of money:

A.) from the bank,
B.) to producer, trader, farmer,
C.) to wage earners, or supplier of the trader and **his** wage earners,
D.) to store where the wage earner buys its supplies,
E.) to wholesaler of the store, or farmer, in case of grocery stores,
F.) to producer or trader who has supplied the wholesaler,
G.) back to the bank.

This cycle may work very well e.g. in the business district of Vienna, whereas in the district of Graz it can simultaneously be very disturbed.

I even came to the following conclusion on further thinking through the problem:

No economic sphere, yes, no individual has the right to readily use the means of payment of foreign economic spheres. Rather everyone has at least a moral duty to provide for his part for the circulation of means of payment. The railway for example in my opinion has the **obligation** to make available for circulation as many means of payment and has no right to make use of means of payment of other business spheres. For smaller economic units than the railway, from that principle follows the obligation to join a clearing bank and with its help to mobilize as much appropriate credit as possible. However, this is exactly the opposite of what the prevailing theory claims: that the supply of currency is a government **prerogative**, while nonetheless it apparently confuses **this** prerogative with the old **state monopoly of coinage**.

Another error of the prevailing theory I find classically expressed in Geld-, Bank- und Börsenrecht, II. Aufl. S. 36 (Heilfron, monetary, banking and stock exchange law, II. edition p.36), where H. says:

"The note issuing privilege thus gives the bank - by issuing banknotes - the opportunity to gain capital, for the surrender of which it does not need to pay any interest to the donors."

So many words, so many errors! Correctly it should read: A note issuing bank gives its **customers** the opportunity to mobilize their assets through use of the notes (which are divided and typified bills of exchange), that is, to use them as means of payment in retail traffic (shops).

In principle, clearing banks are not different from note issuing banks, except that there is no metal-redemption.

With best regards
Yours very truly,

sgd. U.v. Beckerath.

Translation by Theo Megalli and Tom Greco