# KNAPP'S THEORY OF MONEY [1]

PROFESSOR KNAPP's lectures in Berlin in 1895 had laid down two leading principles: (1) that a country's money is what the State accepts in payment at its own counters,[2] not simply what is of general acceptance among the people; (2) that a particular metal is selected for the standard of currency not from any regard to the qualities of metals, but with an eye to the better control of exchanges with the commercially strongest foreign States (see Preface, v, to 1st ed., 1905).

The Professor developed these ideas further in his Chair at Strasburg, and the first edition of his book is dated from that city with the present title. He has become the chief spokesman of what is called inexactly the legal theory of money. The adjective is inexact, because, though he indeed says, "Money is the creature of Right" (*Rechts*, p. 276), it is government and administration, the State and not the Statute Book, which he regards as settling a country's money (pp. 95, 97, 105, 159). The title is therefore best rendered "The State Theory of Money."

His attitude to the theory of currency is like that of Bagehot to economics. As an Economist, Bagehot deliberately confined himself to modern great industry and commerce without denying the right of their predecessors to be studied, indeed himself studying them in another capacity. Professor Knapp deliberately chooses (Preface v, § 2; cf. pp. 82, 201, 281) to regard money as it now is in fully developed civilisations, without denying that primitive man had means of exchange worthy of study (*e. g.* pp. 8, 23). In a century when absolute sovereignty is challenged on all sides, he contends that the *fiat* of the ruler decides what shall be the money of the country, the money in which (*a*) the State shall make its own payments ("apocentrically"), (*b*) the subjects shall make their payments to the State ("epicentrically"), and (*c*) their payments to one

[1] *The State Theory of Money* (*Staatliche Theorie des Geldes*). By GEORG FRIEDRICH KNAPP. (Duncker and Humblot: Munich and Leipzig. 1921. Third Edition, revised and enlarged. Pp. viii + 461.)

[2] Cf. pp. 87, 99, 121. But on p. 105, middle, it is what the State *pays out* (cf. pp. 93, 97, 148 foot).

another ("paracentrically") (p. 86). He gets to the heart of his subject by considering (p. 9, cf. VI.) what is implied in "means of payment," and he finds the most fruitful element is the notion of Debt and Obligation, indispensable in all business. Money is necessary because obligations incurred in the past must be met in the future, and it is the part of the State to provide the appropriate instrument, which may be this metal or that metal, or (it may be) paper and no metal at all (p. 52; cf. pp. 42, 43). In a change from one to another, say from silver to gold, the old units of value are preserved in order that the obligations may be evidently maintained; if a man owed five pounds before, he owes five pounds now (cf. p. 47). Our author has not much sympathy for sufferers by altered value; they must be prepared for the chapter of accidents like other mortals (pp. 12, 14–17, 195, 443). The essence of the change of standards is the preservation and transfer of the obligation, which during the process of change is disembodied, existing only in a condition of "Nominality" (p. 21). Most Germans would have said "Ideality," for the process is like that of translation from one language into another; to translate is to transfer; and, during the translation, the transferred subject of the change, for the moment disembodied, is not the words but the meaning. In the change of standard this disembodied meaning (in Professor Knapp's opinion) throws light on the whole mystery of money. Later, he finds help in a similar disembodiment, the bare form of "payment," which is the legal transfer of claims and counter-claims, expressed in units of value (p. 138). Money is essentially no metal but a "chartal" creation of authority (pp. 20, 26, 31, etc.). The State finds itself in surroundings made for it by history, tradition and custom. It acts according to its lights, which are sometimes very imperfect (p. 172). In the discussion of monetary theory, therefore, though money is of political origin, politics should be excluded so far as may be (pp. 447; cf. p. 101, etc.). Hence there is only a brief account of Bimetallism (p. 101 *seq.*). He finds in it a good illustration of his State theory. There is always one of the two metals really the standard, the one in which the State elects to pay its own obligations. The chosen money has then (in his phraseology) the position of "valutary" money, the other being "accessory," in which the subjects may pay if they like (pp. 94, 97, 105; cf. 305).[1] In ordinary language, both gold

[1] English Treasury Bills being receivable in payment of taxes might presumably be classed as "accessory."

and silver money would be legal tender, but, when the State pays only in one, that one thereby becomes the standard money of the country. The State is most influenced in its choice by the example of its commercially strongest neighbour. If countries had no need of foreign loans, they might, like England, imitate nobody (pp. 259, 261, 278); but the continental States in their own interest have followed English example and adopted the gold standard. Each State deals in a sovereign manner with its own "chartal" money, but cannot so deal with that of any other State. It may fight this difficulty by treaties and by unions, such as the German-Austrian Monetary Union of 1857 (pp. 252, 330), the Latin Union, and even the German Empire itself with its removal of Particularist currencies (p. 341; cf. p. 331). Apart from these it handles inter-state relations, on serious occasions (p. 242), by what our author calls "exodromic" policy, a policy seeking to improve the position of its currency among foreign currencies (p. 238). He concedes that, where the related States have a common metallic standard, ordinary short-lived fluctuations regulate themselves automatically; but he thinks that, where there are signs of a long-continued depression of our money in the foreign exchanges, there should be intervention (pp. 242–3, 257). So England intervenes with the Rate of Discount: professedly to guard its reserves, really to keep up the par of its money (p. 244). This is not to be called a metallic par; it results from general trade, not the trade in metals alone, and from deliberate policy (p. 209; cf. p. 211). So Austria from 1894 regularly formed a store of bills on England, which it sold at par when the exchange was below par.[1] So Russia about the same time (1894) supplied its banking agents in Berlin with a stock of roubles and marks, with instructions, when exchange fell below the par of 2·16 marks per rouble, to offer 2·16 marks for roubles brought to them, and, when exchange rose above 2·16, to offer roubles at that figure of 2·16 (pp. 248, 249). Like the "pegging" of the dollar in 1918, this last proceeding was at the expense of the taxpayer. In Austria the proceedings were at the expense of the Bank, in England at the expense of the world of business (p. 251). It would be better to be so strong commercially that we need no

[1] P. 246. See Mr. J. M. Keynes, *Indian Currency and Finance*, 1913, p. 24: "In the third quarter of 1911 the Bank placed not less than £4,000,000 worth of gold bills at the disposal of the Austro-Hungarian market in order to support exchange." Cf. *ib.*, pp. 28, 33. See also ECONOMIC JOURNAL, June 1909 (articles of Mr. Conant and Herr v. Mises).

such sacrifices; and for this we need a firm commercial policy; mere monetary regulation will not go to the root of the matter (p. 252). But it will go farther than most people think. Our author tries to show that in the gold and silver markets its scarce-suspected presence animates the whole (pp. 216–236). First of all, consider two extreme assumptions: (1) That the gold standard has been adopted everywhere. Then silver becomes a mere metal, like lead or tin, the price of which depends on "supply and demand," and the use of it is left to the arts entirely (pp. 216–7). (2) That only one country, say India, clings to the silver standard, that there are no arts in competition with the Mint, and that therefore the only employment of silver is in the coinage. London is the great silver market of the world. The price of silver, then, is determined by the Anglo-Indian exchange, in short by purely monetary causes (pp. 217–8).

As a matter of fact (he says) neither hypothesis is true; but the second is the nearer to the truth, for, under free coinage, the Mints dominate the markets, not the markets the Mints. Even in presence of a gigantic disturbance of normality like the great increase of the production of gold in California and Australia, the machinery by which the price of gold is lowered and of silver raised is the foreign exchanges, and this means "exodromic policy." In India, for example, the Mutiny of 1857–8 created a State need for rupees without end, and the price of the rupee rose, followed by the price of silver generally (pp. 226–7). "It was not the dear silver that made the rupee rise; it was the dear rupee that made the silver rise" (p. 227). After the adoption of the gold standard by so many States in 1871–6, the position of India was weaker; India and Mexico were the only maintainers of the silver standard. China (we are startled to hear) need not be considered (p. 229). Free coinage gives a lowest limit of market price, and the cessation of it in so many countries would tend to a lower price for silver even if there had been no increased production from the mines (p. 228). In 1893, when there was suspension of free coinage in India, the want of the lowest limit was soon felt. The case was the reverse of the case in 1857, when rupees must be got at whatever cost. In order now (after 1893) to pay pensions and interest, it is the sovereigns that must be got at any price, even if the weekly drafts go below the figure fixed in 1893. From being a buyer the Indian Government has become a seller of rupees (pp. 231–2; cf. p. 233). Though the condition of trade and commerce contributed to the depression, it is the new monetary situation which explains why the rupee went to such depths so often and remained there so long (p. 233).

These are cases where Professor Knapp himself allows that the *fiat* of Government can do nothing; it cannot lay down the law for foreigners. Contrariwise, his critics would admit that within each State legal tender money cannot be so without the *imprimatur* of the State, and in this sense it is open to the author to declare that no money is money but what the State chooses. But in spite of a strong assertion (p. 280; cf. p. 68) that the rule of custom is over, it turns out that the State more often follows its subjects in this matter than leads them, giving a desirable though sometimes reluctant ratification to the claims of commerce and custom (cf. p. 66). The numismatist's doctrine that the rule of tradition and custom prevails nowhere so obstinately as in types of coins is no doubt not decisive of the larger question. But modern history tells of " currency zones " and of an invasion of dollar currency in North America, spreading from the islands to the ends of the earth and forcing its way into legal recognition. The Maria Theresa dollars persist in Abyssinia, the rupee persists in India. Government may indeed control the money that figures in foreign exchanges, and credit itself with having led its people, when really (as our author often tells us) following the example of foreign States. Within its own borders it seems to some of us not more but less free to modify things as they are.

Passages might be quoted (*e.g.* pp. 1, 178, 201, 248) to show that Professor Knapp is substantially at one with orthodox economists in currency policy and practice. His par of exchange, though not to be called a metallic par, coincides therewith. Even his plea for paper money does not involve heresies in practice. He is fond of disguising his own orthodoxy by preferring new names to old, and new reasons to old. Jomini said that the Moscow army was " destroyed not by the cold but by the commander." A conjunction of causes is surely conceivable, whether in politics or in economics, as our author himself has warned us (p. 446, foot). But he usually suggests that the new reason is enough by itself, and the old may be set aside. He is not a Bimetallist; he is not a Metallist at all (p. 7; cf. pp. 101, 235). Gresham's Law is to him a half-truth (pp. 147–8, but see p. 77, top); for example, paper does not displace metal because it is the worse driving out the better, but because the State has made it the better. It might be replied that the State chose it because it was the cheaper.

In the new order of things after the War (p. 362) he foresees no reign of mere paper, but a *régime* of domestic paper under a Gold Exchange standard. He thinks, however, that both the laity and the economists have wrong ideas about paper money. Bank-notes, he says, are not rightly taken as promises to pay, and an inconvertible note is not a thing of nothing (p. 120). The notes are not money unless the State says they are (p. 121), and they would be, if promises at all, promises to pay the legal tender money of the country, which, if the State will, might be simply paper (p. 118). A bank-note is an official instrument for making payments to the Bank itself; and this function survives even when redemption ceases (pp. 118, 120). The note is a till-warrant (*Kassen-schein*) of the Bank, becoming money when so proclaimed. The State in standing behind the banks has made them privileged beyond other forms of "capitalism" in sure hope of service in return (pp. 123, 128). The old Hamburg Giro (or Transfer) Bank gives a useful hint. Its customers were depositors who drew on their deposits by orders of transfer in payment of creditors who were also depositors. In this private Paying-club (*Zahlgemeinschaft*, p. 135) there was even created a new unit of value, in the marc banco. No money passed; payment did not mean a transfer of gold or silver or any other "thing" (pp. 131, 133). The State, too, is a Paying Society and can effect transfers without "things" (p. 138). Payment is essentially the legal transfer of claims and counter-claims in units of value (*ib.*, cf. p. 21). The money itself need not pass; and all that is left to pass is the payment itself, an obligation expressed in units of value (p. 142). Value itself is not discussed. Professor Knapp stands perhaps alone in presenting a theory of money without a theory of value. The problem, he says, is a "shoreless sea" (p. 446), and is best left to economics (p. 437) from which, therefore, we are to understand monetary theory can be safely detached. Criticism of index numbers is begun but not pursued, for the same reason (p. 441). In our author's view his subject belongs rather to politics than to political economy. He does not, however, find much comfort in politics, and the action of the State, for example, in causing revolutions in prices is not praised (p. 448). In spite of his self-denying ordinances, he gives us occasional criticisms of political economy. We are told, for example, that the Quantity theory of money is of little value. By that theory the Californian gold affected prices by so increasing English money that the exchange against silver countries was made to fall (p. 225). Our author, without questioning the result, thinks the process of arriving at it was probably quite different; that the acquirers of the new gold, seeking investment for it, found the rate of interest higher in the silver countries, especially Germany in the 'fifties, and sent their gold thither for investment, say in German State loans (p. 225), thereby raising the rate of exchange in favour of the silver countries. The theory (which is Ricardo's) that the par of exchange is restored by the diminished money of one country being replenished from another is an amateur's theory (*völlig laienhaft*, p. 241; cf. pp. 339, 340, 381). Professor Knapp usually answers an opposing theory by setting up his own against it. This would be quite fair, if his own covered as much ground as the other, which is not always the case. He sometimes leaves us with the feeling that he has made his own theory plausible by narrowing the field of difficulties.

On the other hand, he has been too much blamed for his terminology. He adopts it for brevity and clearness of statement (Preface, vi, 1905), and finds that the want of it may have led to mistakes in policy (pp. 16, 168, 340, etc.). He does not try the patience of his readers nearly so much as Bentham and Herbert Spencer in their later days, and his own countryman Krause all his days. Some of his new terms (say exodromic and accessory) may become as familiar as entity and quiddity. All are derived from Latin or Greek words with their meaning in their face or not far to seek. But it is not an example to be generally followed. Few learned men can be safely trusted with the invention of a new language.

He says himself (Preface, viii, Darmstadt, 1921) that in teaching he usually begins with the historical part of his book. It covers England, France, Germany, Austria (283–405), and is a masterly sketch, with many fresh incidents. We read, for example, that, when free coinage of silver was suspended in Austria for the general public in 1879, the Government went on coining from the product of its own silver mines, which naturally came to it cheap (p. 384). We read also in an Appendix (pp. 406–30) the full story of the Austrian Customs duties, which were under a special monetary arrangement from 1854 to 1906.[1] At the time of the Crimean War, to raise silver money for payment of interest on a foreign loan (where the lenders could not be expected to take paper) the Government exacted all Customs dues in silver pieces of the agreed standard

[1] The heading of the section says 1900, but the statement on p. 419 gives the later date explicitly.

of the Monetary Convention between Austria and Prussia, all inland taxation being satisfiable in paper. Austrian importers were thus driven to purchase silver with paper, thereby sending up the paper price of silver. This *agio* on silver encouraged exports while the silver dues discouraged imports, a joint result possibly desired on the principles of Mercantilism (pp. 410–11). Gold displaced silver in 1878. Customs payments thereafter must be made in gold pieces duly coined *ad hoc* by the Austrian Mint, though equivalents in German or other gold were accepted. The unit of value was called the "gold gulden" (pp. 413, 415, 418). The arrangement was really a second system of currency; and to our author it is an instance of "Synchartism" or two standards at once (p. 417). Perhaps we have no close parallel. In one respect the regulations prevailing in Canada before the War for the chartered Banks supply an analogy. The banks paid for their supplies of Dominion notes and token money in gold, which went into the reserves of the Finance Department.

The "Synchartism" in Austria seems to have lasted till 1906 (p. 419). It is common knowledge that the gold standard of 1892 had not satisfied expectations. After 1892, gold was procured by a foreign Gold Loan and coined into gold pieces, not for issue but as a reserve against the State notes (pp. 391, 394). The exchanges remained unfavourable, especially with Germany, for commercial reasons, in spite of the full covering of the notes (pp. 395, 396); and a decree of 1899 redeemed the notes, not with the gold pieces but with silver coin, solid and satisfactory (p. 398). The State notes disappeared in favour of ordinary Bank-notes (p. 399). After 1900 the domestic money of Austria, in spite of the legislation of 1892, was notes and silver (p. 402). The foreign policy above described (see also pp. 430, 431, 433) kept the Austrian money at par abroad (p. 402). Austria, in fact (to use common language), had slipped into the Gold Exchange standard, where it stayed till the war (pp. 404 foot, 436). Gold pieces were issued tentatively; but there was no evident desire for them (p. 426; cf. p. 428). They came back to the banks, like the Canadian gold pieces of 1912–4.

Professor Knapp's history of the currencies is full of instruction, not only in regard to Germany, France and Austria, but even in regard to our own country. He regards our system of gold currency before the War as exemplary (p. 298). Most of the book was written before the War, or he would not have said that there have never been State notes in England (p. 292). What he says of the Germany of 1914 applies to the England of 1922—that coining of gold was not stopped, but the permission was a dead letter, for private persons were not allowed to handle it with the old freedom (p. 360).

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